



Central Bank of Nigeria Communiqué 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 15.0 per cent from ₦13.23 trillion to ₦11.24 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 ₦157.31/US\$ and closed at ₦157.32/US\$, reflecting a marginal depreciation of ₦0.01. 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 ₦1.75 or 1.06 per cent to \$/₦165.55 from \$/₦163.80. In the same vein, the exchange rate depreciated by ₦1.00 or 1.19 per cent from US\$/₦169.00 to \$/₦170.00 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 ₦155/US\$ to ₦168/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:

- i. Increase the MPR by 100 basis points from 12.00 to 13.00 per cent;
- ii. Increase the CRR on private sector deposits by 500 basis points from 15.00 to 20.00 per cent with immediate effect;
- iii. Move the midpoint of the official window of the foreign exchange market from ₦155/US\$ to ₦168/US\$;
- iv. Widen the band around the midpoint by 200 basis points from +/-3 per cent to +/-5 per cent;
- v. Retain public sector CRR at its current level of 75.00 per cent;
- vi. Maintain a symmetric corridor of +/- 200 basis points around the MPR; and
- vii. 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

PERSONAL STATEMENTS BY MEMBERS OF THE MONETARY POLICY COMMITTEE

1.0 ADELABU, ADEBAYO

Current macroeconomic conditions revealed a relative fair performance albeit build-up of vulnerabilities to shocks in the global environment. It is remarkable that the uptick in inflation, particularly headline inflation which peaked at 8.5 per cent in August 2014, has subsided with deceleration observed in September and October. Output expansion is equally on solid footing with the estimated GDP growth of 6.23 per cent for the third quarter of 2014 comparing favorably with the long term trend. It is equally remarkable to observe that the robust output growth is beginning to translate to improvement in the labour market condition with the latest data from the National Bureau of Statistics (NBS) indicating the creation of about 350, 000 new jobs in the third quarter of 2014.

These developments ought to provide space for considerable degree of flexibility in the stance of monetary policy in order to support the existing reform measures that would unlock the potentials of the formal sector particularly when cognizance is taken

that almost 50 per cent of the newly created jobs were in the informal sector. The major challenge to monetary policy however is the financial market condition, emanating from rising vulnerability to adverse conditions in the global environment. Significant depreciation was not only recorded in all the three segments of the foreign exchange market but wide divergence in rates was equally prevalent among these markets, heightening the risk of arbitrage, among others. In addition, the equities market continued to show depreciation with All Share index shedding about 15 per cent between end-December 2013 and end-October 2014. The most worrisome aspect of this development, however, is that the country appears to be the only one among emerging and frontier economies that recorded loss in the capital market as other countries such as South Africa, Egypt, Ghana, and Kenya recorded modest gains in their stock exchange markets during the period. This is indicative of heightened risk profile of the domestic economy.

Against this background, the challenges in the macroeconomy must be confronted frontally with appropriate policy tools in order to avoid risking credibility of monetary policy. The overarching issue now is the need to contain the pressure in the foreign exchange

market with a view to bolstering the naira, which has been plummeting in the recent times. The threats are coming from both the supply and demand ends of the market. From the supply side, weakening oil price has shrunk the current account surplus thereby reducing accretion to reserves and by extension the Bank's ability to sustain the exchange rate. It is pertinent to bring to bear that development in the crude oil market does not suggest that the present softening in price is a transitory ones like the one experienced in 2008 given that the underlying currents are different in a significant way. The major underlying factor for price softening is improvement in shale oil technology which is being subject to further refinement by the day. In addition, the supply side is weakened by the termination of quantitative easing and commencement of monetary policy normalization in a number of developed economies which have led to retrenchment of portfolio flows in a number of emerging economies.

The issues however appear stronger on the demand side. Demand pressure has scaled up to unrivalled magnitude in the last couple of months. Available data indicated that less than 20 per cent of the demands in the foreign exchange market were due to divestment

by foreign investors thereby suggesting speculative demand. This could have only been aided by liquidity condition in the banking sector. This issue raises the question of the relative tightness of the markets. The current monetary policy measures have been in place for a while as the last increase in the CRR was done in March 2014. The implication is that the dynamic of adjustment by economic agents would have neutralized the effect of these measures. For example, data on money market rates revealed that both the interbank and Overnight Buy Back (OBB) rates have been at the lower end of the Monetary Policy Rates in the last couple of months. Again, the Broad Monetary Conditions Index (MCI) revealed monetary easing for most parts of 2014. At the last meeting, the challenge was quite anticipated but consideration was given to the need to give some breathing space to the DMBs in view of their rising cost profile upon the understanding that such excess liquidity would be channeled to growth enhancing sectors. Available data in the recent times, however, have shown otherwise.

Besides, the rising demand pressure is also an indication of price misalignment that characterizes a dysfunctional market. Effective market correction therefore, should involve proper alignment of

price; otherwise the burden of administrative measures may be too heavy in as much as arbitrage opportunity exists. Thus, I am of the view that the subsisting mid-point exchange of ₦155/US\$ should be allowed to adjust towards the market equilibrium while the band should equally be widened to improve space for monetary policy operations.

As I have always advocated, broad based economic reform measures are required to open up macroeconomic space to investment particularly foreign direct investment. The major source of pressure in the foreign exchange market is the continuously elongating list of imported items particularly refined petroleum products. In addition to the ongoing power sector reform therefore, a robust import substitution strategy is critical with particular reference to fixing the moribund domestic refineries. Until this is achieved, the domestic monetary policy would continue to be vulnerable to the vagary of the global environment.

Against the background that the present challenge requires policy response from both the supply and demand sides of the foreign exchange market, I will like to vote for further tightening using the instruments of both the MPR and CRR. In addition, I recommend a

shift in the rDAS exchange rate mid-point to a more competitive level with a view to correcting market malfunctioning and closing opportunity for arbitrage, among others.

Consequently, I vote for an increase in the private sector CRR by 500 basis points to 20 per cent and MPR by 100 basis points to 13 per cent with symmetric corridor of 200 basis points. I would like the public sector CRR retained at 75 per cent while the midpoint exchange rate be moved to ₦168/US\$ with a symmetric band of 5.0 per cent.

2.0 ALADE, SARAH O.

This MPC meeting is coming at a period of great uncertainty in the Nigerian economy. Although GDP remains robust and inflation is trending downwards, low international oil prices and dwindling foreign reserves is a cause for concern in the midst of intense pressure on the foreign exchange rate. The Naira has weakened 8 percent at the interbank segment since the last MPC despite interventions and regulations to prevent speculative attack on the currency. On the fiscal side, government budget has been constrained by revenue shortfall following the continuing decline of oil prices. The global economic outlook is clouded by risks from weak activity in the Eurozone, ongoing geopolitical risks, and the timing of the anticipated Federal Reserve monetary tightening. All these developments suggest that monetary policy at this time must be responsive and clear in communicating its stance to restore stability and confidence.

Global economic environment is showing strong growth clouded with uncertainties. The IMF in its last World Economic Outlook (WEO) downgraded global growth to 3.3 percent from 3.7 percent in the previous projections. There are marked divergences among countries both in terms of growth and monetary policy, leading to volatility in debt and foreign exchange markets. The United States and Britain are expected to stay on stronger growth trajectory, while the euro zone, Japan, Russia and China are showing some signs of slow down. In the emerging market countries, India, Indonesia and South Africa are set to recover steadily. In the United States, the economy is growing at an above trend with strong job growth. In October 2014, the unemployment rate fell to 5.8 percent suggesting a stronger job market growth. Third quarter GDP growth was at 3.9 percent, against the estimate of 3.3 percent, pointing to strengthening fundamentals that should support the economy for the rest of the year.

