CENTRAL BANK OF NIGERIA COMMUNIQUÉ NO 114 OF THE MONETARY POLICY COMMITTEE MEETING OF 24th AND 25th JULY, 2017

Background

The Monetary Policy Committee met on the 24th and 25th of July 2017, against the backdrop of a relatively improving global economy. However, protectionism in trade and immigration; fragilities in the financial markets, remain the key risks to global economic stability.

On the domestic front, the economy is on a path to moderate recovery with a positive short- to medium-term outlook, premised largely on fiscal stimulus and a stable naira exchange rate. Inflation expectations also appear sufficiently anchored with the current stance of monetary policy.

In attendance were 8 out of 12 members of the Committee. The Committee examined the global and domestic economic and financial environments in the first half of 2017 and the outlook for the rest of the year.

External Developments

The momentum witnessed in the global economy in Q1 2017 continued through the second quarter, driven by a generally accommodative monetary policy stance in most advanced economies, moderation in energy prices and improved global demand. The emerging markets

and developing economies, are experiencing positive spillovers from somewhat improved commodity prices and developments in the advanced economies. The growth prospects for this group of countries in 2017 are expected to rise to about 4.6 per cent from 4.3 per cent in 2016.

Complemented by the momentum in other blocks and a potential positive prospect for expansion in world trade, the IMF in its July edition of the World Economic Outlook (WEO) projected global output growth in 2017 at 3.5 per cent from 3.1 per cent in 2016.

The MPC, however, noted some headwinds confronting the optimistic outlook to global growth arising mainly from receding market expectations of expansionary U.S. fiscal policy, weaker than expected growth in the U.K due to difficult BREXIT negotiations and geo-political risks associated with the forthcoming German general elections. In addition, the Committee noted the downward trend in global inflation after earlier indications of an uptick as the U.S. continues to build up inventories in shale oil, while emerging economies such as Brazil, Russia and South Africa witness strong economic headwinds leading to sharp downturn in output.

Domestic Output Developments

Data from the National Bureau of Statistics (NBS) showed that the contraction in the economy moderated to 0.52 per cent in Q1 2017 from 1.30 per cent in Q4 2016. The data further revealed that fifteen economic activities recorded positive growth in Q1 2017, showing strong signs of recovery. The Purchasing Managers Index (PMI) for

manufacturing and non-manufacturing activities stood at 52.9 and 54.2 index points in May and June 2017, respectively from 52.7 and 52.5 index points in May 2017, indicating an expansion for the third consecutive month. Similarly, the Composite Index of Economic Activities (CIEA) rose from 55.85 to 59.50 index points between April and June 2017. The Committee noted the continuous positive effects of improved foreign exchange management on the performance of manufacturing and other economic activities. Non-oil real GDP grew by 0.72 per cent in Q1 2017, reflecting growth in the agricultural sector by 0.77 per cent in the same period. Provisional data also showed that the external sector remained resilient in Q2 2017, as the overall Balance of Payments (BOP) position recorded a surplus of US$0.65 billion, equivalent to 0.8 per cent of GDP. The Committee hopes that the implementation of the 2017 budget and the Economic Recovery & Growth Plan (ERGP) will further strengthen growth and stimulate employment.

Developments in Money and Prices

The Committee noted that money supply (M2) contracted by 7.33 per cent in June 2017, annualized to a contraction of 14.66 per cent, in contrast to the provisional growth benchmark of 10.29 per cent expansion for 2017. The development in M2 reflected a contraction of 7.45 per cent in net foreign assets (NFA) in June 2017. Similarly, M1 contracted by 7.98 and 10.70 per cent in May and June 2017, respectively, consistent with the directive of the MPC that expansion in narrow money should be controlled. On the other hand, net domestic credit (NDC) grew modestly by 1.02 per cent in June 2017, (annualized at 2.04 per cent), driven mainly by net credit to government, which

grew by 5.91 per cent. Credit to the private sector, however, declined relative to end-December 2016 by 0.02 per cent. The MPC noted the widening fiscal deficit of N2.51 trillion in the first half of 2017 and the growing level of government indebtedness and expressed concern about the likely crowding out effect on private sector investment. The constrained growth in the monetary aggregates provides evidence of weak financial intermediation in the banking system arising from the constraints imposed by developments in the macroeconomy.

Headline inflation (year-on-year) declined for the fifth consecutive month in June 2017, to 16.10 per cent from 16.25 per cent in May, and 18.72 per cent in January 2017. Core inflation moderated to 12.50 per cent in June from 13.00 per cent in May 2017 while the food index rose marginally to 19.91 per cent in June from 19.27 per cent in May 2017. This development was traced to intermittent attacks by herdsmen on farming communities, sporadic terrorist attacks in the North-East and other seasonal farming effects. The Committee was particularly concerned about the unabating pressure from food inflation but hopeful that the situation will dampen in the third quarter as harvests begin to manifest.

The Committee also attributed the moderation in inflation to be partly due to the effects of the relative stability in the foreign exchange market, stemming from improved management, which promoted increased inflows. Against this backdrop, the Committee reiterated its commitment to sustain and deepen flexibility in the foreign exchange market to further enhance foreign exchange flow in the economy. The Committee, however, noted the protracted effects of high energy and

transportation costs as well as other infrastructural constraints on consumer price developments and expressed hope that government will fast-track its reform agenda to address these legacy issues. The Committee noted that while responding to the current tight monetary policy stance, inflation still had a strong base effect which is expected to wane by August 2017.

Money market interest rates moved in tandem with the high level of liquidity in the banking system. The interbank call rate opened at 16.13 per cent on May 25, 2017 and closed at 4.43 per cent on June 29, 2017. However, the average inter-bank call rate during the period stood at 12.49 per cent. The movement in the net liquidity position reflected the effects of OMO, foreign exchange interventions, statutory allocation to state and local governments, and maturity of CBN Bills.

The Committee noted the improvements in the equities segment of the capital market as the All-Share Index (ASI) rose by 33.33 per cent from 25,516.34 on March 31, 2017, to 34,020.37 on July 21, 2017. Similarly, Market Capitalization (MC) rose by 32.84 per cent from N8.83 trillion to N11.73 trillion during the same period. Relative to end-December 2016, capital market indices rose by 26.59 and 26.81 per cent, respectively, reflecting growing investor confidence due to improvements in foreign exchange management. The Committee however, noted the seeming bubble in the capital market and cautioned on the utilization of the inflows.

Total foreign exchange inflows through the Central Bank of Nigeria (CBN) increased by 35.41 per cent in June 2017 compared with the

previous month. Total outflows, on the other hand, decreased by 12.73 per cent during the same period, as a result of reduced CBN intervention in the interbank foreign exchange market, which also reduced TSA (dollar) payments balances by 61.4 per cent in the period under review. The positive net flows resulted in an improvement of gross external reserves to $30.30 billion at end-June 2017, compared with $29.81 billion at end-May 2017.

The Committee noted the emerging convergence between the bureau-de-change (BDC) and Nigeria Autonomous Foreign Exchange (NAFEX) segment rates and the stability of the average naira exchange rate at the inter-bank segment of the foreign exchange market during the review period.

2.0. Overall Outlook and Risks

Available forecasts of key macroeconomic indicators point to a fragile economic recovery in the second quarter of the year. The Committee cautioned that this recovery could relapse in a more protracted recession if strong and bold monetary and fiscal policies are not activated immediately to sustain it. Thus, the expected fiscal stimulus and non-oil federal receipts, as well as improvements in economy-wide non-oil exports, especially agriculture, manufacturing, services and light industries, all expected to drive the growth impetus for the rest of the year must be pursued relentlessly. The Committee expects that timely implementation of the 2017 Budget, improved management of foreign exchange, as well as security gains across the country, especially, in the Niger Delta and North Eastern axis, should be firmly anchored, to enhance confidence and sustainability of economic recovery.

