Central Bank of Nigeria Communiqué No. 95 of the Monetary Policy Committee Meeting of May 19 and 20, 2014

The Monetary Policy Committee (MPC) met on 19th and 20th May, 2014 against the backdrop of continuing modest recovery in the US economy, lingering fragile recovery in Europe, slowing output growth in the emerging market economies and possible risks to domestic price stability. In attendance were 9 members including Mr. Adebayo Adelabu, the new Deputy Governor, Financial System Stability. The Committee considered major developments in both the global and domestic economies up to May 2014, and the outlook for the rest of the year.

International Economic Developments

The Committee noted the prospects of improved global growth in 2014 predicated on expectations of sustained favorable developments in the US and the euro area. Driven by the recovery in the advanced economies, global growth strengthened in the second half of 2013, averaging 3.6 per cent from the 2.6 per cent recorded during the first half. In the United States, improved domestic demand continues to strengthen growth outlook. In Europe, a pickup in growth in the core states continued to compensate for the decline in most of the peripheral states even as debt, low inflation, financial fragmentation and unemployment persisted as threats to sustainable long term economic recovery in the region. Growth in the emerging markets and developing economies is projected to rise from 4.7 per cent in 2013 to 4.9 per cent in 2014. The effects of tighter financial conditions in these economies are expected to be moderated by improved external demand from the advanced economies.

Global inflation is generally expected to remain subdued in 2014 with sustained sizable negative output gaps in the advanced economies, weaker domestic demand in several emerging economies, and falling commodity prices. In the euro area and the United States, headline inflation at about 1.5 per cent is projected to remain below the long-term inflation expectations. Lower world commodity prices in U.S. dollar terms would help reduce price pressures, although in some economies, exchange rate depreciation continues to pose a threat to consumer price stability.

The Committee noted that monetary policy stance across the advanced economies could begin to diverge in 2014/15. In the United States, the Federal Open Market Committee (FOMC) rate is expected to increase, post-tapering, in 2015. On the contrary, markets continue to expect a prolonged period of low interest rates and supportive monetary policy in the euro area and Japan. In the emerging market economies, there has been a tightening of monetary and financial conditions since mid-2013, owing to the combined effect of spillovers from rising bond rates and better economic prospects in the advanced economies based on the markets' reassessment of medium-term growth prospects. The risks posed to the emerging economies by capital reversals in the post-tapering era remain a major challenge to the outlook.

Overall, global economic outlook remains benign with prospects of steady and gradual improvements in the major economies, as well as slowing but sustained healthy growth in the emerging markets and developing economies.

Domestic Economic and Financial Developments

Output

The Committee noted that real Gross Domestic Product (GDP) growth remains robust. The recently rebased GDP figures released by the National Bureau of Statistics (NBS) indicated that real GDP grew by 7.41 per cent in 2013, compared with the 5.09 and 6.66 per cent recorded in 2011 and 2012, respectively. From the rebased GDP, the new major sectors of the economy in 2013 in terms of their share in GDP were: Services (36.08%); Industry (21.73%); Agriculture (21.50%) and Trade (17.06%). Figures for the first quarter of 2014 based on the rebased GDP are yet to be released by the NBS. The non-oil sector remained the main source of overall growth performance (7.77%), driven largely by: agriculture (0.43%), industry (1.28%) of which manufacturing was 1.26% and construction (0.62%); trade (1.54%) and services (3.89%).

Prices

Inflation has remained within the indicative benchmark target range of 6.0-9.0 per cent during the first four months of 2014. On a year-on-year basis, however, headline inflation inched up to 7.9 per cent in April from 7.8 per cent in March 2014. Food inflation, which was 9.3 per cent in January, declined to 9.2 per cent in February and slightly increased to 9.3 and 9.4 per cent in March and April, 2014, respectively. Core inflation, which declined to 6.6 per cent in January, increased to 7.2 per cent in February, and rose further to 7.5 per cent in April, 2014. The Committee noted that headline inflation has remained within single digit in the last sixteen months and stressed its commitment to sustain price stability; defined by the Bank's indicative benchmark range.

Monetary, Credit and Financial Markets' Developments

Broad money supply (M2) increased by 1.94 per cent in April, over the level at end-December 2013. When annualized, M2 increased by 5.83 per cent. M2 was however, below the growth benchmark of 15.52 per cent for 2014. The increase in money supply reflected the growth in the net domestic credit (NDC) of 1.62 per cent in April. Annualized, NDC grew by 4.85 per cent over the end-December, 2013 level. It is, however, below the provisional benchmark of 28.5 per cent for 2014. The slow growth in aggregate credit was traced mainly to Federal Government borrowing which contracted by 18.06 per cent in April 2014 or 54.18 per cent on annualized basis. In the period under review, money market interest rates remained within the MPR corridor of +/- 200 basis points; oscillating in tandem with the level of liquidity in the banking system. The inter-bank call and OBB rates averaged 10.5 and 10.59 per cent, respectively, in April. As at mid-May, the inter-bank call rate stood at 10.57 per cent while the OBB rate was 10.32 per cent.

