



Central Bank of Nigeria Communique No. 98 of the Monetary Policy Committee Meeting of Monday 24th and Tuesday 25th November, 2014

The Monetary Policy Committee (MPC) met on November 24th and 25th 2014 against the backdrop of moderate but uneven growth in the global economy and build up of vulnerabilities in the domestic economy. In attendance were all 11 members, following the expiration of the tenure of Dr. Kingsley C. Moghalu as a Deputy Governor of the Bank on 5th November 2014. The Committee reviewed key developments in the global and domestic economies during the first ten months of 2014 and assessed the short-to-medium term risks to price and financial stability as well as the outlook for the rest of the year up to the first half of 2015.

International Economic Developments

The global economic space continued to be dominated by strong downside risks to growth, including the softening commodity prices, rising geo-political tensions, and heightening threats to financial markets in the emerging and frontier economies in the aftermath of

the termination of Quantitative Easing by the US Federal Reserve at the end of October 2014. Developments in the international oil market have intensified the risks and vulnerabilities faced by oil exporting countries in the wake of a new episode of falling oil prices. The uncertainty is complicated by the absence of clear signals on how far and how long this episode would last. While the revenue impact of falling oil prices was severest on the oil exporting countries, it was largely positive on the oil importing countries led by the United States, which has also emerged as a major oil exporter.

With considerable divergence across regions, global growth picked up in the second half of 2014 at a lower than predicted pace. In view of the perceived vulnerabilities and associated risks, the International Monetary Fund (IMF) has recently downgraded its global growth forecast for 2015 to 3.3 per cent from an earlier projection of 3.7 per cent. The expected tepid performance in 2015 reflects the impact of the strong headwinds arising from the negative spillover effects of the unwinding of the US monetary stimulus, deteriorating geo-political tensions in many regions, uncertainty about the direction of the US-led economic sanctions on Russia; a development which in combination with the shale oil revolution has created a glut in the oil market at below long run price trends, unsustainable fiscal stance and absence of fiscal buffers in a number of countries and declining aggregate demand in others. These risks were, however, moderated by the expansionary monetary stimulus of the European Central Bank and the Bank of Japan which has led to increased consumption, particularly in the wake of falling oil prices.

Growth in the advanced economies is projected at 1.8 per cent in 2014 compared with 1.2 and 1.4 per cent in 2012 and 2013, respectively. The US is estimated to grow at 2.2 per cent in 2014, driven by strong private consumption, export growth, and contraction in imports. A stronger dollar, softening global growth, and sharp financial market correction could, however, undermine confidence and favorable terms of trade. In addition, the growth could be met by rising wage demands, obviating the Federal Reserve's early normalization of monetary policy with negative impact on global interest rates.

In the United Kingdom, at 3.2 per cent in 2014, output has remained above its long run average compared with 0.3 and 1.7 per cent in 2012 and 2013, respectively. The Euro area performance, however, seem to be at variance with the trend in other key advanced economies. Fundamental fiscal headwinds, high unemployment, and weak bank lending extended into Q3 of 2014, reflecting largely the failure of its comprehensive assessment program designed to reduce financial fragmentation. The Committee observed that the monetary stimulus of the ECB has neither stimulated aggregate demand nor restored growth to a sustainable long run path as the prospects of a deepening recession looms large. A key for the ECB is that decoupling the euro zone from the US monetary conditions would create its own shocks but the impact would be even more severe when the Federal Reserve commences monetary policy normalization. An uptick in global demand, a weakening euro and the ECB's monetary stimulus could create a benign environment for

growth. The depth of the slowdown, however, suggests that the ECB may need to implement full quantitative easing to return the Euro area to its long run growth path.

The emerging markets and frontier economies remain constrained by limited macroeconomic space to implement demand-enhancing monetary stimuli. A retrenchment of portfolio flows has already begun following the end of Quantitative Easing by the Federal Reserve, thus scaling up exchange rate pressures. Thus, growth has been revised downwards to 4.4 per cent in 2014 with China facing its lowest growth of 7.4 per cent since 1990 due to the cooling of its property market. The divergence in the monetary policy stance of the US, China, and Japan has further heightened risk in most emerging economies, elevating financial market fragility and currency risk in the balance sheet of banks and corporate bodies.

In Sub-Saharan Africa, growth was revised downwards to 5.1 per cent in 2014 from the earlier projection of 5.4 per cent to reflect the ongoing sluggish global growth and declining commodity prices. In addition, political crisis, infrastructural challenges, and of late the Ebola outbreak in Guinea, Liberia and Sierra Leone have moderated earlier robust growth outlook. The key risks remain declining aggregate demand, falling commodity prices, delayed recovery and potential intensification of the euro zone financial stress, sharp adjustment in the bonds and equities markets in the US, and muted growth in China.