The Committee identified the downside risks to this outlook to include weak financial intermediation, poorly targeted fiscal stimulus and absence of structural programme implementation.

3.0. The Considerations of the Committee

Notwithstanding the improved outlook for growth, the Committee assessed the implications of the uncertainties arising from the continued normalization of monetary policy by the US Fed and the implications of a strong dollar, the weak recovery of commodity prices, and the uncertainty of US fiscal policy. The Committee similarly evaluated other challenges confronting the domestic economy and the opportunities for achieving economic growth and price stability in 2017.

The Committee expressed satisfaction with the gradual but consistent decline in inflationary pressures in the domestic economy, noting its substantial base effect, continuous improvements in the naira exchange rate across all segments of the foreign exchange market, and considerable signs of improved investments inflows. The Committee welcomed the move by the fiscal authorities to engage the services of asset-tracing experts to investigate the tax payment status of 150 firms and individuals in an effort to close some of the loopholes in tax collection, towards improving government revenue. However, the Committee expressed concern about the slow implementation of the 2017 Budget and called on the relevant authorities to ensure timely implementation, especially, of the capital portion in order to realize the objectives of the Economic Recovery and Growth Plan. The MPC believes that at this point, developments in the macroeconomy

suggest two policy options for the Committee: to hold or to ease the stance of monetary policy.

Against the backdrop of the outlook for the domestic and global economy; the enthusiasm around the base-effect which reduced inflationary pressures and the continuous relative stability in the naira exchange rate, there is need to maintain cautious optimism, given the potential ramification of a major deviation from the existing policy path. The Committee is not unmindful of the high cost of capital and its implications on the still ailing economy, which arguably necessitates an accommodating monetary policy stance. The MPC also noted the liquidity surfeit in the banking system and the continuous weakness in financial intermediation, but agreed on the need to support growth without jeopardizing price stability or upsetting other recovering macroeconomic indicators, particularly the relative stability in the foreign exchange market.

The MPC thinks that easing at this point would signal the Committee's sensitivity to growth and employment concerns by encouraging the flow of credit to the real economy. It would also promote policy consistency and credibility of its decisions. Also, the Committee observed that easing at this time would reduce the cost of debt service, which is actually crowding out government expenditure. The risks to easing however, would show in terms of upstaging the modest stability achieved in the foreign exchange market, the possible exit of foreign portfolio investors as well as a resurgence of inflation following the intensified implementation of the 2017 budget in the course of the

year. The Committee also reasoned that easing would further pull the real interest rate down into negative territory.

The argument for holding is largely premised on the need to safeguard the stability achieved in the foreign exchange market, and to allow time for past policies to work through the economy. Specifically, the MPC considered the high banking system liquidity level; the need to continue to attract foreign investment inflow to support the foreign exchange market and economic activity; the expansive outlook for fiscal policy in the rest of the year; the prospective election related spending which could cause a jump in system liquidity, etc.

The MPC expressed concern over the increasing fiscal deficit estimated at N2.51 trillion in the first half of 2017 and the crowding out effect of high government borrowing. While urging fiscal restraint to check the growing deficit, the Committee welcomed the proposal by government to issue sovereign-backed promissory notes of about N3.4 trillion for the settlement of accumulated local debt and contractors arrears. The Committee, however, advised the Management of the Bank to monitor the release process of the promissory notes to avoid an excessive injection of liquidity into the system thereby offsetting the gains so far achieved in inflation and exchange rate stability.

On the outlook for financial system stability, the Committee noted that, in spite of the resilience of the banking sector, the prolonged weak macroeconomic environment has continued to impact negatively on the sector's stability. The MPC reiterated its call on the Bank to sustain its intensive surveillance of deposit money banks' activities for the purpose of promptly identifying and addressing vulnerabilities. The Committee

also called on the DMBs to support economic recovery and growth by extending reasonably priced credit to the private sector.

4.0. The Committee's Decisions

In consideration of the headwinds confronting the domestic economy and the uncertainties in the global environment, the Committee decided by a vote of 6 to 2 to retain the Monetary Policy Rate (MPR) at 14.0 per cent alongside all other policy parameters. Consequently, 6 members voted to retain the MPR and all other parameters at their current levels while two members voted to ease the stance of monetary policy. In summary, the MPC decided to:

(i) Retain the MPR at 14 per cent;
(ii) Retain the CRR at 22.5 per cent;
(iii) Retain the Liquidity Ratio at 30.00 per cent; and
(iv) Retain the Asymmetric corridor at +200 and -500 basis points around the MPR.

Thank you for listening.

Godwin I. Emefiele
Governor, Central Bank of Nigeria
25th July, 2017

PERSONAL STATEMENT BY THE MONETARY POLICY COMMITTEE MEMBERS

1. ADELABU, ADEBAYO

The improvement in the performance of key macroeconomic variables, which commenced in the early part of the year, appears to have been fairly sustained. Recent statistics suggest that the economy may completely exit recession by the end of the third quarter, while a positive growth could be recorded at the end of the fiscal year. Of significant interest is that the growth is all inclusive, as the manufacturing sector, which has been in comatose for the past three years, is beginning to show some signs of revival. The Purchasing Manager Index (PMI) for the manufacturing sector increased by 1.2 percentage point to 54.1 points in July, which was not only the highest level since 2014, but equally represents expansion in the sector's activities for the fourth consecutive month. Similarly, the non-manufacturing sector's PMI increased modestly by 0.2 percentage point to 54.4 points during the period, representing an expansion for three consecutive months. Inflation is still relatively high, particularly in reference to the Bank's target, nonetheless, headline inflation eased to 16.1 percent in June, representing a consistent deceleration for five months.

Furthermore, the stability in the foreign exchange market is becoming firm and accompanied by significant reduction in premium between the two markets. In particular, the recent return of current account balances to a surplus would have profound positive influence on the overall macroeconomic condition. Apart from the positive spillover in terms of enhancement of accretion to external reserves, which would

strengthen the stability of the exchange rate, it also has the capacity to alter the structure of GDP in favour of employment enhancing sectors. This is predicated on the thesis that continuous surplus on current account is normally associated with rapid growth of tradable sectors than the non-tradable, and given that high quality employment is generated mostly in the tradable sectors, the new trend will rub off on employment and ultimately reduce poverty. On a similar dimension, the growing confidence in the macroeconomic environment is also generating a positive spillover in the equity market, with the capital market witnessing sustained rally since April 2017 on the backdrop of enhanced confidence cum optimistic outlook by investors. The foregoing positive outcomes reflect the various measures of monetary policy, particularly the improved liquidity as well as enhanced access to the foreign exchange markets coupled with the commitment of government to the Economic Recovery and Growth Plan (ERGP).

The medium term outlook is fairly optimistic but replete with challenges that have considerable capacity to reverse the gains recorded so far. One of the major risks is the limited fiscal space, which may threaten discretionary expenditure that could provide strong impetus to the implementation of the ERGP. Preliminary data suggests that actual revenue of the fiscal authority significantly underperformed in relation to projection in the first half of the year on the backlash of recurring price and volume challenges in the oil sector. A key adverse outcome of this development is the elevated interest to revenue ratio in the fiscal authority's balance sheet, estimated to be in the neighborhood of 40 percent. The interest to revenue ratio may further rise with the continuing tightening of monetary policy stance by the Federal Reserves (Fed) of the US. My view is hinged on the strong correlation

between gross capital inflows and market risk index for most emerging economies. A rise in gross capital flows is normally accompanied by a decline in market risk index and vice versa. Given that the continuous normalization of monetary policy stance by the US Fed would, invariably, be accompanied by a shift in risk appetites and policy stance of most systemic important financial centers against emerging market economies, a reduction in capital flows to emerging economies is inevitable. Consequently, financial market risk for the domestic economy may head northward, exerting additional strain on the fiscal budget through increase in interest charges.

