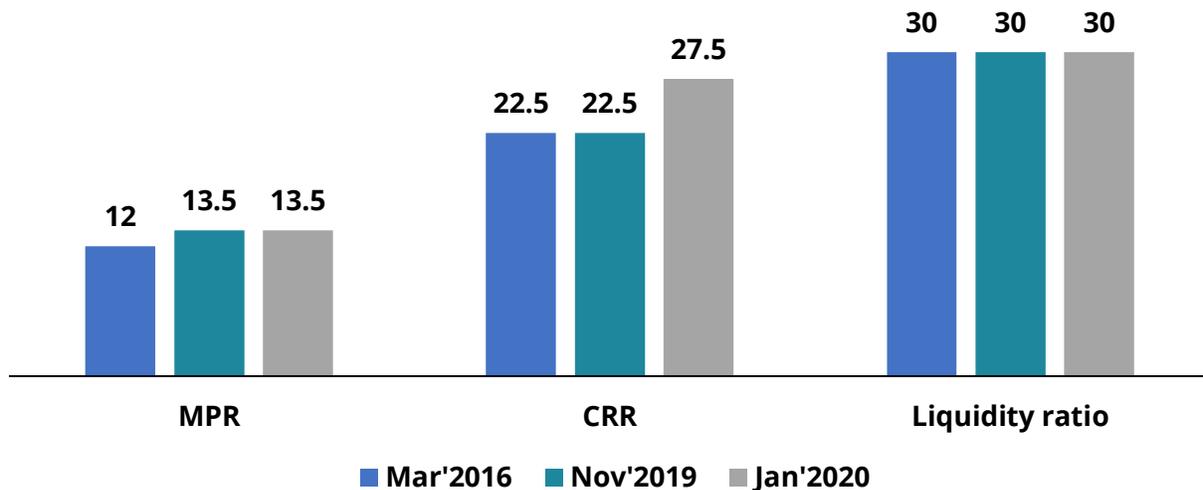


MPC appears hawkish; raises CRR by 5 percentage points

The Central Bank of Nigeria's (CBN) Monetary Policy Committee (MPC) held its first meeting of the year 2020 on January 23-24. At the meeting, MPC committee members, with a vote of 9 to 2, agreed to increase the Cash Reserve Ratio (CRR) by 500 basis points to 27.5%. This represents the second time in five years that the MPC will increase the CRR, following the harmonization of the CRR for public and private sectors in May 2015 (see **Figure 1**).¹ However, other monetary policy parameters were kept unchanged: Monetary Policy Rate (MPR) at 13.5%, liquidity ratio at 30% and an asymmetric corridor of +200/-500 basis points around the MPR.

Figure 1: Trend of monetary policy parameters (%)



Source: CBN, NESG Research

The rationale behind the decision was to curtail possible inflationary pressures that could emanate from higher market liquidity due to impending Open Market Operations (OMO) maturities.² Since September 2019, inflation rate has been on an upward trend, reaching a 20-month high of 12% in December 2019. The increase in CRR is aimed at moderating liquidity-induced inflationary pressures.³ The committee noted that broad money supply (M3) grew by 6.22% (year-to-date) in December 2019.

¹Initially, the MPC raised the harmonized CRR by 250bps to 22.5% in March 2016.

² In October 2019, the CBN banned local corporates and retail investors from participating in OMO bill auctions. This class of investors would not be allowed to roll over their investments, thereby boosting market liquidity and depressing interest rates. For instance, yields on Treasury bills across tenors have crashed to single digits at the primary and the secondary markets.

³ Other drivers of inflation according to the MPC include a combination of structural and supply side factors, as well as, an expansionary fiscal policy.

Meanwhile, the decision to leave other monetary parameters constant was predicated on the need for a careful assessment of the recent CBN's heterodox policies aimed at boost lending to the private sector, as well as, the employment-elastic sectors, such as, agriculture and manufacturing. The new mandatory loan-to-deposit ratio of 65% has been yielding positive outcomes, as reflected in the sustained rise in private sector credit growth. According to the MPC, credit to the private sector grew by 13.61% in December 2019 from 12.82% in the previous month.

Africa's largest economies differ in their monetary policy stance

While the Nigeria's MPC voted to raise its CRR in order to tame liquidity-induced inflationary pressures, the South African Reserve Bank (SARB) appeared dovish as it reduced its MPR by 25bps to 6.25% during its first meeting in 2020. The interest rate cut decision was premised on the need to stimulate economic recovery. South Africa's economy contracted by 0.6% in the third quarter of 2019 from a positive growth of 3.1% in the previous quarter.

Conclusion and Implications

The MPC's decision to increase the CRR signifies the beginning of a monetary policy tightening cycle. Several industry estimates show that the additional 5 percentage points in the CRR could push up the cash reserves of commercial banks with the CBN by over N800 billion. Meanwhile, the direction of monetary policy stance for the rest of 2020 depends on key factors such as inflation, domestic economic growth and external reserves position. Nonetheless, a sustained rise in private sector credit growth stemming from the commitment of banks to meet the new loan-to-deposit ratio of 65% is expected to stimulate growth in employment elastic sectors, and filter through to improvement in overall economic growth in the near to medium term. The IMF expects the Nigerian economy to grow faster by 2.5% in 2020 from an estimated 2.3% in 2019.

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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