In emerging market and developing countries growth projection is slightly lowered to 4.6 percent from 4.8 percent previously projected on the back of tight financial conditions from the US, and possible

capital reversal in most emerging markets including Nigeria. Under these uncertain conditions, monetary policy at this time should be focused at minimizing the downside risks and restoring confidence in the economy.

Gross Domestic Product (GDP) is showing strong momentum, although risks remain. The 2014 third quarter GDP grew by 6.23 percent, a decrease from the 6.54 percent recorded in the second quarter, but higher than the 5.17 percent recorded in the corresponding period in 2013. The decline was driven mainly by the oil sector which declined by 3.6 percent in the Third Quarter of 2014, although lower than the 5.47 percent decline in the Second Quarter of 2014. The Oil sector contributed approximately 10.45 percent to real GDP in the third quarter of 2014, lower from the 10.76 percent contribution in the Second Quarter of 2014, and the 11.51 percent contribution recorded during the Third Quarter of 2013. The decrease was driven by decreased oil production as third quarter production stood at 2.15 mbpd compared to 2.26 mbpd in the same period in 2013. The non-oil sector grew by 7.51 percent in the third quarter, although lower than 8.46 percent recorded in the corresponding

period in 2013, it is higher than the 6.71 percent recorded in the second quarter of 2014. However, the security situation in the Northeast, the food producing belt of the nation may affect non-oil sector growth and food inflation in the medium to long-term.

Headline inflation is trending downwards, but some risks remain.

Headline inflation decreased to 8.1 percent in October from 8.3 recorded in September. The decrease is as a result of muted increase in core index and a decrease in food inflation. The food inflation decreased to 9.3 percent in October, down by 0.4 percentage points from 9.7 percent recorded in September. This is the second consecutive month that food prices have been relatively muted. The ease in the increase in food prices was as a result of slower increases in imported and local food production. Staff projection suggests a benign outlook in inflation with headline inflation expected to end the year in single digit. Despite this, the risk to inflation in the short-term is on the upside due to election-related spending in the build-up to 2015 general elections and food supply shocks arising from insurgency activities in the North-Eastern region, the food basket of the nation.

The banking system liquidity continues to be high, suggesting that some measure is needed to reign in the excess liquidity. Banking system deposits at the CBN deposit lending facility has consistently been high reaching N800 billion on some days during the review period. Even with open market operations, Interbank-call and OBB rates during the review period traded below the standing deposit facility rate reflecting the quantum of liquidity in the system. There is therefore, need to sterilize some of these liquidity through increase in cash reserve requirements to avoid distortion in the system and to minimize the feedback effect on inflation.

Naira has come under intense pressure in the last couple of weeks leading to depletion of the Reserve. The naira has come under intense pressure since the last MPC, depreciating by about 8 percent at the interbank market and about 1.7 percent in the official market. As at November, 2014, foreign exchange reserves stood at \$37billion, as foreign investors repatriate their investments in the face of improved investment climate in the US and greater uncertainty in the domestic market. The market reaction to end of tapering by the US Fed is already causing reversal of capital flows to emerging markets including Nigeria. This has resulted in the weakening of

currencies. Naira in addition, has come under pressure because of the country's dependence on oil which price has fallen by more than 30% in recent months with the attendant consequence on government revenue and external reserves. In order to allow monetary policy to sustain price stability and minimize the impact of the capital reversal on the nation's current account it is important to adjust the currency.

The flexibility will not only reduce the pressure on the exchange rate, it will help conserve external reserves. The adjustment in the exchange rate and falling oil prices will no doubt exert pressure on inflation, therefore, it is important for the Bank to increase efforts to maintain the rate within the band.

Against this background, I support an increase in Monetary Policy Rate, flexibility in exchange rate, an increase in Private Sector Cash Reserve Requirement (CRR) and retention of 75 percent of Public Sector Cash Reserve Requirement (CRR) to ensure macroeconomic stability.

3.0 BALAMI, DAHIRU HASSAN

GLOBAL ECONOMY

Growth- Global growth remains weak through the year 2014 and into the half of year 2015. The International Monetary Fund/World Bank marked down growth rate of 3.3 per cent in September as against 3.4 in August and 3.7 in April; and 3 per cent in 2014. This is due to weaker growth in US Projected at 1.7 per cent for 2014 and 3 per cent for 2015. The Euro zone recorded a 1.1 growth rate in 2014 and 1.5 for the 2015. Accumulated evidence of weakness in Euro zone in the month of September slowdown in the GDP growth. Growth is expected to remain uneven across emerging markets and developing countries. These markets were projected to grow at 4.6 in 2014 before strengthening to 5.2 per cent in 2015. In China the growth rate is projected to average out to 7.4 per cent which was consistent throughout. The slow growth is not unconnected to the geopolitical risk at the global level which include renewed tension between Russia and Ukraine, and the middle east (Libya, Iraq and Syria) in which further tension in the region will have the potential of causing disruption to energy markets and reduction in investor risk

appetite and business confidence. For example in UK, there is slowing down of manufacturing exports. It should be noted that in China one of Nigeria's biggest trading partner industrial production has slowed down to 6.9 per cent in August the lowest rate since December 2008 partly due to political unrest in Hong Kong. Tight monetary policy had also weighed on the growth outlook.

International Oil and Gas prices

The price of crude oil in the international market has remained fairly stable despite tension in the Middle East at above its \$103 per barrel. However, the OPEC reference basket of 12 crudes continued to trend downwards and stood at \$78.08/b on 14th November 2014. USA which was the greatest oil importer internally satisfies 89 per cent of its domestic demand with only 11 per cent to import. The US continues to take less and less from Nigeria's crude supply. The low level of growth in Europe, Japan, Germany and Brazil has implication on the demand for the crude supply from Nigeria.

Inflation

Inflation has been subdued in 2014 and 2013. In the Euro zone inflation has fallen to 0.3 per cent in September from 0.4 per cent revised in August due to lower commodity prices, weakening in

business confidence particularly in Germany, higher exchange rate, lower crude oil prices, some utility price effects following commodity price. Weaker domestic demand and negative output gaps in advance economies. In emerging countries inflation is projected to decline from 6 per cent to 5 per cent in 2015.

Interest rate

Interest rate in Euro zone and UK has remained low. It is also low in China one of the biggest trading partners to Nigeria. The ECB has also cut its policy rates and asset purchase.

Domestic Economy

Growth in the domestic economy is projected to firm up (6.54per cent) in 2014 despite the various challenges which include insecurity particularly Boko Haram in the northeast, decline in the exportation and demand of the Nigeria crude particularly by the US, falling price of its Nigerian crude oil from \$115.62 per barrel in June 2014 to \$78.08 per barrel in November 2014, rising level of domestic debt, pressure on the Naira, unemployment, inequality and poverty, reduced agricultural output, and inadequate infrastructure and rising import demand.

The sliding oil prices from \$115 per barrel in June 2014, \$81.97 at the end of October 2014, to about \$78.08 per barrel in November 14th 2014 was the lowest the price has fallen in years and its implication on government meeting its statutory obligation will affect the working of the economy negatively. There is also the problem of oil theft and vandalization of oil and gas infrastructure. There is growth in Nigeria but this does not reflect in the living standard index.

The implication of declining oil price often result in further tightening of monetary policy to pressure macroeconomic stability. It could lead to high interest rate and superior returns on investment. In money market which could have negative effects on the nations stock market. It may moderate the cost of fuel importation which is known to be a burden on the finances of the economy. It will lead to reduction in the level of foreign exchange reserve and exchange rate because 95 % of foreign exchange comes from oil exportation and the erosion of external reserve given the mounting and continuous pressure from beneficiaries.

Challenges of the Economy

- How to sustain the stability in Naira exchange rate?
- How to manage the vulnerability to capital flow record?
- How to build focal buffers to ensure against global shock?
- How to manage inflation and exchange rate expectation?
- How to safeguard the financial system?