Furthermore, the economy is expected to exit recession by the latter part of the year but the projected GDP growth is just 0.8 percent, a relatively marginal increase that could barely make appreciable impact on socio-economic condition in the country. In order for the impact of growth to reflect on poverty and welfare, it is expected that the rate should not be less than 7 percent for at least five consistent years. This may be a little bit challenging under the present regime of inflation induced high interest rate. There are at least two reasons why the interest rate may not trend downward in the near term. Firstly, the tight monetary stance on account of elevated inflation and secondly, the cost of the rising NPLs in the banking industry may be factored into the pricing models by the banks. Thus, the capacity of the banking sector to support the ongoing recovery may be constrained. Another worrisome dimension is that the short fall in government revenue has increased government demand for banks financing, leading to the crowding out of the private sector in credit allocation.

In a related dimension, the Federal Government has just refunded another tranche of overcharged deductions on Paris Club debt to

states of the Federation, bringing the cumulative amount refunded in the course of the year to about N740 billion. This amount is equivalent to about 10 percent of current fiscal year's budget. The fund would indeed considerably alleviate the current financial burden confronting most of the states and it is more likely that a significant proportion would be used to defray outstanding salaries and pensions. In as much as this would enhance the purchasing power of citizen and stimulate aggregate demand, it is also necessary to bear in mind that increases in aggregate demand without commensurate plan to stimulate the supply side would ultimately lead to general increases in price level, hence the likelihood of reversing the current downward trend in inflation.

Apart from the challenges in the macroeconomic environment, a key risk that cannot be discounted is the rising socio-political tension on the backdrop of agitations and issuance of threats and counter threats from various parts of the country. These developments, no doubt, reduces the rating on ease of doing business index, with severe consequences on investment, output and even inflation. It is against this background that the sustenance of ongoing recovery requires a collaborative and coordinated commitment from all stakeholders, including the monetary authority, the fiscal authority and wholesale engagement with the civil societies.

In view of the fact that the balance of risks to outlook is mixed, arguments for easing at this meeting are as convincing as for further tightening. The compelling reason for easing is the need to support the ongoing recovery by complementing the ERGP of the Federal Government, but I would like to quickly add that in as much as this is a desirable option, it should be seen as a long term perspective. The

current period is not appropriate because inflation is not only high, the ongoing deceleration is equally not strong enough and is vulnerable to a costly setback. This, invariably, reduces the policy choices to either of further tightening or maintaining the status quo ex-ante. The key arguments for further tightening include the need to enhance the inflow of capital to strengthen the stability in the foreign exchange market. This is more so, in the light of gradual increase in interest rate by the US Fed and rising financial market volatilities in the advanced countries. I am however of the view that the magnitude of interest rate increase should be taken cautiously because of the long term consequence on the banking sector. The prevailing interest rate differential between the advanced countries and the domestic economy is crossing the acceptable threshold and this may engender unfriendly debt-type capital flow, which could elicit unsustainable appreciation in the exchange rate and ultimately increase the fragility of the banking system.

Against the perspective of the foregoing, I think the appropriate choice at this meeting is to maintain the current stance of monetary policy. Consequently, I would like to propose that all the current measures of monetary policy be retained. Specifically, MPR at 14 percent with a symmetric corridor of +2/-5 percent and CRR at 22 percent.

2. BALAMI, DAHIRU HASSAN

The July MPC meeting came at a time when the macro level and the growth rate expectation figures have risen by 0.80% while inflation has slightly improved from 16.10% in June to 16.05% in July 2017. There was also some stability in the official foreign exchange market at N305.80 Naira to a Dollar. Stress test at the financial sector shows that the Capital Adequacy Ratio (CAR) has worsened from 12.81% in April to 11.51% in June, with slight improvement of the Non-Performing Loans (NPLs) ratio from 15.18% to 15.07% in June against the prudential requirement of 10% -15% for banks with national and international authorisation, and a maximum of 5% for NPLs ratio. The banking sector Liquidity ratio showed that all DMB's registered above the minimum of 30% liquidity ratio with the exception of 4 outlier banks. The stress test therefore shows that the Deposit Money Banks (DMBs) are less resilient to shocks. However, the Return on Equity (RoE) and Return on Assets (RoA) registered some improvement from 17.69% to 22.44% in June and 2.32% in April to 2.42% in June 2017, respectively, partly due to annualised effect.

The financial performance indicators showed that when the four outlier banks were removed, the CAR, the NPLs ratio as well as the Liquidity ratio are all above the prudential requirement of 10%-15%, maximum of 5% ratio for NPLs. The critical question is how do we grow the economy with high rate of inflation as well as high rate of interest charged by the DMBs? It should be noted that the economy is exiting the recession by registering slight fall in inflation and rising growth rate compared to the April figures. Low inflation is partly instrumental to the growth registered in the economy in July. However, the fall in inflation is fragile because

energy prices, transportation cos t, food inflation, liquidity pressure due to Paris club refund are likely to heighten the level of inflation in the economy if not properly handled.

It should be noted that MPC Policies over the past six months have assisted in improving the performance of the economy. However, how do we sustain the effort? How do we create an incentive for the DMBs to lend to the real sector of the economy particularly the private sector? Currently, greater percentage of the credit is going to the government rather than the private sector. It seems that DMBs have low knowledge of the various sectors of the economy. The areas they favour are usually capital intensive industries that have low employment generation area such as oil and gas, telecommunications and electricity sectors. Other employment generation areas which include agriculture, small scale industry and transport services are not favoured.

The way forward requires the restructuring of the economy- This will require diversification of the economy, to be an export driven economy. Both Federal and Sub-national governments need to improve their revenue base and collection efforts and make all levels of government pro-active in promoting growth at all levels through less reliance on the oil and gas sector.

The clamour for low Interest rate cannot happen now because of the high level of inflation and rising operational cost in the economy. Again, there is the need to encourage the inflow of FDI both real investment and hot money into the economy. To move the economy forward there is also need for MPC to examine the effect of credit concentration as well as banks concentration and how the two will

impact on the growth of the economy. It should be noted that banks have seen how NPLs ratio are rising due to the effect of external shocks on various sectors of the economy, for example low levels of commodity prices such as oil at the international market to grow the economy.

Deficit financing of the budget and Economic Recovery Growth Plan (ERGP) 2017 is necessary. Usually Government budget deficit can be financed through borrowing or nominal money growth which is done by debt monetisation or stock monetisation or both. Debt monetisation is a situation whereby government raise the treasury bills or bond and ask the CBN to take the bonds. The CBN then monetise the bonds through growing normal money and pass it to the government to finance the deficit. It should be noted that deficit financing through money creation can be expanding at the initial level. Nominal money growth will affect lower nominal interest and real interest rate in the short term because nominal money supply takes time to impart on Inflation. However, as deficit financing through growth in nominal money supply continues and start reflecting in inflation, the inflation becomes dominant. This will further promote inflation because the money provided through nominal money creation will not be adequate for financing the deficit due to fall in the value of nominal money, hence the need for government to request for more nominal money growth to further cover the deficit. Currently, the case for loosening does not arise because the DMBs will not react in the same way if the CBN lowers the Monetary Policy Rate (MPR) so as to benefit the real sector of the economy. I maintain that if inflation trends downwards further then loosening can take place. Tightening will hurt

the economy because the DMBs are likely to raise their rates which will be detrimental to investment in the economy.