The Committee noted the modest improvement in the equities segment of the capital market in the review period. The All-Share Index (ASI) rose by 0.7 per cent from 38,748.01 on March 31, 2014 to 39,018.34 on May 16. Similarly, Market Capitalization (MC) increased by 3.3 per cent from N12.45 trillion to N12.85 trillion in the same period. However, relative to end-December 2013, the indices declined by 5.6 and 2.8 per cent, respectively. This was traced partly to the impact of the response of global financial markets to Q.E. tapering by the US Fed, weak economic performance in the emerging markets and fragile recovery in the Eurozone.

External Sector Developments

The naira exchange rate remained stable at the rDAS window but appreciated at the interbank and the BDC segments of the market. The exchange rate at the rDAS-SPT during the review period (March 26,-May 16, 2014) strengthened to N157.29/US$ from N157.30/US$, representing an appreciation of N0.01k or 0.01 per cent. At the Interbank foreign exchange market, the selling rate opened at N164.65/US$ and closed at N162.33/US$, representing an appreciation of 1.41 per cent or N2.32k in the same period. At the BDC segment of the foreign exchange market, the naira which sold at N172.00/US$ on March 26, closed at N167.00/US$ on May 16; indicating an appreciation of 2.91 per cent.

Gross official reserves as at May 15, 2014 stood at US$38.30 billion compared with US$37.40 billion at end-March and US$42.85 billion at end-December 2013. The current level of the country’s external reserves could provide approximately 9 months of imports cover.

The Committee’s Considerations

The MPC noted the mixed signals over the global growth prospects in the advanced, emerging markets and developing economies. From the United States, the continued gains in employment, rising inflation and growth stability could soon pave way for policy tightening. On the contrary, the outlook for monetary policy appears biased towards sustaining easy monetary stance in the euro area and Japan against the backdrop of slow and uneven recovery in the region. For the emerging markets and developing countries, the Committee was concerned that the current underlying pressures on their currencies arising from capital flow reversals, increases in consumer prices and declining inflows, which preclude the use of expansionary monetary policy to stabilize domestic output and employment in the short run, could dampen growth prospects.

The Committee noted with satisfaction Nigeria's overall domestic economic environment which has remained stable with inflation contained within the target range, the recent stability in the foreign exchange market, stable interbank rates and strong growth outlook. The key challenge for policy, in the Committee's view, was that of sustaining and deepening the outcomes of existing policies. It noted, also, that over the medium term, the major risks to price stability appeared to be emanating from both external and internal sources.

From the external environment, risks to the domestic economy include the prospects for increased yields and interest rates in the US and the rather low level of economic activity in the emerging markets; both of which could have repercussions for foreign exchange inflows (private and official) and stability of the naira exchange rate. Internally, the key risk factors include the high systemic banking system liquidity, elevated security concerns and anticipated high election-related spending in the run-up to the 2015 general elections. High domestic liquidity could exert sustained pressure on both the exchange rate and consumer prices, as well as accentuate the already high demand for foreign exchange, further depleting the country's external reserves. In addition, core inflation has continued to send conflicting signals since January 2014. If the upward trend continues as observed in April 2014, it could be a major factor in the upward trend in prices.

The Committee also expressed concern over the eroded fiscal buffers which have exposed the economy to vulnerabilities arising from both domestic and external shocks. The erosion has accentuated the regime of persistently high interest rates, elevated demand for foreign exchange and declining reserves accretion. The Committee enjoined the Management of the Bank to continue to monitor developments in the fiscal space with a view to taking appropriate monetary policy actions.

In the light of the foregoing, the Committee acknowledged the success of monetary policy measures in attaining price and exchange rate stability and considered: the potential headwinds in 2014, the ultimate goal of transiting to a truly low-inflation environment; and the need to retain portfolio flows. The Committee unanimously voted to retain the current stance of monetary policy. In addition, one member voted for an asymmetric corridor around the MPR.

Consequently, the Committee voted to:

- hold the MPR at 12%;
- keep the CRR on public sector deposits at 75% and CRR on private sector deposits at 15%;
- retain the MPR corridor at +/-200 basis points.

Thank you

Sarah O. Alade
Acting Governor
Central Bank of Nigeria
20th May, 2014