Exchange Rate

In the month of October 2014, the Naira slipped 0.27 per cent. The currency fell 0.15% by Monday 27th 2014 against the dollar on its interbank market due to surge in dollar demand. This is despite about \$112 million in sales by an oil company (₦165 to dollar compared to ₦164.7 at the close of Friday the 24th). The Naira came under pressure in the last five weeks owing to concern over falling global oil prices which led to offshore investment cutting back their position in local debt market repatriating their fund(167 -169)and due to shortage of dollars on the interbank markets, higher demand coupled with declining global oil prices. It is doubted if the CBN can continue to support the Naira. The pressure is partly due to Dollar demands from politicians holding their asset in hard currency ahead of election next year. The naira is also expected to experience

further pressure as the liquidity position worsens with AMCON injection in October. Foreign exchange market will experience further volatility as well as additional idle funds to the coffers of the Banks (devaluation may be the ultimate goal). There is likelihood of increase in inflation thereby eroding the consumer purchasing power. The consumer inflation for September rose to 8.3% according to NBS.

Policy Options

- I vote that the MPR be raised to 13% with a corridor of +/-100 basis point.
- Retain the public sector Cash Reserve Requirement at 75%.
- Raise the private sector CRR at 20% from 15%.
- Retain the liquidity ratio at 30%.

Raising the MPR could improve the attraction of Nigeria's asset to foreign investors due to the consequent higher risk adjusted real returns on Nigeria's assets as well as attracting new investors (FDI) to our capital market.

Reason for raising CRR is that DMB are holding excess reserve averaging over 300 billion and injecting further addition of 866 billion Naira through the maturing AMCON in October, will also assist in reducing the level of banking sector liquidity in the economy. It should be noted that keeping banking rate at its current rate for too long is likely to offset these effects risked unbalancing recovery and growth in the economy.

4.0 BARAU, SULEIMAN

Background

The current MPC is taking place at a time of significant, almost unprecedented, series of developments from the external environment. Firstly, decline in oil price was noted during the last MPC but it was initially interpreted in the context of normal market volatility. The sustained decline in oil price actually started in June but it remained above the psychological floor of \$100/per barrel. As at November 20, 2014 Bonny Light was trading at \$78.91pb, compared to \$88.51pb as at end of October, 2014.

Secondly, the possible termination plan of the Assets Purchase Program (APP) of Fed by the Federal Open Market Committee

(FMOC) was expected to be announced in October, 2014. However, FOMC's statement at its September meeting was also not conclusive as to the actual date the asset purchase program will end. However, the favourable unemployment and inflation numbers met the conditions for the end of QE3 and the decision to terminate in October was made.

Within the domestic environment, Headline Inflation (HI) declined to 8.06% in October compared to 8.3% in September. Core Inflation (CI) also declined to 6.25% in October compared to 6.28% in September. Food Inflation (FI) also recorded a decline to 9.34% in October from 9.68% in September.

The level of foreign reserves witnessed a decline to \$36.25 billion in October from \$38.20 billion in September. The source of downward pressure continued to be, reduced inflow due to oil theft and the rapid decline in oil price. There was also reversal of foreign portfolio flows which reduced supply and increased demand. The pressure was compounded by increased demand at both rDAS and interbank segments as the sustained decline in oil price and end of QE3 by the Fed, made market operators and end users (including

foreign investors) to quickly bring forward their demand in order to hedge against foreign exchange rate risks.

The exchange rate continued to come under pressure at all segments of the market in view of the foregoing developments. The Naira depreciated to ₦159.99, ₦176.90 and ₦179.50 or by 1.71%, 8.63% and 6.21% at rDAS, Interbank and BDC markets respectively during review period. In addition, the premium between rDAS, Interbank and BDC segments widened by 10.57% and 12.19% respectively.

Nigerian banking remains strong, liquid and profitable. Total assets, credit and deposits grew by 1.7%, 4.25% and 0.52% between September and October respectively. Liquidity ratio at 44.65% in October, though below the 45.41% recorded in September, remains very strong. Industry liquidity in the context of declining reserves and exchange rate concern remains a pressure point for the MPC.

2.0 Issues and Pressure Points

The successes recorded by the MPC, over the last few years, in maintaining price stability and particularly in keeping inflation at single digit is being aggressively threatened by the following recent developments and outlook;

Liquidity – CBN's QE strategy following the global financial crises of 2008, the creation of AMCON and continued monetization of Excess Crude Account (ECA) has kept the banking system largely awash with liquidity. This has been exacerbated by CBN's balance sheet expansion (balance sheet almost doubled between 2007 and 2013) through various interventions and fiscal expansion through deficit financing. I have further concerns over the outlook for liquidity in 2015 given that it is an election year. Current liquidity and outlook is clearly a threat to price stability with particular emphasis on our single digit inflation credentials.

Price stability is further threatened by the likely removal of subsidy on petroleum products. The end of the Asset Purchase Programme (APP) under QE3 in the US by the Fed and the sustained decline in oil price has combined to put pressure on the exchange rate of the Naira and the level of foreign reserves. The end of the APP has impacted exchange rate and reserves in the context of some dramatic exit of portfolio investment and the reduction of portfolio inflows. The Nigerian Stock Market witnessed 9.78% month to date

(MTD) and 18.04% year to date (YTD) decline in All Share Index (ASI) and 10.08% MTD and 15.44% YTD decline in market capitalization by November 21.

The reduction in the international price of our crude which impacted exchange rate and reserves, caused a massive change in market perception of CBN's ability to hold exchange rate current levels, made market operators to subsequently bring forward their foreign exchange demand and enabled some to take long positions in exchange, all supported by current liquidity in the system.

The outlook for oil price is disturbing. Firstly, the Organization of Oil Exporting Countries (OPEC) does not have the consensus of its members on the control of production and exports, which has been a tool used to control the market and ultimately the price of oil. It would appear that OPEC's strategy is to favour market determined price system. Saudi Arabia, the largest exporter of oil among the OPEC countries is the champion of this strategy going forward. OPEC's meeting of 27/11/14 is therefore not likely to reverse the declining trend in oil price. Import from the US has reduced because

of the discovery of Shale Oil. The US is forecast to soon meet all its demand for oil in the medium term if oil price can continue to support the cost of Shale Oil production.

Secondly, global demand continues to be weak due to slow recovery particularly in the Euro area and slower growth rate from emerging markets such as China and India.

Thirdly, in the current war in Ukraine, oil price is clearly being used as a weapon against Russia. Given Russia's reliance on oil (50% of revenues), the lack of interest in stemming the declining tide in price by the advanced economies of the West can clearly be appreciated.

In the light of the foregoing, the reversal of flows and the declining oil price will combine to continue to put pressure on our foreign reserves and exchange rate. Inflation is forecast to accelerate gradually over the next six months into 2015 according to staff estimates.

3.0 Way Forward

In the light of the foregoing, I have come to the following conclusion:

- i. That it is sensible to continue with the current tightening stance in policy;
- ii. That though markets have already factored in the impact of the stoppage of the Assets Purchase Programme by the US and that we remain an attractive investment destination, the radical reduction of ASI and Market Capitalization on the NSE, does suggest significant exit of foreign investment and that would be the direction of things unless something is done;
- iii. That oil price decline may continue and that would put further pressure on government revenues, reserves and exchange rate;
- iv. That there is still evidence of huge liquidity in the banking system occasioned by fiscal operations and CBN's prior years balance sheet growth. This was aggravated by the recent repayment of private investors by AMCON. This should elicit further tightening and the removal of liquidity from the system; and

- v. That inflation outlook is negative. This calls for further tightening.
- vi. That the main focus of this MPC meeting should be to address exchange rate and declining foreign reserves challenges. MPC's position has been that the Naira exchange rate stability would continue to be guaranteed but not at all cost. Several measures have been put in place to contain demand pressures in the past with some limited success. However, the supply side of foreign exchange, which is outside the control of MPC has always been a source of concern for policy and has rendered demand management measures as very short term and ineffective. The current challenge to supply due to declining oil price, leaves MPC with no option than to allow the Naira exchange rate band to move, in order to secure a minimum level of foreign reserves that would guarantee overall macroeconomic stability.