Since the past policies have shown some improvement in the economy as buttressed by data presented to us, to hold will enable us to await clarity on the evolution of key fiscal variables which include budget implementation, and monetary variables such as increase or decrease in exchange rate, interest rate and inflation.

On the basis of the above, I vote to hold:

(i) Retain the MPR at 14 percent
(ii) Retain the CRR at 22.50 percent
(iii) Retain the liquidity Ratio at 30.00 percent and
(iv) Retain the Asymmetric corridor at +200and -500 basis points around the MPR

3. BARAU, SULEIMAN

Background

I voted to hold on the back of relative in gains in reducing inflation, stability in exchange rate and indication that the economy will come out of recession sooner than later. In taking this decision, I am aware that the continued existing of liquidity surfeit, Government deficit and that the fact that the decline in inflation is largely due to base effect and that there exist real threat to the gains mentioned unless further tightening is elicited. However, I passed by this option and the option of easing based on the observed need for sustained stability in policy.

The relative improvement in the macroeconomic environment, which commenced at the beginning of the second quarter, has been fairly reasonably sustained. The notable depreciation in the foreign exchange rates for the Naira have been largely contained and this has elicited improved confidence in both the interbank and the BDC segments, culminating in significant reduction in the hitherto huge premium at the BDCs' market. The latest projection by the IMF reveals that the Nigerian economy would outpace South African economy in 2018 while it is remarkable that the Economic Recovery and Growth Plan (ERGP) of the Federal Government is receiving endorsement of international development partners like the World Bank. Although headline inflation at 16.1 percent in June is still above the Bank's target, the good news is that deceleration has been consistently observed in the last five months. As noted in my last statement, the task at this period is to strengthen the seemingly nascent macroeconomic stability including building resilience and I am of the view that this should not be an elusive goal given that some of the major risk factors are waning.

The major risks continue to be the normalization of monetary policy by the US Federal Reserve, uncertain course of crude oil prices and pockets of tension within the domestic polity. Some other developments, however, could provide sufficient countervailing force to these apparent risk factors. Among others, the recent refund of overcharged deduction on Paris debts to states of the Federation would stimulate aggregate demand and thereby complement the Federal Government ERGP, which has equally received impetus with the commencement of the implementation of the 2017 Budget. A faithful implementation of the economic blueprint, in addition to sustained proactive monetary policy measures, should strengthen the macroeconomic environment and invariably put the economy on a firm recovery path.

As indicated earlier, the need to support the tepid recovery in output gives prospect for consideration of other policy options but the balance of risk to outlook is still mixed. Consequently, prematurely altering the stance of monetary policy stance may cause severe setback to the gains recorded so far in the macroeconomic environment. I will therefore opt to retain all monetary policy measures in place.

Pressure Points

Global Environment:

Developments so far in 2017 have signaled improvement in the global economy, but the outlook is still fraught with significant downside risks and uncertainties. One of the key issues is the rising financial markets volatilities, with severe implication on external financing conditions,

particularly for emerging and developing market economies. External financial conditions could have loosened relative to 2016, but the terms for accessing global financial markets still remain tighter for emerging and developing market economies on the backlash of inherent features of vulnerability in these economies. Progressive normalization of monetary policy stance by the US Federal Reserve is expected to further strengthen the US dollar against most emerging market currencies, and for Nigeria in particular, it could translate to a setback in the evolving stability in the foreign exchange markets.

Furthermore, the medium term outlook of crude oil prices remains uncertain on the backdrop of market fundamentals. Although oil prices have witnessed a fair rally in recent weeks, sustainability of the trend remains a serious source of concern as oil majors in the US scaled up investment in shale exploration, while OPEC has been facing challenges in ensuring total compliance on its output cut deal. From the demand side, apart from the fact that global economic recovery is yet to keep pace with the pre-global financial crisis, the concern over climate change with particular reference to Paris climate accord is shifting technology away from carbon-based energy sources. For example, France has just announced a plan to ban petrol-driven vehicles as part of the commitment of becoming carbon neutral. Similarly, Norway and Netherlands are planning to ensure only electric-run vehicles are used in their countries by 2025. Apart from these countries, Germany and India are looking at 2030 towards compliance with carbon neutral environment, while the manufacturer of Volvo automobile is working towards making its cars at least partly electric by 2019. In a nutshell, the dynamics in crude oil markets is revealing an indicative equilibrium price at the south of US$50 per barrel.

Domestic Environment

The overall medium term path could be challenged by the following risk factors.

Threat to implementation of 2017 Budget: The 2017 Federal Government Budget was predicated on crude oil price benchmark of US$44.5 per barrel and production volume of 2.2mpd. Crude oil prices, after the initial rebound in the early part of the year, have been more of a downward trend reaching a 7-month low of US$43.3/barrel, about 3 percent lower than the benchmark price. Besides, in an attempt to contain the softening crude oil prices, OPEC is contemplating further production freeze in a scheme that may specifically affect Nigeria and Libya. This, in essence, implies that projected oil revenue for the budget may be adversely affected in both price and output contexts. This development would either lead to reduction in total spending or widening of budget deficit. Either of these options is a risk factor to monetary policy. A cut in expenditure would logically be from growth enhancing capital spending thereby acting as incubator of structural inflation, while increase in fiscal deficit would increase interest rate as well as crowding out private sector credit and ultimately stoke price level.

Injection of Funds to State Governments: As part of the wider efforts to stimulate the economy, the Federal Government has just released about N244 billion to the states of the Federation, being the second tranche of the refund of overcharged deduction on the Paris Club debt. The latest tranche brings the total amount released so far to about N760 billion, while the possibility of more tranches in the course of the year appears very high. In view of the terms attached to the

release of the fund coupled with labor union agitations, a significant portion of the fund would be deployed to payments of salaries and pensions. The whole idea underlying the deployment of the fund is not completely bad as it could stimulate growth in output in the long run. The reality, however, is that the impact of this type of injection on aggregate demand tends to precede the influence on aggregate supply and invariably stoke inflation in the short run. Besides, there is evidence of growing liquidity surfeit in the banking industry in the face of sluggish growth in credit particularly to the private sector. It is not unlikely that the current injection may complicate the liquidity surge with potential adverse impact to the foreign exchange markets.

Recommendations

Enhancement of net inflows to External Reserves: The improved confidence in the foreign exchange markets has been significantly bolstered by the increased liquidity in the market, but at the same time accompanied by relative degree of outflow on external reserves. Conventionally, stemming the tide on external reserves would involve increase in domestic interest rate, but I would not be disposed to that option for now, out of concern for growth and the fact that the flows to the external reserves, on net basis, has been positive. Without prejudice to these logics, it is equally important to bear in mind the strategic move of rational economic agents. Monetary authority loses the driver seat to the market, when the stock of external reserves is approaching a threshold in which economic agents perceive that it would be difficult for the monetary authority to defend the exchange rate. The cost of maintaining stability at such threshold becomes elevated through significant increase in interest rate. As such, while I would prefer

to hold the current stance of policy, it may also be strategically optimum to begin exploring other means of increasing net inflows to external reserves given the current vantage position of the monetary authority.

