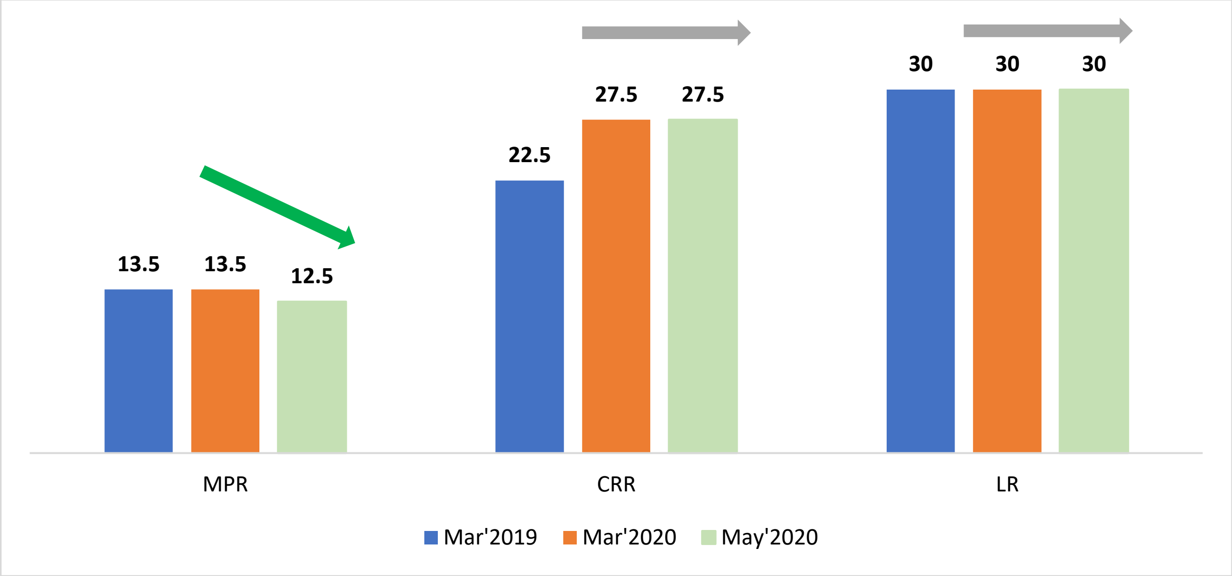
NESG MPC Alert

May 2020

MPC makes a U-turn, slashed MPR by 100bps to avert coronavirus-induced recession

The Central Bank of Nigeria (CBN) Monetary Policy Committee held its third meeting for the year 2020 on May 28. The MPC members met at a time when COVID-19 - that emanated from Wuhan City of China as a mere health crisis - has plunged almost all countries of the world into an unprecedented economic crisis.[1] At the meeting, 7 out of 10 committee members voted for a cut in MPR by 100 basis points (bps) to 12.5%. Two members voted for a 150bps reduction in the benchmark interest rate, while one member voted for a 200bps cut in MPR. However, there was a unanimous agreement to keep other monetary policy parameters unchanged as follows: Cash Reserve Ratio (CRR) at 27.5%, liquidity ratio at 30% and an asymmetric corridor of +200/-500 basis points around the MPR. This is the second time in over a year that the MPC would shift towards an accommodative monetary policy stance (see **Figure 1**).

Figure 1: Trend of monetary policy parameters (%)



Source: Data: CBN; Chart: NESG Research

The rationale behind the decision was premised on the need for the CBN to balance its price stability objective against concerted efforts directed towards improving the country's economic growth

[1]For instance, US economy contracted by 4.8% in Q1'2020. Similarly, reports showed that the UK and Germany slipped into recession in the same quarter.

trajectory. According to NBS, inflation rate stood at an 8-month high of 12.3% in April 2020, while economic growth slowed to 1.9% in Q1'2020 from 2.1% in Q1'2019. Several industry estimates point to higher likelihood of recession in FY'2020. The IMF and the Nigerian government unanimously have projected that the economy would contract by -3.4% in 2020. Similarly, the NESG's revised growth outlook for 2020 showed an economic contraction of -4.1% in the best-case scenario and -7.3% in the worst-case scenario[2].

As a way of moderating the adverse impact of COVID-19 on households and businesses across the country, the CBN has recently rolled out a number of monetary stimulus packages. These measures include a N100 billion Intervention Fund set aside for the Healthcare Sector, a N1 trillion intervention to boost productive activities in key sectors, such as, agriculture and manufacturing, as well as, a N50 billion credit facility targeted at vulnerable households and SMEs.

In addition, the MPC extolled the effectiveness of the CBN's mandatory Loan-to-Deposit (LDR) of 60% which was introduced in July 2019, and was subsequently reviewed upwards to 65% in December 2019. Since inception, the LDR policy has resulted in the expansion of aggregate domestic credit by 20.5% to N3.1 trillion currently. The need to sustain the growth momentum of banking sector credit – at a time when recession fears are heightening - ultimately informed the committee's decision to keep all other monetary policy parameters constant at current levels.

Concluding Remarks

Though the MPC's dovish approach is timely, the CBN would have to contend with a recurring trade-off between liquidity-induced inflationary pressures and the need to save the economy from slipping into another recession since 2016. Against the backdrop of intense pressure on the country's external reserves position arising from lower crude oil export receipts, the CBN has started rationing Forex among end-users and investors. According to FMDQ data, there were no forex sales by the CBN at the Investors and Exporters' (I&E) market in April 2020, after the Apex Bank intervened with a total forex auction of $2.9 billion (78% of total forex inflows) in March 2020. Meanwhile, the Nigerian government has recently secured a $3.4 billion emergency funds from the IMF. This would help mitigate the negative impact of lower global oil prices on the country's external reserves, currently at $36.6 billion.

[2]Refer to NESG Macroeconomic Outlook Update for 2020, retrievable via: https://www.nesgroup.org/research

About NESG

The NESG is an independent, non-partisan, non-sectarian organization, committed to fostering open and continuous dialogue on Nigeria's economic development. The NESG strives to forge a mutual understanding between leaders of thought so as to explore, discover and support initiatives directed at improving Nigeria's economic policies, institutions, and management.

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