4.0 Recommendations

It is in the light of the above that I voted as follows today;

- That we maintain the Tight Monetary Policy stance;
- That we increase the MPR to 13%;

- That we maintain the Symmetric Corridor of minus and plus 2% around the MPR for SDF and SLF respectively;
- That we maintain CRR on Public Sector deposits at 75%;
- That we increase the CRR on private sector deposits to 20%;
- That we move the mid-point of rDAS sales rate to N168/USD;
- That we widen the band around the mid-rate to (minus/plus 5%) from (minus/plus 3%);
- That we keep the Net Open Position (NOP) limit at 1% of Shareholders Funds.

5.0 DANIEL-NWAOBIA, ANASTASIA

Recovery in the global economy has continued at a gradual pace. Developed economies have recorded mixed performances but inflation is significantly lower than the target of most monetary authorities in those jurisdictions. This indicates that those economies are not functioning close to maximum capacity, with wide output gaps and weak labour markets. Lower growth in emerging market economies—notably China, which is a major buyer of Nigeria crude poses considerable risk for the economy which is heavily reliant on oil exports.

Outlook for domestic output in the coming months is largely positive due to the sustained implementation of the on-going economic reforms through the Federal Government transformation agenda. In particular, the continued implementation of the power sector reform, as well as all the accompanying investments in the sector is expected to improve power generation and supply.

However, developments in the external environment, particularly the decline in oil prices pose a threat to public sector revenue in the medium-term with negative consequences for achieving fiscal stability. Non-oil revenue is also not performing well implying that Federal Government Budget could be constrained if this trend continues.

Given perceived country risk due to the 2015 national elections and the winding down of quantitative easing in the US, foreign portfolio investors may cautiously participate in our capital market. Monetary policy should therefore continue to anticipate divestments from the capital market in the coming months.

The exchange rate was relatively stable at the RDAS segment while it depreciated at the BDC and Inter-bank segments of the market due largely to reduced sales of foreign exchange from oil companies. Falling oil prices have seen the naira trading around the ₦165 to the dollar which is above the reference trading band of US\$-₦155 (+/- 3%), while the external reserves stood at US\$37bn, covering about 6 - 7 months of imports. Also, the ongoing capital outflows and renewed foreign exchange intervention could potentially deplete the foreign exchange reserves at a fast pace. Consequently, efforts need to be made to stabilize the naira in the short run.

The year-on-year headline inflation which accelerated to 8.5 per cent in August, 2014 from 8.3 per cent in July 2014 fell to 8.3 and 8.06 per cent in September and October, 2014, respectively. Staff projections for the next six months indicate that the year-on-year headline inflation would increase from 8.4 per cent in November to 8.5, 9.1, 9.2, 9.6 and 10.0 per cent in December, January, February, March and April 2015, respectively. Thus, though inflationary pressure is expected to remain subdued in 2014, policy action would be

needed to ensure that the downside risk to inflation is minimized in the first quarter of 2015.

The main challenges to monetary policy currently are: excessive liquidity in the banking system, pressure on the exchange rate and decline in external reserves. Other policy challenges include: improving the performance of non-oil revenue and VAT to enhance fiscal sustainability; and reduction in the interest rate as well as ensuring the flow of credit to the real economy. Consequently, strategic efforts need be made towards addressing the issue of high interest rates as well as ensure the flow of credit to the real economy in order to engender growth and create employment.

Given the current challenges to monetary policy, particularly excessive liquidity in the banking system, pressure on the exchange rate and decline in external reserves, I will advise that the monetary policy stance be tightened further.

Consequently, I vote as follows:

- (i) The Monetary Policy Rate (MPR) to be increased by 100 basis point from 12% to 13 % while maintaining the existing corridor of +/- 2% for the inter-meeting period.
- (ii) The Private sector CRR should be increased by 500 basis points from 15 to 20 per cent, given the current banking system liquidity profile.
- (iii) The public sector CRR should however, be retained at its current level of 75 per cent.
- (iv) The current policy on foreign exchange (mid-point and exchange rate band of ₦155/US\$1 +/- 3%) needs to be adjusted. The mid-point could be adjusted to ₦168/US\$1 while the exchange rate band of +/- 3% could be widened to +/- 5% in order to minimize the pressure on the exchange rate. The Bank should, however continue to intervene in the market when necessary.
- (v) The current net open foreign exchange trading position should be retained at 1 per cent.

6.0 GARBA, ABDUL-GANIYU

Background

May 2013 offered emerging nations a foretaste of what they will face in a post-quantitative easing era. The “Bernanke effect” - the effects of Bernanke’s perceived miscommunication of his forward guidance about the timing of US tapering in May 2013 unsettled global financial markets. The miscommunication unsettled investor’s confidence who responded with a global selloff in most stock markets. In emerging markets, the problem was worse in intensity and scope: it affected yields on government securities, exchange rates and commodity prices in addition to stock prices and market capitalization. Most emerging markets opened themselves to strong contagion effects in the way they went about attracting portfolio flows to build reserves, stimulate asset price recovery in the stock markets and stabilize or engineer appreciation in their domestic currencies.

For emerging markets clearly, May 2013 was a game changer whether they realized it or not. It signaled the beginning of the end of the honeymoon with investors who responded to the high country risk premiums offered by emerging markets. The portfolio flows

funded public deficits and asset price bubbles hence, giving the illusions of recoveries in capital markets that had been decimated by the flight of 2008-2009.

The events of May 2013 signaled a coming turbulence. Therefore, while the turbulence appears more intense now hence, more obvious, the tide turned not in October-November 2014 but in May 2013. In the aftermath of May 2013, the long run trend of the Nigerian Stock Exchange (NSE) in terms of indexes and market capitalization has been downward. In addition, the exchange rate spread steadily widened. Between May 2013 and November 2014, the global political and economic environment became more risky and uncertain. In addition to the growing global security challenges and the strategic political-economic conflicts between Russia and the West, the growing disconnect between the United States and Europe in terms of paths of their economies and monetary policy stance has been systematically unsettling key financial and commodity markets to the dis-advantage of vulnerable emerging markets. It is important to understand the secular nature of the current problems to inform a correct analysis of strategic and policy options.

I had repeatedly expressed concern about the exposure to portfolio flows. In my personal statement at the end of May 2013 MPC, I argued after observing the pull back of portfolio flows in March and April 2013 that “there is need for further adjustments (of portfolio flows) to levels that would not threaten the financial and economic stability of Nigeria. Human history and Nigeria’s recent history provides strong foundation to expect that the flows are reversible while sound theoretical and empirical analysis provides sound foundations in support of a claim that the net flows are non-positive in the medium term.” I had no doubts that future stability of prices, of the exchange rate, of the financial system and of the economy was at risk if volatile financial flows are incentivized to grow beyond a destabilization threshold. Also, that the real choice was between inevitably short term stability and, medium to long term stability. MPC communiqués repeatedly urged fiscal authorities to build buffers to support a more effective monetary policy strategy. “Real fiscal savings” would have significantly limited public debt and the opportunities for hot money in Nigeria.