Strengthening of Domestic Resource Mobilization: Apart from the fact that oil prices are declining the issue of output cap has been on the front burner at OPEC with Nigeria and Libya likely to now be at the receiving end. In light of the apparent anti-benign external environment, the smooth implementation of the economic recovery and growth plan would be contingent on the quantum of resources that could be mobilized within the domestic economy. This, invariably, requires intensification of various structural policies that could enhance non-oil revenue. Fortunate enough, recent studies have confirmed that most of the Sub Saharan African countries including Nigeria have potential to increase tax revenue by about 3-6 percent of GDP. In this regard, the ongoing tax reform measures by the Federal Inland Revenue Service (FIRS) are a commendable step in the right direction provided that it will elicit a rather significant and radical increase on tax revenues.

Food Security Measures: The recent policy announced by the Federal Ministry of Agriculture to commence the export of yam to the US and UK is a major breakthrough in the quest to promote non-oil exports. The implementation of the new trade scheme should however be approached circumspectly in view of relatively high weight of food in the Nigeria consumer's basket. Food inflation has been a major driver of the prevailing episode of high inflation, driven in part by supply deficit. As such, the implementation of the new trade schemes should

take on board measures that would preserve domestic food security with a view to avoiding domestic supply deficit which could fuel inflation.

Conservative Benchmark Price for Crude oil in 2018 Federal Government Budget: The benchmark price for crude oil in the 2017 Federal Government budget is US$44.5 per barrel while the first half of the year has seen the actual price sliding below the budget benchmark. OPEC has tried to rise up to the challenges by negotiating a deal on output cut from member states. Compliance by OPEC members with production cut deal has not only been low, but the precarious situation has been further exacerbated by rising supply by non-OPEC members led by US, Brazil and Canada. In addition, the production cut deal is expected to expire in March 2018 while OPEC has not clearly shown the exit strategy. Except for such temporal disruption to output, it is high time to adjust to the reality that the era of astronomical crude oil prices has ended and this should be duly recognized in the revenue projection for 2018 to avoid unplanned budget deficit.

Robust Framework to Calm Rising Socio Political Tension: The importance of peace and security in fostering investment, an acknowledged accelerator of economic prosperity, cannot be overemphasized. To build on the fledgling gains in macroeconomic environment, issues that bother on security cannot be compromised. Against this background, it is expedient that a holistic framework be put in place to address all kinds of security threats across the various geo-political zones to avert the possibility of major crisis.

Decision:

The ongoing recovery requires some measures of interest rate support but in view of the fact that the balance of risk to outlook on macroeconomic stability is still mixed, I will vote for the retention of all monetary policy measures.

4. GARBA, ABDUL-GANIYU

Decision

I vote to reduce the MPR by 200 basis points (2%). This implies (i) a reduction in the MPR from 14% to 12% and (ii) a reduction in Standing Lending Facility (SLF) from 16% to 14% and the Standing Deposit Facility (SDF) from 9% to 7%.

My vote is a vote for (i) consistency and effectiveness of monetary policy and (ii) growth in private investment, creation of new jobs, output growth, financial system stability and medium term macroeconomic stability.

Justification

The first joint fiscal and monetary retreat which held in March before the March MPC laid down a sound set of principles for effective strategic and policy coordination (humility, sincerity and integrity) and emphasized the organic links between fiscal, monetary and prudential policies and the grave dangers of independent and uncoordinated strategic and policy analysis and choices. It is important that we keep in mind the frameworks, mandates and goals of macroeconomic management and the specific domains of each monetary, prudential and fiscal policies and the initial conditions of recession. Otherwise, policy decision making will be within strategic vacuums. Such policy choices may not drive the economy towards paths of low inflation conducive to growth, financial system stability (FSS) and fiscal discipline. I believe strongly that it is critically important to build on the foundations of the "March retreat" if we are not to be matching in retreat.

It is very easy to lose focus, squander opportunities to learn key lessons and repeat fundamental and disastrous strategic and policy errors if challenges and pressures are allowed to overwhelm strategic analysis and policy choice. However, if we let the lessons of history, of clear and consistent reasoning, of evidence and of the legal mandate of monetary policy guide our thinking, conclusions, and choices, it would be easier to find quicker and less costly pathways to low inflation growth, low unemployment, fiscal prudence and financial system stability.

This MPC meeting brought to focus three key macroeconomic challenges in increasing order of difficulties: technical exit from recession (achievable even by a positive growth that is not significantly different from zero growth such as 0.000000001%); economic recovery (that is, taking the economy to where it was in 2014) and economic growth (growing the economy from the 2014 base). It is obvious that the least challenging is the technical exit from recession. However, there is no guarantee that the economy will not slid back into recession or that the economy will recover and grow and surpass the level of 2014.

The macroeconomic challenge revealed by the data is overwhelming: five quarters of negative aggregate growth from 2016:Q1 to 2017:Q1 compounded by the economic slowdown since 2014Q1, nine quarters of negative growth in industrial GDP; six quarters of negative growth in construction GDP, four quarters of negative growth in trade GDP and three quarters of negative growth in services GDP, reversed in 2017:Q1 by a very low positive growth of 0.37%. Unemployment trending up to 14.2% in 2016:Q4 from 13.9% in the previous quarter and expected to trend upwards in 2017 given that unemployment starts to decline

several quarters after the recovery in economic growth had commenced and sustained. Though headline inflation is trending downwards, it is driven mainly by base effects: the month on month for imported food inflation and core inflation are higher in June than they were in May 2017.

The fiscal performance indicates a rise of cumulative fiscal deficit to ₦2.51Trillion in the first six months of 2017 from ₦1.211 Trillion in the first six months of 2016. This represented a 107.3% rise in deficit. In the same period, the ratio of revenue rose from 93% to 204%. In addition, the public debt rose by 32.4% in 2016 and by 11.5% in the first half of 2017 as the public debt stock rose from ₦10.98 trillion in 2015 to ₦16.21 Trillion in June 2017.

The money market remains characterized by **excessive** concentration in assets, credit and deposits among financial institutions and excessive concentration in the loan book per obligors and per sectors. For instance, big ticket borrowers –those who borrow above ₦1 Billion account for about 81% of the loan portfolio while those borrowing less than or equal to ₦1 million account for just about 1.3%. Majority of small and medium scale enterprises who have highest employment and output elasticities typically borrow under ₦1 million. Similarly, agriculture attracted just 3.2% (mostly guaranteed by the Central Bank). In contrast oil and gas continues to attract almost a quarter of new credits **allocated** in June 2017 despite relatively high ratios of non-performing loans. Not only does agriculture and small and medium scale players attract low allocations of credit, they do so at high costs. The maximum lending rate was 30.75% while the prime lending rate and deposit rates were 17.59% and 8.9% implying spreads of between 13.16% and 21.85%. It is hard to see how such high spreads and high lending rates will

stimulate growth in investment, employment, productivity and output or conduce a path towards financial system stability.

The coexistence of high interest rate and growth in money supply are unnatural. Indeed, it generates a **contradiction or inconsistency problem.** Strong growth in money supply in all countries that adopted quantitative easing pushed down interest rates almost to zero. And it was such almost zero interest rates that partly helped economic recovery and excessive growth in asset prices. The injection of liquidity through AMCON, frequent and wide ranging interventions, frequent injections through monthly monetization of FAAC oil revenue income and budget supports continually undermine the deflationary policy that has dominated monetary policy since September 2010. Persistent deflationary policy is incompatible with economic recovery and economic growth because deflation deflates!

