

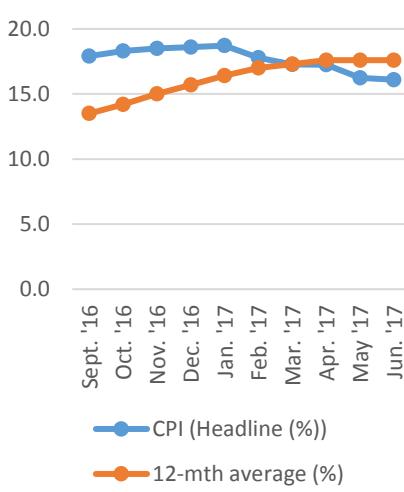
Tuesday, July 25, 2017

MPC keeps rate at 14% for the seventh session in a row

Real GDP Growth (%)



Inflation Index Movement



The Monetary Policy Committee (MPC) of the Central Bank of Nigeria (CBN) on Tuesday, July 25th, 2017 rounded up her fourth meeting of the year with the following decisions;

- 1) Retained the Monetary Policy Rate (MPR) at 14.0%
- 2) Maintained the Cash Reserve Ratio (CRR) at 22.5%
- 3) Retained the Liquidity Ratio (LR) at 30.0% and
- 4) Maintained the asymmetric window around the MPR at +200bps/-500bps.

Recall that in our Economic Brief on CPI June 2017, we anticipated that the MPC would maintain status quo on all rates as result of positive economic developments in recent time and also to allow time for the implementation of 2017 Budget which was passed into law by the National Assembly in late June. In opting to maintain the basic policy rates, the MPC granted our narrative. The last time rate was reviewed was a year ago when it moved from 12% to 14%.

Though, the MPC acknowledged the challenges that confronts the economy going forward, such as;

- The continued negative growth in the economic space
- Expected low oil prices due to renewed investments in US shale oil exploration and production and increased in oil supply
- Anticipated strengthening of the US dollar
- Continued high inflationary pressure
- Weak DMBs' credit facility to the real sector and
- Yet to be diminished demand pressure in the FX market

but opted to consolidate on the recent positive development in the economy especially the FX policy that has seen disparity between the official and parallel rates shelved 0.82% as at July 25th compared to the previous decision date in May. The recent FX policy is designed to improve liquidity, confidence and stability of foreign exchange market.

The steady decline in inflationary trend, now fifth months in a row, was graciously welcomed by the MPC. Recall that in our CPI June 2017 brief, we noted the reduced impact of core inflation on the headline due to lesser FX pressure. The core inflation declined by 500 basis points in June to 12.50%, largely on the strengthening of the Naira over US Dollar. Other important considerations were lower pressure from water, electricity, gas and other fuels.

...Dilemma of decisions

The MPC noted that further tightening of the MPR might induce an income gap, dampen aggregate consumption and adversely affect credit to the real sector of the economy. On the other hand, it noted that easing the policy rate could counter the gains made in the FX market by reopening the window for speculation and unattractive rate to foreign investors as well as resurgence of inflation following the expected intensification in the implementation of 2017 budget.

Expected impact on investment environment and asset classes

.... Stability on the Exchange rate would strengthen the more

The FX will remain a major winner. Given the CBN's recent measures on the FX, retaining status quo is expected to provide good time for the policy to crystalize firmer in the market. Our argument here is based on the recent development witnessed thus far. Though, the structural and inflationary pressures could deter this objective. Again, with oil prices rebounding, the effect of defending the naira on foreign reserves will not be severe.

.... Productivity expected to track northward

In the recent release of the National Bureau of statistics (NBS), the economy continued traction on recovery from recessionary trend. GDP contracted marginally by 0.52% in Q1 2017 compared to 2.06% and 1.30% posted in Q3 and Q4 2016 respectively. This is a positive development and we may likely see a firmer growth in Q2 2017 given that the economic environment has witnessed improved triggers.

.... Inflation pressures could subside the more

With the headline inflation shifting backward for the fifth month in a row as result of lesser pressure on the FX and base effect, we expect a consolidation in the months ahead. This is hinged on the fast approaching harvest season.

.... Commodity market would consolidate

Given that a significant amount of commodities are imported, the exchange rate issues facing the country which is reflected in the commodity market would be moderated. Key imported commodities include wheat, raw sugar, barley, coffee, cocoa and palm oil. Even commodities that are locally produced have had their prices increased as producers try to make up for lost income in other items.

.... Treasury bills yield likely to maintain trend

The treasury bills market will continue to attract better interest. Being the short end of safe securities, the DMBs and other financial institutions will continue to play active roles here. The six months' rates are currently trading on the average of 20%, which is currently above MPR and inflation rates.

.... Fixed income activity expected to be mixed

With lesser inflation pressure, the new issues would be positively priced against existing policy rate. It would create investment attraction to fund managers such as Pension Fund Administrators (PFAs), portfolio managers etc. Activities in the market is expected to find stability as investors intermediates between new and old issues.

.... Stock market likely to consolidate trend

The stock market has gained substantially from lesser pressure on the FX in recent time. We expect this to continue periodically and laced with profit taking correction. Meanwhile, much would be expected from the executive authority implementation of the 2017 Budget and ERGP. When the policies as stipulated in the document are implemented, the chances of positive catalyst that will drive the economy will be high. This is expected to rob off on the equity market.

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