

20 March 2017

Goodbye Inflation; Hello Rate Cut? .

The Central Bank of Nigeria's (CBN) Monetary Policy Committee's (MPC) 255th meeting (second this year) is scheduled to hold this week – 20th - 21st March, 2017. Indeed, expectation around the meeting is modest – particularly among local market and economic agents – owing to the fact that the Committee is highly unlikely to announce any major policy changes. This is also in line with Bloomberg's analyst poll showing a consensus for a rate hold. While we equally expect the Committee to maintain status quo, we look forward, more specifically, to its assessment of economic changes following its January meeting – particularly issues around output growth and key prices (consumer prices and exchange rate).

As widely expected, the MPC played the wait-and-see card in January, reassessing the headwinds which confronted the Nigerian economy in 2016 and potentials for recovery in 2017. **Much more important to us was the overall tone of the Committee which revealed that members were conscious of the prevailing market sentiments in favour of a rate cut.** Nonetheless, the MPC's sense was that it remains committed to addressing the delicate balance between price stability and growth, which requires more than popular simplistic approaches and quick fixes. Clearly, certain conditions will have to hold for the Committee to consider a rate cut.

Diverging Monetary Policy Paths across Regions

On the international scene, we guided in our Nigerian 2017 outlook, "In Search of the Missing Link", that one of the major considerations of the MPC this year would be the normalization of interest rates in the U.S. Indeed, the Federal Reserve, on Wednesday, raised interest rates (for the second time in three months) by 25bps to a range of 0.75% to 1.00% while signaling the possibility of additional two cuts during the year. However, the MPC appears less driven by the movement of interest rates in the U.S. given the fact that central bankers elsewhere in advanced economies remain committed to monetary easing. For insight, the Bank of Japan maintained status quo in its last meeting, the European Central Bank (ECB) held interest rates at historic lows and left mass bond-buying plans unchanged, while the Bank of England (BoE), for the seventh consecutive month, held the line on key lending rate at a record low with no changes to its GBP435 billion (USD533 billion) quantitative easing program.

In the cases cited above, the underlying theme is consistent, being that monetary policy makers around the world (the Swiss National Bank and the Norges Bank in Norway similarly held their lending rates at record lows on Thursday) are ignoring the diverging paths in policy between the U.S Fed and other central bankers while focusing on the need to boost growth, and in some cases, inflation as well.

Subsiding Apprehension on the Domestic Front...

We expect dovish comments to dominate the discourse stage, on the back of a stream of positive developments in the domestic economy, namely moderation in

20 March 2017

inflation, steady rise in external reserves, slower output contraction in the fourth quarter of 2016, naira appreciation, and foreign exchange market stability.

Data released by the National Bureau of Statistics in March revealed that the economy contracted by 1.30% in the three months to December 2016, albeit a slower pace compared to the -2.26% recorded in the previous quarter. Expectation is for output growth to return to positive in the first quarter of 2017, supported by favourable base effect and improved performance of the oil component and key sub-sectors of the non-oil sector. In addition, as anticipated, inflation commenced a base-effect driven moderation in February, dropping 94bps to 17.78%, from January's 18.72%, with further deceleration in the offing.

Figure 1: Real GDP Growth and Components (y/y)

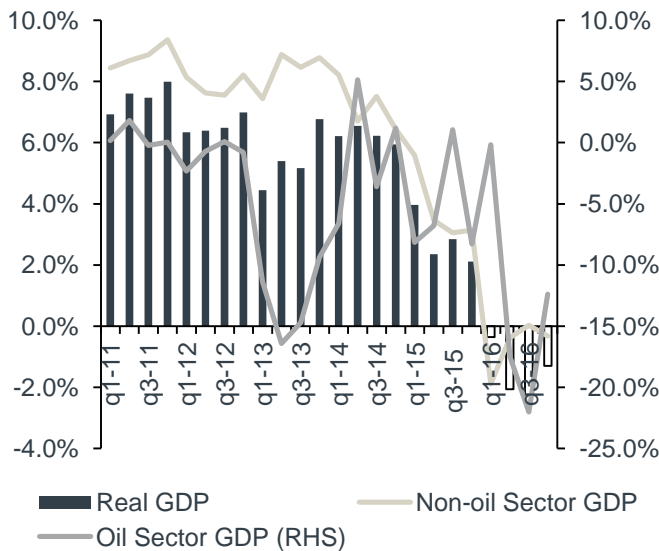
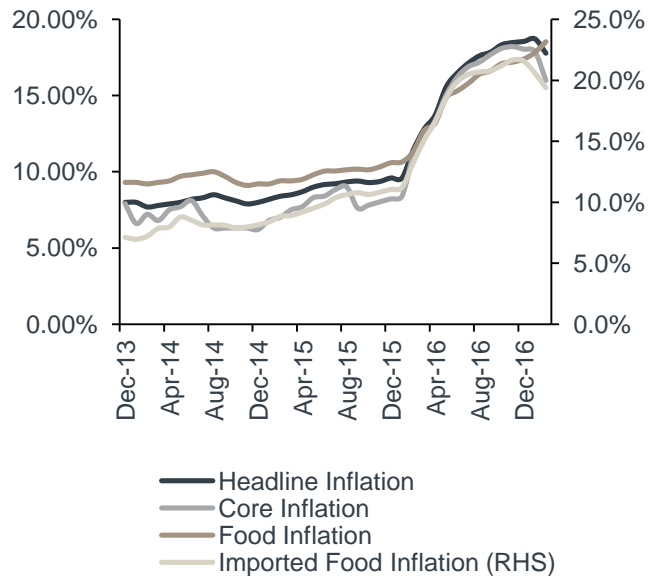