Lessons of history - Mexican currency crisis of 1993-94, the Asian crisis of 1997-98 and the Russian currency crisis of 1998 - offer clear lessons

about the likely path and consequences of unwise and untimely monetary response to speculative attack. In the case of Nigeria with multiple and segmented markets, a widening spread was inevitable given the events in the aftermath of May 2013. The spread between BDC and RDAS/WDAS rose from an average of ₦2.05 between January and April 2013 to ₦6.64 between May and December 2014 and November 24, the spread was ₦25 (about 16% of the RDAS exchange rate). It is obvious that the size of the spread was a strong incentive for arbitrage, rule-violations in forex use, currency substitution and for short positions against the Naira. The loss of about 40% in the price of crude oil simply made a problem that has been building since May 2013 more visible. In my view, the falling price of crude oil was simply a trigger. It is important to see beyond the trigger factors to the structural vulnerabilities, market functioning problems and failures to rein-in fiscal deficits, public debt and dis-savings that are the real problems.

We have emphasized repeatedly that it is important to see beyond the short term to develop a medium and long term forward looking perspective and to build long term resilience. The Gulf Cooperation countries are estimated to have saved about 2.5 trillion US\$ in foreign

reserves during the longest oil boom in human history. In addition, they seemed to have invested wisely through their Sovereign Wealth Funds to develop their economies and secure the medium to long term interests of their commonwealths. Their case seems to offer positive lessons.

Decision

My concern at this November 2014 MPC is short, medium and long termed. In the short term I am convinced that the MPC must direct the economy away from the paths of Mexico (1993-4), Asian Tigers (1997-8) and Russia (1998). We cannot afford a “confidence cycle” that destroys the capacity of the monetary authorities to influence the path of the economy. Medium to long term, we have to address the key vulnerabilities in economic policies (monetary and fiscal), market functioning and disconnect between financial and real sectors. If we think through carefully and analyze the path of the economy from 2004 (pre-banking consolidation) to date, it will become obvious that a short-sighted perspective is dangerous.

My vote at this last MPC meeting of 2014 addresses short term, medium and long term paths of the economy. It takes due account

of current realities and expectations that are influencing the pricing of Nigeria's country risks by speculators (revealed by the spread between Euro Bonds and FGN Bonds) and of the pricing of the Naira in the Inter-Bank market and other markets. It is clear that the market has increasingly moved well outside the band announced in 2011 after the events of May 2013.

I vote for moving the mid-point of the band and the width of the band. My vote is informed by a clear analysis of the paths of the economy in the short to medium terms and the urgency of eliminating an "arbitrage spread" that is fuelling the speculative attack on the Naira, currency substitution and sharp practices. I am convinced that moving the mid-point and the width of the band is just a first step towards correcting the weak mechanism design that inevitably segments the forex market creating an "arbitrage spread". Market segmentation and arbitrage spread make arbitrage, currency substitution, sharp practices and short positions rational. Auction theory is clear that in repeated auctions such as RDAS/WDAS, the likelihood of collusion is very strong. Indeed, at least three Nigerian studies have provided strong evidence of collusive behaviours in Nigerian foreign exchange auction markets.

A silver lining for policy implementation is that collusion in the Nigerian forex auction market is easy to detect. A closing of the spread between the highest and the lowest bids that opens an “arbitrage spread” is a strong signal of the high likelihood of collusive behavior. Rational bidders who are driven purely by profit are best served by widening spreads even when a widening spread could destroy the currency. It is important therefore, to ensure that the auction systems in the financial markets are no longer rigged against the goals of monetary policy or the commonwealth. The Monetary Policy Implementation process would support policy effectiveness if it gives priority to quick detection and punishment of collusive behaviours. This will help to sustain the closing of the “arbitrage spread”.

At the September meeting, I voted for tightening because I was convinced that it was necessary to sterilize the “inverted intermediation liquidity” that was sitting idle in the SDF window daily. I was also convinced that tightening was necessary to sterilize the expected “AMCON injection” of ₦876 billion into the banking system in October when it redeemed maturing Series V zero coupon AMCON Bond. I was convinced that such an injection will inevitably

add to the size of the *inverted intermediation liquidity* and provide more ammunition for currency substitution, short positions hence, pressure on the Naira. The data confirmed my expectations. It is therefore clear to me that sterilizing *inverted intermediation liquidity* must be a fundamental principle of monetary policy. This is because *inverted intermediation liquidity* is a “costly noise” in the monetary policy process. Minimizing inverted intermediation liquidity is therefore, necessary to minimize (1) its collateral damages on market functioning and macroeconomic stability and (2) to improve the effectiveness of monetary policy. I vote therefore, for increasing the private sector CRR from 15% to 20%. This significantly minimizes the collateral damages of inverted intermediation liquidity. Analysis of previous CRR increases has shown them to be very effective in stemming artificial pressures on the Naira but with a lag. The lag effect is actually the implementation lag. The old argument was that because of reserve averaging, it was necessary to effect the CRR deductions at the end of the cycle. Policy effectiveness demands a zero implementation lag this time. In addition, closer supervision is necessary to minimize the effectiveness of “policy neutralizing moves”.

I voted to maintain MPR at 12%. I understand the argument about compensating for country risks to attract portfolio flows. However, I am not convinced by the argument. I am more convinced by the medium to long term argument. In any case, the effects of MPR increases are asymmetrical because of the asymmetries in the money market: wholesale borrowers with high interest rate elasticities are unlikely to be affected while retail sector borrowers with low interest rate elasticities are most likely to be adversely affected. This would heighten the risk of NPLs.

I have consistently expressed my preference for asymmetric corridors around the MPR. My argument consistently has been that it is necessary to improve the functioning of the interbank market. I also believe that economic agents respond to incentives. Therefore, improving market functioning by a creative use of incentives is far more critical to the effectiveness of monetary policies. Given that it is well established that financial markets malfunction when incentives are distorted to favour the greedy and powerful whose allegiance is to a corrupted idea of self-worth, much efforts must be devoted to improving market functioning. At this last MPC of 2014, I maintain the vote for an asymmetric corridor of -5 and +2 around the MPR.

The real challenge for economic management (monetary, fiscal and political economy) in 2015 and the medium term remains that of steering the economy seamlessly through the coming turbulence when the US Fed begins to increase rates and Europe and Japan remain weak. I therefore, feel compelled again to draw attention to (1) the fact that monetary policy is not a panacea (a cure all); (2) the urgency of a rule-based and performance oriented forward looking fiscal strategy and budgeting system and (3) the urgency of eliminating all forms of distortions embedded the fiscal system and monetary policy that undermine market functioning. The economic circumstance of Nigeria today is best viewed as an opportunity for policy makers on the monetary and fiscal sides to work together to build medium to long term resilience of the economy through creative approaches to vulnerabilities, systemic coordination, commitment problems and market functioning problems.

7.0 LAWSON, I. STANLEY

The Global Economy

The Quantitative Easing program by the US Federal Reserve was terminated at the end of October 2014 and interest rates are

expected to rise thus ushering in a gradual transition to a regime of tightening in 2015. Plagued by strong vulnerabilities and associated downside risks to growth, which is fuelled by rising geo-political tensions and increasing threats to financial markets in the emerging and frontier economies, the global economy is presently witnessing moderate but uneven growth. Consequently, 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. Global growth may be further depressed by various existing and escalating regional conflicts.

Driven by strong private consumption, export growth, and contraction in imports, the US however continues to provide considerable tail wind as its economy expanded by 3.5% in Q3, 2014, compared with a growth of 2.6% in Q2, 2014. Unemployment has fallen steadily month on month from 6.2% in July to 5.8% in October.

The Euro area continues to witness slight inflationary pressures as inflation rose from 0.3% in September 2014 to 0.4% in October 2014. Unemployment remained high at 11.5% in September while the ECB's policy rate remains unchanged at 0.05%. An uptick in global

demand, a weakening euro and the ECB's monetary stimulus could create a benign environment for growth.

