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January 4, 2016

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NIGERIA RESEARCH NOTE - MONETARY POLICY

Insights into November's MPC deliberations

It was not until Dec. 23rd – i.e. after the financial markets had closed for the festive season – that the CBN published the personal statements made by members during the Monetary Policy Committee's November 2015 session whose upshot was the extremely heterodox 200 b.p. interest-rate cut.

The statements in question offer a fascinating window on to members' views – reproduced below, verbatim - on a number of issues of vital concern to investors. ***A key take-away: the extent of disagreement with the array of unconventional measures to which the Governor has committed the central bank - in what is clearly a doomed effort to maintain the Naira's dollar parity***[1] ***at N197.***

1) On the challenges of maintaining reserves

⇨ The external sector is fairly stable, with external reserves only slightly lower than in the last month - but this is ***largely due to transitory factors such as the implementation of the TSA and lower payments to Joint Venture Partners in the oil sector***. *(Shehu Yahaya)*

2) On the breakdown of the policy-transmission mechanism

⇨ The Banking Stability Report presented by Bank Staff shows ***gross lending rose by N39bn following the net injection of approximately N400bn following reduction of CRR in Sept***. [...] In other words, despite the collapse in Money Market rates, banks don't appear to consider lending an attractive alternative deployment for any additional liquidity. *(Adedoyin Salami)*

⇨ All the money market rates have been running below the Monetary Policy Rate, signifying ***excess liquidity in the system, yet the banks are not lending***. *(Suleiman Barau)*

3) On conditions in the banking system

⇨ Notwithstanding the seeming improvement in NPL ratio, a review of available NPL data show that ***12 of the 22 sectors into which the Central Bank of Nigeria classifies lending saw an average increase of 75 percent*** in the year to October 2015. Included amongst the sectors that have seen NPLs grow fastest are Construction (119.64%), Agriculture (107.51), Oil & Gas (95.41%), Manufacturing (39.11%), in my judgment, there are Financial System Stability issues that remain quite potent! *(Adedoyin Salami)*

⇨ As far as the banking system is concerned, [...] ***new credits still show a high level of concentration in sectors that are neither growing nor labour intensive***. *(Shehu Yahaya)*

[1] As investors are aware, over the week-end Angola was forced to devalue the *Kwanza* (another petro-currency), by 13%. This was following a year-long slide, punctuated by two maxi-devaluations, that had eroded its value by a cumulative 18.75%. Nigeria is delaying the inevitable adjustment at an enormous cost to its external reserves, economic output and, potentially the stabilityits financial system.

4) On the macro-prudential implications of the beleaguered Naira

⇨ I am of the opinion that ***a reasonable proportion of banks' exposure to oil and gas could have been in foreign currency*** ... Thus, with the expected normalization of monetary policy by the US Fed, there is the likelihood of upward re-pricing of these facilities, further impairing borrowers' repayment capacity. *(Adebayo Adelabu)*

5) On the real-sector impact of the effort to defend the Naira

⇨ ***(M)anufacturing activity continues to shrink in consequence, at least in part, of the continuing application of measures to conserve reserves***. *(Adedoyin Salami)*

⇨ Job creation data for the past year shows [...] 90 percent of the new jobs are in low paid informal sector activity. ***It is a source of regret that monetary policy measures aimed at conserving forex demand may be responsible for job destruction rather than support and enhance job creation***. *(Adedoyin Salami)*

6) On the illusory nature of the (inter-bank) Naira's stability

⇨ Although the interbank exchange rate of the Naira remained steady, the rates at BDC fell and t***here is clearly suppressed pressure in the market***. *(Shehu Yahaya)*

⇨ Pressure at the foreign exchange market has continued as ***demand outstrips supply***. *(Sarah Alade)*

7) On the conceptual flaw on which the 'strong' Naira policy is built

⇨ (A)s implied by the concept of the unholy trinity, ***conventional monetary policy tools cannot simultaneously achieve commitment to a stable exchange rate and independent conduct of policy in an open economy***. *(Suleiman Barau)*

8) On the need to ditch the 'strong' Naira policy

⇨ The worsening outlook for Oil coupled with the clearly unsustainable FOREX demand restrictions makes it ***inevitable that the Naira will have to be managed with greater flexibility in the year ahead.*** *(Adedoyin Salami)*

⇨ We will need to address our collective mind to determining how best to remove ***conditions which provide HUGE subsidies to a select few at the expense of pretty much everyone else***. *(Adedoyin Salami)*

9) On the folly of conducting fiscal policy with monetary tools

⇨ The reactionary approach of monetary policy in the outgoing year will have to be replaced, in 2016, with a more proactive stance [centred on] the ***need to urgently return monetary policy to its core mandate and abandon its use as substitute for coherent and internally consistent fiscal, trade and industrial policy***. *(Adedoyin Salami)*

⇨ (T)he idea of using CRR reduction to encourage banks to lend to the preferred sectors of the economy [...] I am philosophically in agreement with this idea. I however believe that there is need for more studies in this area before we take the leap. This is particularly important especially given the fact that ***Nigeria has a long history of using monetary policy to incentivize banks to lend to the preferred sectors of its economy. Learning from the mistakes or successes of the past will in my view lead to better policy making***. *(Chibuike U. Uche)*

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Regrettably, however, not all arguments were as cogent as those cited above, **viz.:**

10) A new spin on the growth story

⇨ ***GDP growth is trending up***, but far lower than the trend in recent years. Third quarter real GDP grew by 2.84 percent compared to 2.35 percent recorded in the second quarter.

11) In favour of quasi-fiscal spending

⇨ I am of the view that ***liquidity support (an unconventional monetary policy tool) should be deployed to support critical sectors like power, manufacturing, and agriculture***, albeit as a temporary measure.

12) On the effectiveness of the strategy to defend the Naira

⇨ The relative success achieved in stabilizing the exchange rate was attributed to ***the effectiveness of the moral suasion of the monetary authorities and the demand management strategy employed by the Central Bank***.

13) In favour of more aggressive demand management

⇨ In my opinion, the monetary authority, and possibly in collaboration with the fiscal authority, may ***need to strengthen the various prudential measures particularly the recent list of items excluded from the official interbank foreign exchange market***.