Figure 2: Headline Inflation and Components



Source: NBS, Cordros Research

Since the last meeting, oil prices have steadied at circa USD56/barrel average while foreign reserve accretion rose steadily by 8% to hit a 16-month high of USD30 billion. Suffice to say that the apex bank found respite, and in display of confidence (following notable improvement in the external reserves), deepened its support for the local currency – in February – with the introduction of a new foreign exchange policy, targeted at improving FX liquidity by (1) providing direct additional funding to banks to meet demands for travel (business and personal) allowances, medical needs, and school fees, (2) reducing the tenor of forward sales from the previous maximum cycle of 180 days, to no more than 60 days from the date of transaction, and (3) ending the allocation/utilization rules imposed on commercial banks. Banks were also directed to disburse forex on weekly basis to retail users at a rate not exceeding 20% above the interbank market rate (we estimate between N366-N378/USD).

20 March 2017

Figure 3: Foreign Reserves and Brent Crude

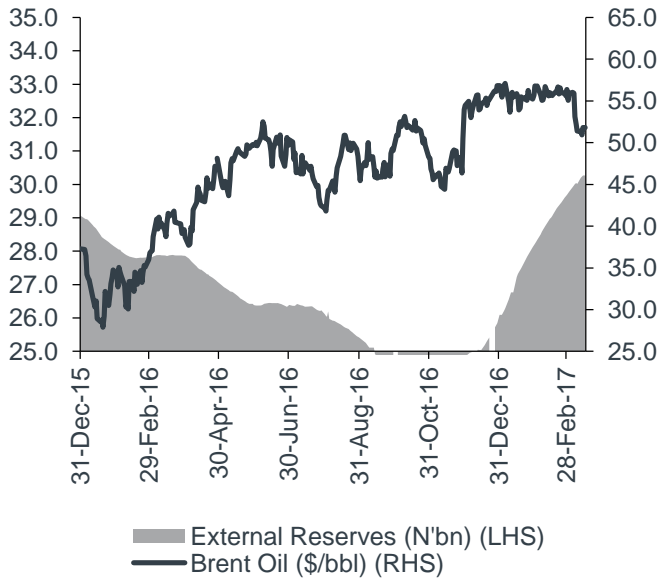
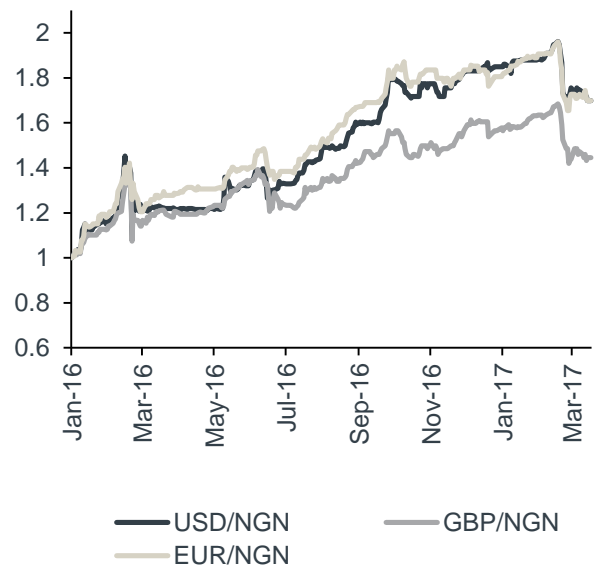


Figure 4: Parallel Market Exchange Rate (Index of 1)



Source: CBN, Bloomberg, AbokiFX, Cordros Research

Following the introduction of the new FX policy, the CBN has sold circa USD1.4 billion in spot and forwards auctions, with the latter taking a considerable proportion. Consequently, the naira has appreciated significantly at the parallel market, touching 6-month highs of N540/GBP and N460/EUR, and 5-month high of N450/USD.

...but the MPC Just Won't Change Gear Yet

In continuous alignment with the CBN's zero tolerance for liquidity surfeit (demonstrated through frequent OMO auctions totaling N803.33 billion since January 24), the MPC will likely hold rates constant at current levels in a bid to prevent speculative tendencies that may undermine the effort to achieve stability in the FX market. We think the Committee will be more compelled to lower rate upon realization of the moderation of the headline inflation towards 12% by July, progressive GDP growth by the first half, and a much stronger Naira.

*20 March 2017***Analyst:****Peter Moses** (*peter.moses@cordros.com*)**Important Disclaimers**

This document has been issued and approved by Cordros Capital (Cordros) and is based on information from various sources that we believe are reliable. However, no representation is made that it is accurate or complete. While reasonable care has been taken in preparing this document, no responsibility or liability is accepted for errors or fact or for any opinion expressed herein. This document is for information purposes only. It does not constitute any offer or solicitation to any person to enter into any trading transaction.

Investments discussed in this report may not be suitable for all investors. This report is provided solely for the information of Cordros clients who are then expected to make their own investment decisions. Cordros conducts designated investment business with market counter parties and customers and this document is directed only to such persons. Cordros accepts no liability whatsoever for any direct or consequential loss arising from any use of this report or its contents. This report is for private circulation only and may not be reproduced, distributed or published by any recipient for any purpose without prior express consent of Cordros. Users of this report should bear in mind that investments can fluctuate in price and value. Past performance is not necessarily a guide to future performance.

Cordros and/or a connected company may or may not have a relationship with any of the entities mentioned in this document for which it has received or may receive in the future fees or other compensation. Cordros is regulated by the Securities and Exchange Commission to conduct investment business in Nigeria.