Growth in the emerging markets and frontier economies has been revised downwards in 2014 to 4.4% with China witnessing its lowest output growth of 7.4% since 1990. The GDP growth in China also slowed down from 7.5% in Q2 to 7.3% in Q3, 2014.

Falling crude oil prices have exposed and intensified the risks and vulnerabilities faced by oil exporting countries. The sharp southward trend in oil prices is due mainly to diminishing demand by the US, increased supply by the US and other countries as well as the US proxy war with Russia. All of these have converged to inflict a drastic and direct negative impact on Nigeria's foreign reserve.

Staff research shows that growth in Sub Saharan African countries continues to be robust though marked down to 5.1% in 2014 from the earlier projection of 5.4% due to the contagious ripple effect of the on-going sluggish global growth. Other downside risk factors that may further dampen output growth of the region are external vulnerabilities, political crises, security threats and infrastructural challenges in most countries of the region.

The Domestic Economy

The domestic economy though in a decline mode, has remained comparatively strong and resilient with a real GDP growth of 6.23% in Q3, 2014, down from 6.54% in the preceding quarter. The main sectors contributing to the growth have remained services, agriculture and trade. Employment improved as a total of 349,343 jobs were created in Q3, 2014 as against 259,353 created in Q2, 2014. Inflationary pressure moderated across the three measures of inflation during the review period. Headline Inflation dropped steadily from 8.5% in August to 8.1% in October; though this trend is expected to reverse in the near term and trend northwards due to upside risks associated with increased spending in the build-up to the upcoming general elections in 2015, a potential hike in food inflation arising from exchange rate pressures, and an expected increase in consumption expenditure towards year end festivities. Staff forecasts however suggest that despite all of these, headline inflation would remain well anchored at single digit within the band at year-end. Staff research indicates that Interest rates in all segments of the money market showed further moderation between September and October 2014, reflecting persisting excess liquidity in the banking

system. Available data also indicate that banking system liquidity has been lavishly deployed in pursuit of speculative foreign exchange trading at the short-end of the market.

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.

Worthy of note, however, is the fact that developments in the external sector, particularly the oil industry in the recent past has manifested in a build-up of pressures in the foreign exchange market. An attempt to maintain and stabilize the exchange rate at the existing rDAS level saw gross official reserves decline from US\$40.7 billion in the middle of September, 2014 to \$36.75 billion at end-October 2014. The Naira depreciation at both the interbank and the BDC segments of the market largely reflected recent demand pressures arising from the falling oil prices, dwindling external reserves, and the resultant speculative posturing of economic agents.

Of paramount concern is the declining level of external reserves arising from demand and supply constraints. While excess liquidity conditions in the system and significant speculative activities

continued to aid and catalyze demand pressures on the foreign exchange market, the falling oil prices steadily and considerably reduced the accretion to the external reserves.

Considering all the above, it is my candid opinion that firm and drastic measures must be taken to stem speculative demand of foreign exchange and save the external reserves from further depletion. I am also mindful of the need to avoid a situation of reverse capital flows especially on the back of the Fed's termination of Quantitative Easing in October 2014.

Conclusion

I am mindful of the enormous key risks and several challenges that we face as a nation at this time of continued declining oil prices. These risks and challenges which are diverse in content and effect, include high interest rates which negatively impacts credit extension to the real sector, high bank liquidity which is being channeled to speculative foreign exchange positions, declining oil prices which is negatively impacting our foreign reserves, domestic security challenges with its attendant impact on food inflation, increasing pressure on the exchange rate, and capital reverse flow challenges especially in the face of the Fed's termination of Quantitative Easing.

I am reasonably persuaded that these risks and challenges, especially in the face of non-existent fiscal buffers, are at this time best mitigated using drastic and pointed monetary policy adjustments.

I therefore vote as follows:

1. Increase the Monetary Policy Rate (MPR) by 100 basis points to 13% from 12% with a symmetric corridor of +/- 200 basis points around the MPR
2. Increase Cash Reserve Requirement (CRR) on private sector funds to 20% from 15%, effective immediately.
3. Retain CRR on public sector funds at 75%.
4. Move the midpoint of the official window of the foreign exchange market to ₦168/US\$ from ₦155/US\$ and widen the band around the midpoint to +/-5% from +/-3%.
5. Retain the foreign exchange trading position at 1 per cent.

8.0 SALAMI, ADEDOYIN

With inflation remaining within band, reflecting on, and responding to the challenge posed by declining international price of crude oil provided the background to this meeting of the MPC.

Since conclusion of the MPC meeting, oil price has dropped below US\$70/barrel. Worse still, Bloomberg reports analysis by the International Energy Agency (IEA) which shows that US production of oil, currently at 9million barrels, is set to rise further in 2015. In addition, the IEA suggests that 80 per cent of US Shale oil is commercially viable at US48/barrel. In other words, the challenge of low oil prices is likely to remain for a while – see <http://www.bloomberg.com/news/2014-11-30/oil-slumps-below-65-amid-opec-inaction-to-stem-glut.html>.

The impact of declining oil prices on Nigeria is not difficult to discern – FOREX Reserve fall as export revenues drop; currency comes under pressure as expectation of adjustment heighten; the threat to inflation also rises. Beyond these, the threat of disintermediation rises as currency substitution deepens. Systemic inefficiencies and

perverse incentives mean that various 'games' to take advantage of arbitrage opportunities become irresistibly attractive – no matter how much moral suasion regulators try. I have always struggled to understand the effectiveness of moral suasion in a framework that is at best amoral!

Whilst arriving at the decision to tighten, in the circumstances of the meeting was, for me, only difficult in the sense that whatever we decided had to be viewed as being, at best, a short term decision prior to a whole strategic review of the direction and steps for monetary policy.

I have maintained for a while that when this day arrives – not if - , we would have to decide the direction to go. For ease of recollection, until now, the strategy for managing inflation, which only kicked-in upon restoration of stability after the banking crisis, was to use a stable (or is it strong) currency to dis-inflate the economy. The stability of the currency derived from competitive (high) interest rates to attract foreign savings in the belief (hope) that as oil prices rise,

buffers would be rebuilt! As we now know, while inflation has moderated, neither fiscal nor FOREX buffers have been rebuilt!!!

The impact of widening the band within which the Naira fluctuates from 3 per cent to 5 per cent around the new mid – point of N168/US\$ and raising the Monetary Policy Rate, measures which I support without reservation, will, in the short – term depend on what happens to oil prices. As noted earlier, oil prices have, since the MPC rose from its meeting, eased further. Determination of an appropriate value for a currency is always a challenge – it is at best an imprecise exercise. Looking at various measures, the dollarization rate and the effective exchange rate give values ranging between ₦167.4/US\$ and ₦189.99/US\$.

Whether our chosen mid – point of ₦168/US\$ is bold enough or not will be revealed in time – maybe not as long as we may hope. However, this price point for the Naira and the band adopted bring both the ‘Official’ and Interbank market exchange rates in - band.

As for the Monetary Policy Rate and the higher liquidity ratio, the increase of 100bps for which I voted will hopefully help in stemming capital outflow whilst the higher liquidity ratio of 20per cent should offer further protection to the currency pending resolution of issues about strategic direction/framework for monetary policy.

In my judgment, the present situation requires greater boldness in reforming systemic inefficiencies. I have argued consistently for consolidation of our FOREX Markets. Continuing to use the R/WDAS is simply to afford subsidies, unfairly, to a section of our population. This segmentation must be removed very urgently. It does us no credit and perpetuates a financial market subsidy enjoyed by a few – very similar to the subsidy on fuel!!!

There are some very contentious and difficult conversations ahead. The proverbial wisdom of Solomon will be required as we seek to navigate the challenges ahead with minimum damage to our national economy.