As we pointed out in previous personal statements, it is the strong growth in money supply in 2015 and 2016 that significantly distorted the forex market, the money market, the stock market and domestic prices. It was almost a classic monetarist phenomenon where an expansion in money supply was transmitted more than proportionally to domestic prices through the amplifying effects of the exchange rate. To continue to grow money supply either through monetization of oil dollar revenue, standard lending facility, liquidity mop ups (each mop-up offsets the size mopped-up by the proportion of the interest rate), episodic release of intervention funds, expanding government securities, roll-overs of maturing securities and so on while keeping interest rates high is a self-defeating policy process. The revolving door of liquidity – pumping in liquidity and them mopping them up – keeps interest rates high, undermines investments, corporate revenues and profits and

employment while increasing public debts and the crowding out of non-debt public expenditure and private investments. The argument that we need to raise interest rates to attract portfolio flows is unconvincing. We have already had two disastrous episodes of portfolio flows triggered distortions of foreign reserves, current account balance, capital market, exchange rates and inflation during and after short lived asset price bubbles. The experiences of 2006-2009 and 2013-2016 are still fresh to start another cycle of flows that in additions to its distortionary effects cause depletion of reserves as well as increase in the sacrifice ratios of deflationary policies that climaxed in recession, high unemployment, high inflation, high interest rates and high public debt.

I was convinced after the March Retreat that finding the paths to low inflation growth conducive to job creation, financial system stability and fiscal prudence was the most urgent priority. I am still convinced that it is important to build on the March Retreat and that a consistent monetary policy is key to macroeconomic stability in the medium to long term.

I was concerned about a high interest rate trap since the deflationary policy phase began in September 2010. I believe that it is important to avoid a similar trap because I do not think the gains of portfolio flows are anywhere near the costs. I am also convinced that it is far more effective to stimulate remittances because they have more significant positive policy elasticities, greater stabilizing effects on the external balances and more positive impacts on the macro-economy and clearly far more virtuous.

No economy can recover and stimulate growth with excessively high interest rate and episodic destabilizing influences of portfolio flows. We have had the opportunity to restore monetary policy independence since 2014 when portfolio investors took flight. Getting into another high interest rate trap is not the answer to economic recovery or low inflation growth. I am convinced that we ought to move away from the Hong Kong Model that sacrifices monetary policy independence. We cannot afford to sacrifice the independence of monetary policy and hope to have a stable path to low inflation growth, financial system stability and fiscal discipline.

Kenya I believe presents a better model for ensuring that interest rate spread and interest rates do not destroy the productive base of an economy as well as the stability of the financial system and the economy. The SLF-SDF window has become a major noise and constraint to the effectiveness of monetary policy as the monetization of dollar oil export earnings. The excellent tracking of the exchange rates (Interbank and BDC) and inflation by M1 is indicative of the dangers of an unconstrained expansion in money supply and the high risks of currency collapse. The high instabilities in both OBB (open buy back) and Call Rates due to liquidity management in my considered view call for greater consistency in constrained liquidity management if the shifts from rent creation and appropriation (wealth transfer) is to give way to wealth creation, jobs and productivity and economic growth. Lowering interest rate is just a first step towards policy consistency and policy effectiveness. It should be a consensus point on which the monetary and fiscal authorities could on build on to produce a consistent forward looking strategic framework for coordinated, effective and constrained monetary, prudential and fiscal policies.

5. NNANNA, OKWU JOSEPH

Economic growth has shown resilience since the last MPC helped by recovery of oil production, industrial sector's increased access to foreign exchange and the 3.4 per cent Q2 growth in agriculture. At 103.8, the index of industrial production rose by 0.7 per cent, higher than the preceding quarter, while manufacturing capacity utilisation remained unchanged at 53.7 per cent. Average capacity utilisation index rose by 1.1 points in Q2 2017. However, downside risks to the growth outlook remain strong as structural rigidities persist and uncertainty which becloud the international oil price may weaken resource buffers for real sector financing.

Inflation continues to decelerate due to the positive core inflation shocks, favourable base effect and the moderation in the pass-through effect of exchange rate appreciation on domestic prices. Headline inflation narrowed by 0.15 percentage point to 16.1 per cent in June relative to its level in May. While core inflation fell to 12.46 per cent from 13.02 per cent in May, food inflation remains elevated at 19.91 per cent higher than the 19.27 per cent in May due to supply-side disruptions associated with insecurity, higher energy costs, protracted transport infrastructure bottlenecks and seasonality factors.

I note that though financial conditions eased-out in the interbank market as evidenced in the decline in the average interbank market rates, the drag on financial intermediation and credit conditions have remained persistent. Interbank market liquidity was bolstered by OMO sales and seasonal statutory disbursements, releases for capital budget execution and maturing CBN bills. Consequently, average inter-bank

call and OBB rates in June fell to 13.46 per cent and 29.57 per cent, respectively from 21.29 and 39.29 per cent in May 2017. Credit to the private sector contracted as a result of the persisting crowding-out effect of government borrowing requirements driving up interest rates. Maximum and prime lending rate rose by 0.19 and 0.01 percentage point, respectively to 30.94 and 17.59 per cent in June, from May 2017. All stock market indices were robust with the ASI and market capitalisation rising by 26.6 and 27.2 per cent, respectively, reflecting buoying investor sentiments.

Global growth which was predicated on stronger economic activity in advanced and emerging economies remains relatively fragile. Growth was hampered by a number of headwinds, namely, major oil exporting economies continue to grapple with weak financial conditions; United States expected fiscal expansion and deregulation is phasing in with a drag on economic activities; and crystalisation of the unintended consequences of BREXIT.

On the fiscal front, concerns about future fiscal slippages remains pertinent. The issue of long-run fiscal sustainability is emerging as revenues are weakening, interest rates on government debt are elevated, while borrowing is rising and interest payments have accumulated. It is my expectation that the authorities would bring to speed implementation of the Executive Orders recently signed to ease conditions of doing business; support local contents in public procurement by the Federal Government; and the Voluntary Asset and Income Declaration Scheme (VAIDS). These Orders should assist in improving the business climate, boost tax revenue, build buffers and

further support investors' confidence. Fiscal reforms including expenditure switching, can further free space to enhance public investments.

External sector indicators remained resilient supported by improved oil production and the effectiveness of the investors'-exporters' foreign exchange window in the provision of foreign exchange liquidity. The exchange rates in the NAFEX and the BDC segment appreciated by 18.0 per cent and 0.1 per cent to close at N363.76/US$ and N365.77/US% near its relative purchasing power trend. External reserves at end-June 2017 stood at US$ 31.26, 15.82 per cent higher than its level at end-December 2016 and could finance approximately 10 months of import cover.

Overall, the macroeconomic outlook is positive, while exchange rate stability is assured. The risk of a reversal of the current deceleration in the inflation path is very unlikely in the short-to-medium term. Against the backdrop of fiscal dominance despite lower than expected growth, and on the balance of risks based on available data, I vote to retain the current stance of monetary policy tightening.

6. SALAMI, ADEDOYIN

At the conclusion of this meeting, I voted with a minority of members to reduce the Monetary Policy Rate (MPR) by 2.0 per cent. As the Communique from the meeting shows, the majority of members voted to maintain the status-quo ante.

By way of background to this meeting, news, data and analysis continue to paint a mixed picture. Despite continuing contraction in overall economic growth – recorded at -0.5 per cent in Q1-2017 -, the non-oil sectors of the economy attained positive growth of 0.7 per cent in the same period. Though still shrinking, the rate of contraction in the oil sector slowed to 11.6 per cent from 17.7 per cent the previous quarter. Inflationary pressure appears to be easing. From 16.25 per cent the previous month, Headline inflation fell to 16.1 per cent in June 2017 – its lowest value for a year and the 5th consecutive monthly reduction. Similarly, Non-food or Core inflation dropped to 12.5 per cent from 13.02percent the previous month. In contrast, food prices continued to rise. At 19.91 per cent in June 2017, they were the highest they have been since 2009.

