Central Bank of Nigeria Communiqué' No. 103 of the Monetary Policy Committee Meeting of Monday and Tuesday, September 21 and 22, 2015

The Monetary Policy Committee met on 21st and 22nd September, 2015 against the backdrop of lingering uneven recovery in the global economy and slowing domestic growth. In attendance were 10 out of 12 members. The Committee reviewed developments in global and domestic economic and financial environments in the first eight months of 2015 in order to provide the policy direction for the rest of fiscal 2015.

International Economic Developments

The Committee observed a divergence in the global economic environment, with a gradual but steady growth in the United States and UK but a slowdown in emerging and developing economies. The underlying drivers of growth in the advanced economies included improving financial conditions and consumer sentiments, suppressed commodity prices and favorable labour market conditions. On the flip side, the slowdown in the emerging and developing economies is mainly attributable to tight external financial conditions, mostly a direct consequence of reduced revenues from weak commodity prices, fragile global demand and other geo-political factors.

Aided by strong consumer spending, continuous improvement in the housing and labour markets and wage growth, the United States continues to benefit from soft energy and other commodity prices evidenced by the country's revised second quarter 2015 GDP growth of 3.7 per cent. Growth outlook in the second half, however, remains moderate as exports could slow on the heels of a strengthening dollar and slowing growth in China.

The Bank of Japan maintained accommodative monetary policy through its asset purchasing program, with monthly injection of ¥6.7 trillion (US$55.48 billion), resulting in stronger than anticipated second quarter growth. Following its September 3, 2015 meeting, the European Central Bank (ECB) retained its key policy rate, even as its asset purchasing program continued, while inflation remained largely subdued.

In the United Kingdom, the Bank of England also continued its asset purchase program as the economy maintained a robust growth path in the second quarter, with a modest uptick in inflation. These developments have started to trigger the debate over when the Bank of England (BoE) would start raising its rates.

Mindful of the potential impact of a rate adjustment, particularly on the emerging markets and considering the sluggish recovery in the Euro Area and Japan as well as the need to firm up recent growth and employment gains in the domestic economy, the US Federal Reserve voted at its September meeting to maintain its key interest rate, and delay monetary policy normalization. The decision is expected to strengthen stability in global economy and moderate volatility in the financial markets, while also consolidating recovery at home.

In the emerging markets and developing economies, expectations of low growth continued into the third quarter of 2015, with strong likelihood of moderate uptick in 2016. Output growth in China at 7.0 per cent in the second quarter of 2015, is expected to moderate further, due to slower productivity and exports, collapsing assets value and excess capacity in the manufacturing sector.

Global inflation is expected to remain tepid as the recent temporary rebound in oil prices and stronger consumer sentiments have mildly raised consumer prices in the advanced economies. Consumer price developments were mixed in emerging and developing economies. Commodity importing economies have continued to benefit from low global oil and other commodity prices, while others, especially exporters of primary commodities, are contending with increased pressure on their currencies and fiscal position; and in some cases, significant inflation pass-through to domestic prices.

Domestic Economic and Financial Developments

Output

Output growth in the first half of 2015 trended downwards from the level in the fourth quarter of 2014, mainly on account of softening oil prices. According to the National Bureau of Statistics (NBS), real GDP grew by 2.35 per cent in the second quarter of 2015, a significant decrease when compared with the 3.96 and 6.54 per cent in the preceding quarter and corresponding period of 2014, respectively. Real GDP growth is projected by the National Bureau of Statistics (NBS) to stabilize at 2.63 per cent in 2015, compared with the 6.22 per cent recorded in 2014. The non-oil sector remained the main driver of growth in the second quarter of 2015, at 3.46 per cent. The key drivers were services, trade and agriculture, contributing 1.80, 0.95 and 0.82 percentage points, respectively. On the other hand, Oil and Natural Gas sector declined by 0.73 percentage point an improvement of 1.13 percentage points relative to the first quarter of 2015.

The overall outlook for economic activity is expected to improve on account of sustained improvement in the supply of power and refined petroleum products and progress with counter-insurgency in the North East axis. The Committee reiterated its commitment to efforts in support of the various ongoing Federal Government initiatives to stimulate output growth.

Prices

The Committee noted that the year-on-year headline inflation edged upwards to 9.3 per cent in August, from 9.2 per cent in June and July, 2015. The increase in headline inflation in August reflected marginal increases in both the core and food components of inflation. Core inflation rose to 9.0 per cent in August from 8.8 per cent in July, while food inflation increased to 10.1 per cent from 10.05 per cent over the same period.