9.0 UCHE, CHIBUIKE U

Although various Nigerian governments have since the country's first oil boom in the early 1970s consistently made public their determination to diversify the country's oil dependent economy, very little progress has been made in this direction till date. The recent sharp and continuing decline in world crude oil prices have again aptly brought out the need and urgency for government to take this matter more seriously. Current data show that crude oil prices continue to fall with no clear indication as to when this will abet. A direct consequence of this is that the Nigerian government is clearly struggling to meet its budgeted obligations for the current year. The basis for next year's budget, which is still on the drawing board, is also being revisited. The fact that the government has been forced to introduce austerity measures, a few months before the 2015 general elections, no doubt underlines the gravity of the current oil price driven economic downturn.

By far the greatest effect of the declining oil revenue on the Nigerian economy is its impact on the exchange rate of the Naira. In recent times, we have seen a widening divergence between the interbank market rate, the Bureau de Change rate and the official exchange

rate of the Naira. This has challenged the official position and determination of the Central Bank of Nigeria (CBN) to defend the value of the Naira. Perhaps more important is the fact that the increasingly divergent rates of exchange for the Naira in the official and parallel markets have created huge arbitrage opportunities for diverse stakeholders. Under such circumstances, currency speculation has gained traction in our economy. With declining reserves, the ability of the CBN to defend the Naira at the current official exchange rate is questionable.

In the light of the above, it is my humble view that the time has come for the Naira to be devalued in order to take into consideration the new economic realities of our time. I am therefore in full support of the MPC decision to devalue the Naira. I am however convinced that unless Nigeria is able to rapidly expand and diversify its economic base, this singular act may not be enough to stem the pressure on the country's currency. It is on the basis of the above that I have also come to the conclusion that there is need to further tighten money supply in the country. In my view, the preferable way to do this is to increase CRR on private sector deposits held in Nigerian banks. While tightening money supply will

increase interest rates, which will be detrimental to the interest of the productive sectors of our economy, the inflation and possibly other devaluation consequences of doing nothing will in my view be even more detrimental to the said sectors of our economy.

In the past, I have also proposed that CRR on public sector deposits be increased to 100 per cent. At the very least this will help correct the anomaly where government departments and agencies hold huge amounts of money in current accounts attracting little or no interests while at the same time borrowing funds at double digit interest rates from banks. The implication of the above is that Government, because of the personal corrupt interests of its decision makers and officers, subsidize bank profits at the expense of promoting national economic development. Despite the obvious advantages of implementing its Treasury Single Account policy, private interests of policy makers have continued to help subvert this laudable government policy.

Interestingly, CBN investigations have revealed that banks have been sabotaging the current CBN regulation of charging 75 per cent CRR on government deposits by underreporting government deposits. This in my view is economic sabotage. I strongly urge the

management of the CBN to stop treating such fraudulent acts with kid gloves. This is because there will be no incentive for Nigerian banks to stop such dishonest practices unless it becomes clear to them that the costs of operating outside the law outweigh the benefits. In the light of the above evidence of widespread abuse of existing CRR rules on public sector deposits, I see no need to continue to propose further increases to the CRR on such deposits at the present time.

Although I support monetary tightening under our current circumstances, I oppose that this be done through increase in MPR. This is because I do not believe that we should be involved in formulating policies that will encourage the inflow of short term foreign capital which in the past constituted a major hindrance to our ability to grow our national reserves in a sustainable manner. The argument that increasing MPR at the present time may provide additional incentives for short term foreign portfolio investors in Nigeria not to flee has not been well thought through. In my view, this is unlikely to result in the speculated outcome as there are several more important factors, like increasing national risks and opportunities and developments in other jurisdictions that determine

the behavior of foreign portfolio managers. While I would not at this stage recommend that restrictions be placed on capital account movements in Nigeria, I am of the view that it would be an error to continue to overtly encourage the inflow of speculative short term capital into our troubled economy.

Perhaps a more important reason why I have refused to endorse the tightening of monetary policy through the instrument of MPR is the fact that our current MPR is already very high and by far above our inflation rate. Further increasing this will have a negative effect on our already high cost of credit to the real sector. Although various Nigerian governments in the past made explicit their determination to develop the real sector of our economy, the recent deterioration in oil prices has now made the diversification of our mono product economy a national emergency.

In the light of the above factors, I hereby vote as follows: (1). To move the midpoint of the official window of the foreign exchange market from ₦155/US\$ to ₦168/US\$; (2) to retain MPR at 12 per cent with interest rate corridor of + 200/- 200 basis points; (3) to increase CRR on private sector deposits from 15 per cent to 20 per cent; (4) to retain CRR on public sector deposits at 75 per cent until the time

when the CBN is able to effectively enforce the current policy, and;
(6) to retain Liquidity Ratio at 30 per cent.

10. YAHAYA, SHEHU

I vote for a tightening of monetary policy to increase the MPR by 100 basis points and to raise the CRR for private sector deposits to 20%. All other variables and corridors to remain the same. Steps should also be taken to re-align the value of the Naira to better reflect its real exchange rate. My reasons are based on the current global financial and economic situation and the developments in the Nigerian economy.

Global Economic Developments

Clearly, the most important development which has the most significant effect on the Nigerian economy is the fall in the price of crude oil. The price of Nigeria's Bonny light crude has experienced a more or less continuous fall in price from over US\$110/barrel in mid-2013 to around US\$78 this month, which is lower than it has been for more than 3 years. Oil demand forecast for next year is also down. Given the dependence of the country on oil revenues for foreign

exchange earnings and government revenue, this obviously has a number of implications for the Economy.

Growth in the global economy, although providing a mixed picture, is generally tepid for the country's main trading partners. There is fairly clear economic recovery in the US and UK, very slow and uneven recovery in the EU. China, although still enjoying a high growth rate, is experiencing a bit of a slowdown in its growth rates, Japan is stagnating, Brazil is in recession, while India is holding up. Overall, there does not appear to be near term prospects for clear and decisive spurts of international demand for Nigeria's exports. Growth in SSA remains strong, although it will require concerted efforts to limit the negative economic effects of EVD.

On the other hand, there is no concern at the moment for global inflationary pressures, as prices in the US, EU, Japan and China are generally on a downward trend. Foods, including cereal prices are also stable.

The prospect for higher interest rates in the US is still present, given the termination of QE3, despite the declared objective by the FOMC that Federal funds rates are likely to remain at the current levels for

some time. The EU, Japan and lately China are all easing monetary policy to stimulate growth in their economies.

Developments in the Domestic Economy

The decline in international oil prices has had a significant impact on the Naira exchange rate in the inter-bank market and BDC, on reserves, the capital market, as well as the distributable pool account for the three tiers of government. Reserves have declined by a little over 14% during the year to just over US\$ 36 billion in October, the ASI in the capital market has fallen by 11.6% since 2014 and market capitalization by a similar level.

In respect of the Naira exchange rate, it has obviously been a challenge to try and maintain the rate around the 3% margin in RDAS. It has involved the deployment of significant amounts of external reserves to help shore up the currency. Further depreciation of the Naira will obviously impact significantly on future price levels and capital flows.

Growth rate of GDP remains solid at 6.23% in Q3 of 2014, mainly driven by the non-oil sector and about 350,000 jobs have been generated in the economy during the quarter, although more than

half of the jobs were in the insecure informal sector. There are some concerns though with respect to Net domestic credit to the private sector which, at 9.3% this year, are both lower than the target rates.

Inflation has fallen to 8.1% in September 2014, mostly due to the fall in food prices, although core inflation has also eased. However, the inflation outlook is upward-trending up to mid-2015.