Domestic Economic and Financial Developments

Output

Available data from the National Bureau of Statistics (NBS) has indicated that the domestic economy remains strong and resilient in the face of strong global headwinds. Nevertheless, key vulnerabilities are emerging. Real Gross Domestic Product (GDP) was estimated at 6.23 per cent for the third quarter of 2014. Although lower than the 6.54 per cent in the preceding quarter, it was higher than the 5.2 per cent achieved in the corresponding period of 2013. The non-oil sector remained the major driver of growth recording 7.5 per cent in contrast to the oil sector, which contracted by 3.6 per cent. Overall, output is projected to grow at about 7.0 per cent in 2014, compared with the 4.2 and 5.5 per cent, recorded in 2012 and 2013, respectively. The Committee noted that the robust expansion in domestic output in the third quarter of 2014 against the tepid growth in the global economy was anchored by the improved performance in services, agriculture, trade, and industry.

The Committee welcomed the impressive output growth performance but cautioned that the continuing insurgency in the North East of Nigeria in combination with other risks could adversely affect the growth outlook. The Committee noted with concern the continued decline in the contribution of the oil sector to growth and urged the political authorities for the speedy passage of the Petroleum Industry Bill to halt the trend. The Committee commended government's efforts to sustain the tempo of the power sector reforms, especially the amortization of the legacy debt owed

to major stakeholders in the power value chain and enjoined the political authorities to fast track the implementation of other complementary measures that would improve power generation and distribution.

Employment

The November 2014 national unemployment survey by the National Bureau of Statistics (NBS) revealed that a total of 349,343 new jobs were created in Q3 of 2014 compared with 259,353 jobs in the preceding quarter. The Central Bank of Nigeria's development initiative under the N200 billion Commercial Agriculture Credit Scheme (CACCS) has created 166,790 jobs since inception in September 2009. The Committee noted with satisfaction that the reforms in the power sector and other complementary policies if followed through; would promote investment and create the needed jobs for inclusive growth and development.

Prices

Inflationary pressure moderated across the three measures of inflation during the review period. Consequently, headline inflation (year-on-year) declined further to 8.5, 8.3 and 8.1 per cent in August, September and October, respectively. Core and food inflation decelerated from 6.28 and 9.68 to 6.25 and 9.34 per cent in September and October, respectively.

The deceleration in food inflation was traced to the decrease in the prices of both processed foods (from 4.4 to 4.3 per cent) and farm produce (from 5.3 to 5.0 per cent). The Committee noted with satisfaction that all the measures of inflation were within single digit. The Committee, however, recognized the upside risks to inflation in the near-term to include increased spending in the build up to the 2015 general elections, depreciated exchange rate arising from the falling oil prices accompanied by external reserves depletion, and food supply shocks arising from the increased insurgency activities in the major agricultural belts of the country. The Committee was satisfied, as indicated by Staff forecasts that headline inflation would remain well anchored at single digit within the band at year-end if the necessary macroeconomic policy actions were taken.

Monetary, Credit and Financial Markets' Developments

Broad money supply (M2) grew by 4.17 per cent in October 2014 over the level at end-December, 2013, which annualized to 5.01 per cent. The annualized growth rate reflects an improvement over the decline of 6.16 per cent achieved in the corresponding period of 2013 but lower than the growth benchmark of 15.02 per cent for 2014. Net domestic credit grew by 9.09 per cent in October relative to the end-December 2013 level. On annualized basis, net domestic credit rose by 10.91 per cent compared with the benchmark level of 28.5 per cent for 2014. The sluggish growth in broad money was largely due to Net Foreign Assets, which contracted by 18.74 per cent in October 2014. The tapered growth in money supply also helped in moderating inflationary pressures.

Interest rates in all segments of the money market showed further moderation between September and October 2014, reflecting persisting liquidity surfeit in the banking system. Average interbank call rate moderated from 10.96 to 10.81 per cent while the collateralised Open Buy Back (OBB) rate moderated from 10.76 to 10.48 per cent during the period. Both rates hovered around the lower band of the MPR during the period. The Committee, however, noted that the structure of rates at the retail end of the credit market did not significantly reflect banking system liquidity conditions as both the prime and maximum lending rates remained largely elevated. The maximum lending rate declined marginally from 25.77 to 25.75 per cent between September and October while the prime lending rate on the other hand increased from 16.44 to 16.48 per cent. The high interest rates notwithstanding, credit to private sector rose by 7.75 per cent during the period. To improve the efficiency of monetary policy, the Committee, urged the Bank to ensure that credit levels reflected liquidity conditions in the banking system.

The bearish conditions in the capital market continued as the equities market indicators trended downwards in the review period. The All-Share Index (ASI) declined by 17.9 per cent from 41,329.19 to 33,962.18 between December 31, 2013 and November 21, 2014. Also, Market Capitalization (MC) decreased by 20.1 per cent from N13.23 trillion to N11.24 trillion during the same period. The decline in equities market performance was largely due to increased capital outflows, as some foreign investors sold off, amidst concerns over

currency depreciation in the face of the steady declines in external reserves and international crude oil prices.