The picture of slowing inflation, around which there has been much positive comment, is sharply disputed when we look at the Month-on-Month data on price changes. Since its low point in November 2016 when it rose by 0.8 per cent, the monthly change (as opposed to the year-on-year change) in Headline has risen quite sharply. In June 2017, it rose by 1.6 per cent. This confirms that minus 'base effects', inflation remains a serious problem which both fiscal and monetary policy makers will do well not to ignore. The present euphoria around slowing inflation is unlikely to last beyond exhausting the 'base effects'.

Quite a bit of the background commentary had focussed on the gain of stability in the Forex Market. Particular emphasis being laid on the resumption of Foreign Portfolio Investor (FPI) inflows. A cursory review of the data for Capital Importation, whilst showing improvement, remains fragile. To confuse stocks and flows in the analysis of forex flows is to do ourselves a dis-service. The fundamental question, which in my view remains unanswered, is will the tentative drift in the direction of consolidating our multiple forex markets survive a downturn in oil prices? Given the uncertainty as to the answer to this question, it may be prudent to suggest that caution needs to attend the seeming haste to declare victory.

The Financial System Stability Report by Bank Staff highlights one of the biggest challenges with which the Central Bank must grapple. At slightly over 15.0 per cent, the portfolio of Non-Performing Loans (NPLs) as a proportion of the total loan book of banks remains above the regulatory maximum and continues to rise. Whilst Bank Staff continue to note that once the figure is discounted for the impact of "4 Outlier Banks", the NPL ratio drops to 8.17 per cent. In another set of circumstances, I may be tempted to suspend my judgement and support their position. However, I note that these "4 Outlier Banks" cumulate in size to at least 1 Systemically Important Bank (SIB). I take the view that since the failure of any of the SIBs is a source of concern, excluding these "4 Outlier Banks" does not adequately take cognisance of the contagion effect which they could trigger.

Perhaps the most challenging of the present characteristics of the economy in Nigeria is the adoption of a quantitative easing stance by the management of the Central Bank. Monetary data shows a sharp rise in the extent of CBN financing of the government deficit. Highlights

of CBN financing of the Federal Government since Dec. 2016 are as follows–

- CBN's claims on Federal Government (FG) at N814bn is twentyfold higher while the claims of Commercial Banks rose marginally by 0.4% to N4.6 trillion;
- 30.0 per cent increase to N454bn in CBN's purchase of government T-Bills;
- 5percent increase in FG Overdrafts to N2.8 trillion; and
- Increase in the 'mirror account' from N3 billion at the end 2016 to N1.5 trillion in April 2017.

It is clear that the CBN has provided 'piggy bank' services to the Federal Government.

To prevent the effect of continuous and massive injections of cash to fund the Federal Government showing up in sharply higher inflation and currency weakness, the Central Bank now applies 'special auctions'. The format of these 'auctions' recall the dark days of 'stabilization securities'. The effect of these auctions is to raise the 'effective' Cash Reserve Ratio (CRR) beyond the 22.5 per cent sanctioned by the MPC. The adverse effect on extension of credit to the private sector is not difficult to understand.

We thus find ourselves at a point where government borrowing from the CBN is 'neutralised' by raising the CRR of banks thereby limiting private sector access to credit. In other words, the private sector is deliberately 'crowded-out'. Its ironic that the government, in need of tax revenues – having in the 1st half of the year accumulated its full-year deficit – is constraining the private sector from which the sorely

needed revenues are to be derived.

Whilst I still wonder what the underlying economics is – I sincerely hopes it works!

Given that monetary policy management is presently about funding the Federal Government – in other words, the stance of policy is easing, policy consistency and credibility demand that the Monetary Policy Rate (MPR) be significantly reduced to reflect the underlying preferences of policy managers. I thus voted for a 2.0 per cent reduction in the MPR.

7. YAHAYA, SHEHU

I vote to maintain the current monetary stance, due to the reasons provided below

Developments in the Global Economy

Growth data for the global economy and for key trading partners of Nigeria is not yet available for the Q2 2017. What has been mentioned earlier for the first quarter of the year therefore still stands. General price levels reduced or remained stable in July in the US, Euro area, UK, China and Japan. This was also the trend in some African countries such as South Africa, Kenya and Ghana, while much of North Africa is experiencing some inflationary pressure.

Some of the most important developments appear to be emerging in the oil sector. Oil prices recovery in the first few months of this year is giving way to new pessimism due to oversupply and increasing shale oil production, and this is despite the extension of the OPEC production cut agreements. With rapidly falling overhead costs of shale oil production (their break-even point having come down to $22-25/barrel, which may even fall further), the prospects for continuing market saturation are getting stronger. In the longer term, an even bigger threat is the expanding use of renewables in the transport and energy sectors. Volvo has announced its intention to stop producing petrol/diesel cars by 2020; India is phasing them out by 2032 and the US is expected to see a collapse in use of petrol for transportation to 14% of current use by 2027. Germany, France, China and others have announced ambitious plans for the expansion of EV cars. The costs of solar power have also significantly shrunk and are continuing to fall further. Longer term prices of oil are therefore bound to experience a

sharp fall and this will obviously have far-reaching consequences on the economies of oil producing countries.

The Domestic Economy

Although yet to be confirmed, GDP is expected to show a positive growth rate of around 0.8% in Q2 2017 for the first time since early 2016. Energy and manufacturing are forecast to contribute to the turn-around. Despite the occasional gains in the price of crude oil and the improvement in production, the oil sector is unlikely to contribute at this time to the growth figures. Construction is also likely to show a small rebound. Nevertheless, the turn-around is still quite tentative and is capable of being interrupted in the event of headwinds.

Headline inflation has maintained its downward trend to 16.10 in June 2017, from 17.24% in April and 16.25% in May. The decline in headline inflation was spurred by the steady, even if slow decline in core inflation since December 2016, and is at 12.5% (YOY) in June 2017; whereas food inflation maintains a slow increase, more or less since April, to 19.91% by June.

The month-on-month inflation figures also indicate a gentle decline in prices, even for the food component, which has reduced from 2.54% in May 2017 to 1.99% in June, driven by both processed food and farm produce. Month on Month core inflation figures have also moderated, led by processed foods and housing, water, electricity, Gas and other foods. A substantial decline in headline inflation figures is unlikely unless there is a significant fall in food inflation. At any rate, the outlook is for prices to tick upward a little in July and September before slowing down again for the rest of the year. It is therefore important to ensure

that policies are aimed at contributing to the downward trend of prices.

At the foreign exchange market, the value of the Naira has remained fairly stable, mainly due to the rising oil production levels and the policies implemented by the CBN which have contributed to the rising levels of reserves. The stability of the Naira value is clearly an important contributory factor to the slightly moderating general price levels. The development of non-oil sectors and the attraction of foreign investment will be important factors in maintaining the level of reserves in the medium term.

The banking and financial sector are still experiencing some challenges. Capital adequacy ratio in the banking sector maintains its downward trend. However, while, NPLs are still too high, they are currently slightly lower than they were in April, and it is hoped that this trend will solidify along with the general economic turn-around. Liquidity is well above the regulatory threshold, while there has been some recovery in the figures for return on assets and particularly return on equity, with the latter experiencing a big surge. Profits have also risen by around 4.5%, despite the much higher level of provisioning in the sector, which is unsurprising, considering that lending rates have risen slightly and are increasingly diverting from deposit rates, which have actually fallen slightly, on average. However, it must be noted that credit to the private sector during the first half of the year has fallen by around 0.56%, while credit to the government is well below the indicated benchmark. Given the declining levels of government revenue and the need for private sector investments to boost growth and jobs, there is clearly a need to increase the flow of credit to the private sector.