Expenditure of the federal government for the first half of 2014 was nearly 10% lower than the first half of 2013. Net credit to the federal government this year is also lower than last year. Generally, the federal government has been able to keep the deficit/GDP ratio low. The main challenge is to extend this fiscal rectitude to the state government level and to maintain the necessary discipline for all levels of government during the election period in the face of mounting pressures for supplementary allocations.

Summary and Conclusion

The main challenge facing the economy relates to the rapid decline in the price of crude oil in the past five months and its impact on the exchange rate, price levels, capital market, government revenue and business confidence. Tackling this problem requires a judicious

combination of fiscal, monetary and broader development policies. Some policies have already been articulated by the government to help rationalize the demand for foreign exchange and stabilize the value of the Naira

From the monetary side, the current imperative is to deploy the necessary tools to help stem excess liquidity in the economy and rationalize the demand for foreign exchange, provide necessary incentives to portfolio investors, preserve external reserves and maintain confidence in the system.

Accordingly, I vote to:

- Raise the CRR on private sector deposits from 15-20%
- Raise the MPR by 100 basis points to 13%
- Take steps to re-align the value of the Naira to better reflect its real exchange and stave off speculative demand.

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

In the last couple of months, the domestic economy broadly continued to be resilient to the strong global headwinds as well as the spillover effects of exogenous factors especially when compared to its peers. At 6.23 percent in 2014Q3, although lower than the 6.54 percent recorded in the preceding quarter, the rate of economic expansion remained robust. This reflected the significant growth in key non-oil sectors especially services, agriculture and industry. The average growth rate of 6.3 percent in the first three quarters of 2013 is remarkable given the tepid growth in the global economy and recomputed domestic growth rates of 4.2 percent and 5.5 percent for 2012 and 2013, respectively; following the GDP Rebasing Exercise. In addition, the economy enjoyed a considerable degree of price stability as year-on-year consumer price inflation remained within the target band of 6 to 9 percent across all three measures of inflation in 2014Q3. During the third quarter of the year, the economy created 349,343 jobs with the private sector contributing almost 60 percent of that number. The country's financial system continues to look good based on fundamental measures of stability, even though there is

always room for improvement. These developments provide reinforcing insulants for the economy particularly as staff forecasts suggest continued robustness of growth and declining inflation in the near-term.

Nonetheless, a number of vulnerabilities and risks are imminent especially in the foreign exchange market. Demand pressure intensified at the domestic foreign exchange market causing a considerable degree of weakening of the domestic currency at both the interbank and Bureau de Change (BDC) segments. During the review period, the naira depreciated by 1.06 percent to ₦165.55/US\$ from ₦163.80/US\$ and by 1.19 percent from ₦169.00/US\$ to ₦170.00/US\$ at the interbank and BDC segments, respectively. At the official rDAS window, relative stability was experienced as the naira depreciated marginally by ₦0.01k to ₦157.32/US\$. The relative stability at the official window reflected the huge outlay of external reserves used by the CBN to defend the naira.

To maintain and stabilize the exchange rate over the course of this year, the Bank has utilised considerable amount of its reserves to maintain the value of the Naira. In contrast to the inflows of foreign currency during the same period, the CBN has had a deficit of flows.

Consequently, the level of 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, comparable oil exporting countries have experienced substantial currency depreciation whereas the naira has depreciated by only 1.74 percent. 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 reinforced by the outflow of capital attributable to the end of the US Fed stimulus programme in October 2014.

With regards to the foreign exchange market and inflationary pressure, the domestic economy is exposed to a number of potential risks both globally and locally. The main global realities includes: (i) the sustained fall in oil prices; (ii) the end of Quantitative Easing by the US Federal Reserve, which implied that the monthly injection of about US\$85 billion into the global economy suddenly ended; and (iii) subsisting sanctions against Russia for its alleged role in the on-going crisis in Ukraine. The bleak outlook provided by the IMF following its lowered forecast for global economic expansion could

imply a fall in the demand for oil which in addition to the shale oil operation of the US further depresses the international price of oil.

Since the beginning of the year, oil prices have plunged by almost 40 percent, from a peak of US\$116 per barrel in January 2014 to as low as US\$72 per barrel. Evidences suggest that improvements in technology have lowered the break-even cost of shale oil production to an average range of US\$52-US\$70 per barrel. I believe that this has caused a downward shift to occur in the oil demand function making the prevailing fall in oil prices non-transient. Continued decline in the price of oil has great ramifications for stability at the foreign exchange market, as it undermines the CBN's flexibility at applying the external reserves for interventions.

Further pressure on the external reserves and domestic monetary policy is due to the US Fed's decision to normalize its monetary policy by stopping the massive injection of liquidity into the global economy. The resultant repatriation of capital from domestic economy particularly with relatively moderate level of market rates intensifies the pressure on the domestic currency and the external reserves. With the CBN's ability to defend the naira and sustain the stability of the naira exchange rate being constrained by the

depleting reserves, a widening arbitrage premium opened up at the foreign exchange market between the rDAS exchange rate and the rates in the other segments.

Another prominent issue I considered in this respect is that the demand pressure in the foreign exchange market is invigorated essentially by the liquidity surfeit in the banking system and speculative activities. As banks remained cautious to lending, the sturdy liquidity condition failed to bring about increased credit to the real sector to engender inclusive growth and boost employment but was instead applied to the foreign exchange market and Standing Deposit Facility window of the CBN. Accordingly, I am of the view that the prevailing challenge calls for unhesitant measures in the management of the nation's stock of foreign exchange reserves in order to align the market towards its long-run equilibrium path.

On domestic prices, I note the satisfying outlook based on Staff estimates that suggest a continued stability in consumer price inflation within a single-digit range in the near-term if appropriate policy measures were adopted. I also recognize the upside risks to inflation in the near term to include intensified fiscal activities and spending in the run-up to the 2015 General Elections, pass-through

from depreciating exchange rate following heightened pressure at the foreign exchange market, and food supply shocks arising from the increased insurgency activities in the major agricultural belts of the country. Besides, the impressive output growth recorded in the year to date could be hampered in the future if the insurgency in the North East of the country is not abated, and bleak global outlook continued.

In this regard, I believe that bold policy action should be taken to dampen the effects of prevailing unsavoury conditions and shield the economy against potential upside risks. While I acknowledge the short-run ramifications of tightening of monetary conditions on credit, aggregate demand and growth, it will be sub-optimal not to act decisively and immediately, especially as the cost of postponing such action will only increase exponentially. Given that the overriding objective of the CBN is to ensure price stability, I believe that:

- A decision to tighten monetary policy will shield the economy from the imminent global and domestic risks while ensuring that inflationary pressure and inflation expectations are well anchored;

- A decision to raise the Monetary Policy Rate (MPR) can be expected to increase capital inflows into the country, which should improve accretion to reserves;
- An increase in the CRR will dampen excess liquidity available to banks for speculative and arbitrage activities and moderate the pressure in the foreign exchange market;
- A gradual realignment of the official rDAS exchange rate with the rates in the other segments, reduces the currently attractive premium and discourages arbitrage tendencies in the market;
and
- A lower value of the naira would also make Nigerian exports cheaper, which should encourage other countries to buy more Nigerian goods with a potential for increased job creation in the domestic economy.

In the light of the above, I vote as follows:

1. Increase the MPR by 100 basis points from 12.0 to 13.0 percent;
2. Increase the CRR on private sector deposits by 500 basis points from 15.0 to 20.0 percent with immediate effect;
3. Move the midpoint of the official window of the foreign exchange market from ₦155/US\$ to ₦168/US\$;
4. Widen the band around the midpoint by 200 basis points from ± 3.0 percent to ± 5.0 percent;
5. Retain public sector CRR at its current level of 75.0 percent;
6. Maintain a symmetric corridor of ± 200 basis points around the MPR; and
7. Retain the net open foreign exchange trading position at 1.0 percent.