External Sector Developments

Developments in the external sector since September 2014, manifested in a buildup of pressures in the foreign exchange market. While the Bank sustained its efforts to maintain the stability of the naira exchange rate at the rDAS window, a considerable degree of weakening was recorded at both the interbank and Bureau de Change (BDCs) segments.

The exchange rate at the rDAS window during the review period opened at N157.31/US\$ and closed at N157.32/US\$, reflecting a marginal depreciation of N0.01k. To maintain and stabilize the exchange rate at that level, gross official reserves declined from US\$40.7 billion on 17th September, 2014 to \$36.75 billion at end-October 2014. From year to date, substantial currency depreciation has occurred in comparator oil exporting countries but the naira has depreciated by only 1.74 per cent.

At the interbank segment, the naira depreciated by N1.75 or 1.06 per cent to \$/N165.55 from \$/N163.80. In the same vein, the exchange rate depreciated by N1.00 or 1.19 per cent from US\$/N169.00 to \$/N170.00 at the BDC segment. The depreciation at both the interbank and the BDC segments largely reflected recent demand pressures arising from the falling oil prices and dwindling external reserves. As part of the demand management measures,

the Bank in two recent circulars excluded certain import items from the rDAS window. Despite the tight measures, the high demand for foreign exchange has continued unabated. This demand does not seem to have any bearing on the genuine foreign exchange needs of the country, which the Bank stands ready and has the capacity to meet. The current level of external reserves provides approximately 7 months of imports cover.

Committee's Consideration

The Committee noted with satisfaction the deceleration in all the three measures of inflation since September 2014; a development which has provided headroom for policy flexibility and maneuver. The robust output expansion amidst strong headwinds arising from a weakening of the international oil market gives credence to the efficacy of our macroeconomic policy. The Committee also noted that unlike in previous episodes, the current downturn in oil prices is not transitory but appears to be permanent; being a product of technological advancement. Currently, the US which use to be Nigeria's former major oil export destination now meets on average 80 per cent of its domestic oil demand from local shale oil retorting technology production and exports over 8 million barrels of crude oil daily.

The Committee found credence in the permanency theory of current oil price dynamics in the fact that the political restiveness in the Middle East and North Africa (MENA) region has not created uncertainty in oil supplies as both Libya and Iraq (Southern) have

open and strong supply lines in the market. A nuclear deal with Iran could further complicate the situation, opening up the supply space for new oil supplies from Iran.

Available data shows that a number of 6-month oil futures are currently signed at below US\$70/barrel while improvements in technology have driven down the break-even cost of shale oil production to an average range of US\$52-US\$70 per barrel. In the light of this development, the Committee is of the view that the oil price benchmark of US\$73/barrel proposed in the 2015 Federal Government budget may be overly optimistic, requiring considerable caution on the budget's revenue projections. A weak public finance may impinge adversely on growth prospects as it shows up in reduction in critical public and private consumption and investment spending.

Without prejudice to this position, the Committee is of the view that the softening crude oil prices could provide necessary leverage for the fiscal authority to reduce budgetary outlays on fuel subsidy and channel such savings to growth enhancing sectors of the economy. The Committee took note of the supportive fiscal stance in this regard and public commitment to take advantage of the low oil price to reduce fuel subsidy spending and liberalize prices as in many emerging economies. Furthermore, the Committee expressed satisfaction with the recent demand management measures announced by the fiscal authorities to contain pressure in both the goods and money markets and provide some respite in the near term.

Notwithstanding, efforts should be geared towards addressing the binding supply side constraints such as the insecurity, infrastructural, and institutional challenges. The Committee also noted the gradual improvement in labor market conditions which resulted in the additional employment of 349,343 in the third quarter of 2014. The dominance of the informal sector in the new jobs profile, suggests the preponderance of underemployment over the unemployment phenomenon, requiring intensification of reforms to unlock the growth potential of the formal sector.

Given the not too impressive fiscal revenue outlook, the Committee challenged the sub-national governments to seize this unique opportunity to reduce reliance on allocations from the Federation Account in funding their operations. To this end, the Committee commended the efforts of some states which recorded unprecedented growth in Internally Generated Revenues (IGRs) in 2013. Consequently, the Committee enjoined other states of the Federation to emulate these states by strengthening their IGR mechanisms with a view to minimizing reliance on FAAC allocations with attendant disruptions to their budget implementation arising from dwindling oil revenues.

