NESG MPC Alert

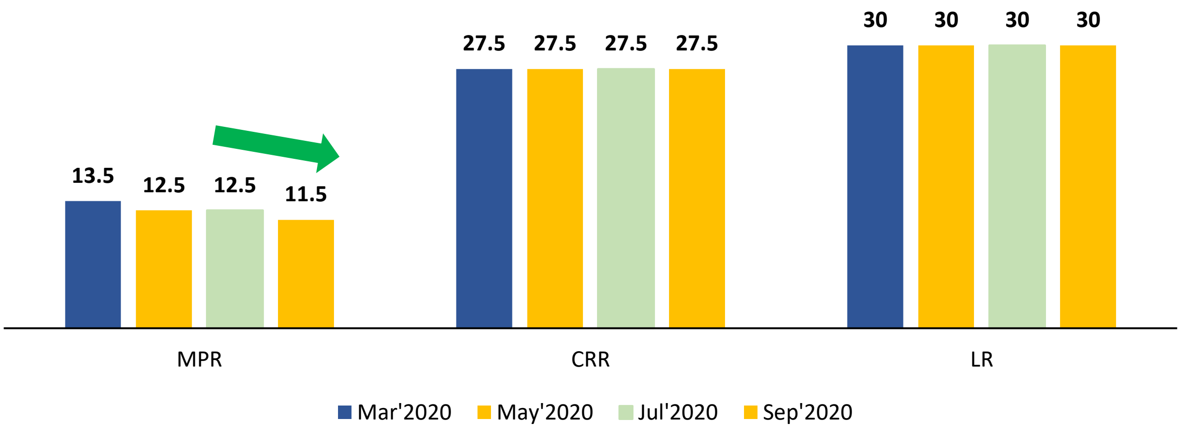
September 2020

MPC cuts benchmark interest rate by 100 basis points over recession fears

The Central Bank of Nigeria (CBN) Monetary Policy Committee (MPC) held its penultimate meeting for the year 2020 on September 21-22. At the meeting, 6 out of 10 committee members voted for a reduction in the Monetary Policy Rate (MPR) by 100 basis points to 11.5%. The committee with a vote of 9 to 1 members agreed to adjust the asymmetric corridor to +100/-700 basis points around the MPR from +200/-500 basis points. However, MPC members unanimously agreed to keep the Cash Reserve Ratio (CRR) and Liquidity Ratio at 27.5% and 30%, respectively.

The current MPC decision represents the second time in the year 2020 that monetary policy stance would be more accommodative (see **Figure 1**). The MPC members met at a time when the Nigerian economy is battling with the fall-out from the coronavirus pandemic including economic contraction (at -6.1% in Q2'2020), high unemployment rate (at 27.1% in Q2'2020), rising inflation rate (at 13.2% in August 2020), declining foreign investment inflows (plunged to $1.3 billion in Q2'2020), widening trade deficits (stood at -1.8 trillion in Q2'2020), falling crude oil prices (down 44% year-to-date), weak external reserves (currently at $35.8 billion) and rising public debt (at N25.7 trillion in Q2'2020).

Figure 1: Trend of monetary policy parameters (%)



Source: Data: CBN; Chart: NESG Research

The MPC's decision to reduce the MPR was premised on the need to avert a looming recession by the third quarter of 2020. Coupled with the various intervention programmes by the fiscal and monetary authorities, the action of the committee members is expected to encourage deposit money banks to increase lending to the real sector. With the current LDR policy, aggregate credit has expanded by 23.7% to N19.3 trillion as at August 2020 from N15.6 trillion as at May 2020.

While it acknowledged a decline in average non-performing loan (NPL) ratio to 6.1% as at August 2020 from 9.4% in the corresponding period of 2019, the MPC considered the current monetary policy stance as appropriate for credit expansion without deteriorating the quality of banking assets. This ultimately prompted the committee's decision to keep other monetary policy parameters (Cash Reserve Ratio and Liquidity Ratio) constant at the current level.

Concluding Remarks

Though the MPC's dovish approach is timely, the CBN would have to contend with a trade-off between rising inflation and the need to save the economy from slipping into recession in 2020. The gradual opening up of the economy and the resumption of international flights is expected to boost economic activities. However, the increase in the price of PMS and the hike in electricity tariffs would fuel inflationary pressures going forward. With yields on money market instruments (T/bills and OMO) at single digits, the resulting negative real return on investment would douse the confidence of foreign investors. The persistent decline in crude oil prices and the resulting depletion in external reserves could force the CBN to embark on another round of exchange rate adjustment. While this policy shift would encourage foreign investment inflows, currency devaluation would be detrimental to domestic investment and slow the pace of economic recovery.

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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