The capital market is experiencing a resurgence, reflecting the cautious but positive sentiments that the economy has bottomed out. Foreign Portfolio and Direct investment are rising

In considering the policy options, it should be borne in mind that inflation, although trending downwards, is doing so very slowly and is still too high to be conducive to growth, since it has exceeded the thresholds beyond which, it is widely accepted, to be inimical to growth. In addition, it is still undermining the real income and consumption of fixed income earners, the poor and the unemployed. Secondly, recovery from growth is still very tentative and can be easily undermined. Thirdly, the stability in the foreign exchange market is critical to both economic recovery and the moderation of inflation.

In consideration of the above therefore, a loosening of monetary policy will undermine the efforts to sustain the moderation of inflationary pressure and therefore undermine the very growth that this approach is seeking to achieve, at a time when the effect of such a loosening on the reduction of interest rates is uncertain. It is also unlikely to encourage foreign investment and may undermine the efforts to maintain the robustness of external reserves.

On the other hand, tightening monetary policy may help the inflation effort, but will put Banks under additional pressure with respect to NPLs, and may also lead to a rise in interest rates (interest rates are more sticky downwards in developing countries). This may further choke off lending, especially to agriculture and manufacturing sectors, which are important for growth and jobs.

I therefore vote to maintain the current monetary stance. In addition, efforts should continue to be made to sustain the stability in the foreign

exchange market and incentivize DMBs to lend to the productive sectors of the economy. The CBN must also intensify efforts to avoid inflationary financing and accommodation.

8. EMEFIELE, I. GODWIN, GOVERNOR OF THE CENTRAL BANK OF NIGERIA AND CHAIRMAN, MONETARY POLICY COMMITTEE

At today's MPC meeting, my inclination is to hold the current monetary policy stance. This is to ensure an orderly transmission of past policy impulses, sustain the gains so far achieved in the domestic economy, and ensure that the improvement in near- to medium-term outlook is not overturned. Available data indicate that the pickup in macroeconomic aggregates which began during the fourth quarter of 2016 were not only sustained in the first half of 2017 but has broadened, *albeit* delicately.

The upturn in GDP trajectory is expected to culminate in positive growth by 2017q2. There were comparable improvements in price levels with a fifth consecutive month of disinflation to 16.1 percent in June 2017 from 18.7 percent in January 2017. These reflected the continued stability in the FX market as exchange rate generally converged downward. Besides, external sector statistics also indicated steady improvements discernible from the positive current account balance so far in the year.

Nonetheless, the medium- to long-term risks are on the downside especially with respect to developments in the crude oil market. Prominent in this regard are the persisting fall in the breakeven costs of producing shale oil towards US$22 per barrel and the green energy deportment of major car producing countries who have announced dates to halt the production of hydrocarbon-powered vehicles. These have dire ramifications for countries, like Nigeria, whose economy are overly dependent of crude oil.

In the near- to short-term, downside risk are contingent on the trajectory of global economic developments. Though near-term global macroeconomic outlook, according to the July 2017 vintage of the IMF's WEO, remained unchanged, the projections for the US and UK were revised downwards while prospects improved for the euro-area and Japan. Global outlook is, however, threatened by the persistent uncertainties in key advanced economies, especially the chaotic Brexit negotiations and somewhat unpredictable policies by the US government. For many emerging countries, this is compounded by the programmed interest rate hike in the US and ensuing capital flow reversals.

For Nigeria, general sentiments on the economy and the financial markets have improved somewhat vis-à-vis the mood 12 months ago. This largely reflected the relative stability in the FX market, continued disinflation, waning recession, recovering capital markets, and improving prospects. From a contraction of 0.5 percent in 2017q1, the economy is envisaged to record a slight positive growth in 2017q2 driven fundamentally by the continued recovery in the non-oil sector. Though household demand may remain weak throughout the year, the rising government investments in capital projects are expected to propel the rebound in domestic aggregate demand. It is important that the pace of capital projects is sustained in the medium-term so as to reduce infrastructural deficits, with potential favourable effects on output and prices.

The continued decline in headline inflation rate for a fifth successive month, from 18.7 in January 2017 to 16.1 percent in June 2017, is a welcome development. Over the same period, core inflation fell from

17.9 percent to 12.5 percent, while food prices accelerated from 17.8 percent to 19.9 percent. Though the benign base-effect is dissipating asymptotically, the continued stability of the exchange rate in the various windows is expected to sustain the pace of disinflation in the near-term. However, the unrelenting ascent of food inflation traceable to widespread flood, herdsmen attack and other factors on farming activities threatens the prospects of price stability in the near-term. Nonetheless, barring any unforeseen shock, the pace of headline disinflation may prevail beyond the year-end. It is, therefore, important that policy shocks are rightly delayed in order not to upset the current trend of disinflation and overturn the imminent recovery of the economy.

Liquidity conditions in the money and credit markets remained tight during the review period. Broad money supply M2 contracted by 14.6 percent annualised as against a target expansion of 10.3 percent. While this parallels the 0.04 percent annualised contraction in private sector credits it contrasts the 11.8 percent annualised expansion of net claims on government. The growth in government credits due to expanded fiscal operations evokes the crowding-out of productive private sector in the short-run. If the government succeeds in reducing the infrastructure deficit through it fiscal operation, I expect a favourable crowding-in of the private sector in the medium- to long-term.

In my consideration, I note that while the fragile prospect of economy recovery is encouraging the need to ensure that it coalesces into a stable equilibrium is non-negotiable. Amidst continued efforts to diversify the Nigerian economy, structural imbalances subsist as supply

constraints persist. As I had noted earlier, the underlying deterrents include: foreign exchange scarcity (due to low crude oil receipts and inadequately diversified economy); constrained fiscal space; infrastructural bottlenecks; high energy prices; and depressed domestic demand (partly attributable to sizeable salary arrears owed to some civil servants). The economy remains delicately balanced on the vagaries of the oil sector. And that is why I would like to reiterate the call to speedily and completely diversify the economy away from oil as this is a critical step in ensuring sustainable economic growth in the future.

Given that the impulses from previous policy adjustments are still permeating the system, it is imperative to be cautious with our decisions. In my opinion, adjustments to key monetary policy instruments may at this time be rather hasty. To safeguard the relative stability in the FX market, we must ensure that the interest rate parity is optimal to attract sufficient inflows to the economy. I emphasise that my personal predisposition is to achieve a regimented fall in interest rate to a low single-digit level; as contained in my inaugural speech of June 2014. However, the current realities do not support that sentiment. Inflation remains at intolerable double-digit level, a level which in-house threshold analyses indicate is inimical to economic growth. Accordingly, the real monetary policy rate is negative and as such obviates real investment analyses.

In my view, the current tight stance of monetary policy should be maintained to ensure that the expected recovery is achieved and sustained in the short- to medium-term. Given that real policy rate is still negative due to high inflation, and interest rate parity is indispensable

for stability in the FX market, easing monetary policy would at this time be sub-optimal. Such decision would re-introduce undue pressure to the FX market, instigate inflation which is already at inimical double-digit levels, undermine the expected rise in domestic investment as the real exchange rate would remain perversely negative, and upend the expected rebound of the economy. To ensure that the corrective effects of previous policies filter-through and also ensure that distortive policy shocks are not introduced into the system, I prefer to maintain the current monetary stance and all its underlying indicators. Therefore, I vote to:

1. Retain the MPR at 14.0 percent;
2. Retain the CRR at 22.5 percent;
3. Retain the asymmetric corridor at +200/–500 basis points; and
4. Retain liquidity ratio at 30.0 percent

GODWIN I. EMEFIELE, CON

Governor

July 2017