A major issue considered by the Committee, however, was the declining level of external reserves, which arose from demand and supply constraints. On the supply side, the falling oil price has considerably reduced the accretion to external reserves thus

constraining the ability of the Bank to continually defend the naira and sustain the stability of the naira exchange rate. The supply side is further weakened by the commencement of normalization of monetary policy by the US Federal Reserve following the termination of the third quantitative easing on 29th October, 2014; a development which has accentuated capital outflows. These developments are against the backdrop of considerable loss of fiscal space following from our inability to build sufficient reserves during the boom days.

On the demand side, the pressures in the foreign exchange market were aided mostly by the excess liquidity conditions in the banking system and speculative activities. It has become increasingly worrisome that improvement in liquidity conditions in the banking system, designed to enhance the resilience and stability of the banking system, has not translated to increased credit expansion to the real sector to engender inclusive growth and boost employment. Rather, it has led to an upward pressure in the foreign exchange market and Standing Deposit Facility window of the Bank while banks continually exercise a cautious approach to lending.

Against this background, the Committee is of the view that the current challenge requires bold policy moves on both the demand and supply sides of the foreign exchange market. Consequently, bold policy and administrative measures in the management of the nation's stock of foreign exchange reserves have become inevitable in order to align the market towards its long-run equilibrium path.

On this note, the Committee wishes to reiterate that the Bank remains committed to a stable exchange rate within the limits of available resources and would continue to maintain sufficiently strong level of external reserves to meet its short term obligations and other regular balance of payments commitments. Without prejudice to this commitment, our foreign exchange management framework would have zero tolerance for infractions and would penalize economic agents whose primary objective is to speculate in the Nigerian market.

The Committee is fully aware of the short run implications of a tight monetary policy stance on lending and growth. However, available data indicates that banking system liquidity has been lavishly deployed in pursuit of speculative foreign exchange trading at the short-end of the market. While the Committee remains fully committed to the goal of promoting inclusive growth through lower interest rates in the medium- to long-term, banks as agents of financial intermediation have a critical role to play in the nation's development process. A banking system with an overly high profit motive negates the core tenets of banking and purpose of a banking license. Under the circumstance, monetary policy must be bold and emphatic on the goals macroeconomic management seeks to achieve and encourage the flow of credit along those lines.

The current situation demands that the Bank confronts the issue of declining external reserves head-on in order to strengthen the value

of the domestic currency. Consequently, stabilizing prices and maintaining exchange rate stability and charting a sustainable path for medium to long-term growth are the immediate top priorities. The Committee remains committed to these in order to sustain the credibility of our policies and anchor the expectations of our core stakeholders.

In the Committee's opinion, a more flexible naira in the face of non-existent fiscal buffers was the most viable policy option at a time of heightened demand pressure for foreign exchange and falling oil prices. The Committee was, therefore, of the view that if it failed in taking the right policy actions now, the market would force the Bank to take more drastic actions in the future with far less foreign exchange reserves. Also, given the level of excess liquidity in the banking system, it becomes imperative for the Bank to address the sources of the foreign exchange demand pressure.

In the light of the above considerations, the Committee was of the opinion that the economy stood to gain by:

- a) Further tightening of monetary policy stance to anchor inflation expectations; and
- b) Allowing some flexibility in the exchange rate to stem speculative activities and depletion of reserves.

Consequently, the Committee decided as follows:

Decision

Having considered all the issues above the Committee decided as follows:

- a) Nine members voted to increase the MPR to 13 per cent while two members voted to retain the MPR at 12 per cent
- b) Ten members voted for a symmetric corridor of +/- 200 basis points around the MPR, while one member voted for an asymmetric corridor of +200 and -500 basis points around the MPR
- c) All the 11 members voted to increase CRR on Private Sector deposits from 15 to 20 per cent with immediate effect
- d) All the 11 members voted to retain CRR on Public Sector deposits at 75 per cent
- e) All the 11 members voted to move the midpoint of the official window of the foreign exchange market from N155/US\$ to N168/US\$
- f) All the 11 members voted to widen the band around the midpoint of the exchange rate from +/-3 per cent to +/-5 per cent.
- g) All the 11 members voted to retain the net open foreign exchange trading position at 1 per cent.

Consequently, the MPC decided as follows:

1. Increase the MPR by 100 basis points from 12.00 to 13.00 per cent
2. Increase the CRR on private sector deposits by 500 basis points from 15.00 to 20.00 per cent with immediate effect
3. Move the midpoint of the official window of the foreign exchange market from N155/US\$ to N168/US\$
4. Widen the band around the midpoint by 200 basis points from +/-3 per cent to +/-5 per cent.
5. Retain public sector CRR at its current level of 75.00 per cent
6. Maintain a symmetric corridor of +/- 200 basis points around the MPR
7. Retain the net open foreign exchange trading position at 1.00 per cent.

I thank you all for Listening

Godwin I. Emefiele, CON

Governor

Central Bank of Nigeria

25th November, 2014