The Committee observed that the uptick in inflation was mainly traceable to higher energy prices, delayed harvests and pass through from imports. It however, noted with satisfaction, the continued moderation in all measures of month-on-month inflation across all the measures. In August, on a month-on-month basis, headline inflation rose by 0.59 per cent from 0.69% in July; core inflation rose by 0.61 per cent, same as in July. Month-on-month food inflation also moderated to 0.63 per cent in August, from 0.77 per cent in July. The Committee, while reiterating its commitment to price stability, noted that the rising inflationary trend was a concern given the already tight monetary policy stance of the Bank.

Monetary, Credit and Financial Markets Developments

Broad money supply (M2) contracted by 2.23 per cent in August 2015, below the level at end-December 2014. When annualized, M2 contracted by 3.34 per cent, which was significantly below the growth benchmark of 15.24 per cent for 2015. Net domestic credit (NDC) rose by 11.00 per cent, which annualizes to 16.49 per cent in the same period. At that level, NDC was within the provisional benchmark of 29.30 per cent for 2015. The growth in aggregate credit was attributable mainly to growth in Federal Government borrowing which reached 140.13 per cent in August 2015 or 210.19 per cent when annualized.

During the period under review, rates in all segments of the money market were largely influenced by the level of liquidity in the banking system. Money market interest rates were relatively volatile, reflecting fluctuations in banking system liquidity during the period. Average inter-bank call and OBB rates, which opened at 10.85 and 10.65 per cent in June, 2015, closed at 31.07 and 28.10 per cent, respectively, in August, 2015. Average inter-bank call and OBB rates for the period were 14.95 and 17.17 per cent, respectively.

The Committee noted the bearish trend in the equities segment of the capital market during the review period. The All-Share Index (ASI) decreased by 9.3 per cent from 33,456.83 on June 01, 2015 to 30,332.68 on September 18, 2015. Similarly, Market Capitalization (MC) fell by 8.8 per cent from N11.42 trillion to N10.42 trillion during the same period. However, relative to end-December 2014, the indices decreased by 12.5 and 9.3 per cent, respectively. The decline in share prices (year-to-date) was largely due to subdued sentiments preceding the general elections, which held in March and concerns for the country's foreign reserves position due to declining global oil prices.

External Sector Developments

The average naira exchange rate remained relatively stable at the inter-bank segment, but significantly volatile in the BDC segment of the foreign exchange market during the review period. The interbank exchange rate opened at N196.95/US$ and closed at N197.00, at a daily average of N196.98/US$ between June 29 and September 18, 2015 representing a depreciation of N0.5K for the period. At the bureau-de-change segment, the exchange rate opened at N224.50/US$ and closed at N211.50. This represented an appreciation of N13.00k for the period. The relative stability in the inter-bank market and improvement in the BDC segment were attributed to the effects of various administrative and policy measures. Consequently, gross official reserves decreased modestly from US$31.20 billion at end-July 2015 to $30.63 billion on September 17, 2015.

Committee's Considerations

The Committee noted that the overall macroeconomic environment remained fragile. The economy further slowed in the second quarter of the year, making it the second consecutive quarterly less-than-expected performance. The Committee noted that growth had come under severe strains arising from declining private and public expenditures. In particular, it noted the impact of non-payment of salaries at the state and local government levels as a key dampening factor on consumer demand. Year-on-year headline inflation continued to trend upwards, although the month-on-month measure moderated. Demand pressure in the foreign exchange market remained significant as oil prices continued to decline. Arising from these developments, there were indications that some of the banking sector performance indicators could be stressed if conditions worsen further. Specifically, the Committee noted that liquidity withdrawals following the implementation of the TSA, elongation of the tenure of state government loans as well as loans to the oil and gas sectors could aggravate liquidity conditions in banks and impair their financial intermediation role, thus affecting economic growth, unless some actions were immediately taken to ease liquidity conditions in the markets.

Having seen two consecutive quarters of slow growth, the Committee recognized that the economy could slip into recession in 2016 if proactive steps were not taken to revive growth in key sectors of the economy.

In the face of prevailing circumstances, the Committee acknowledged that synergy between monetary and fiscal policies remained the most potent option to sustainable growth. The Committee further observed that the impact of the persistent decline in global crude oil prices on the fiscal position of Government continues to reflect in rising credit to government. The Committee also noted that the initial market reaction to the decision by JP Morgan to exclude the country from its Government Bond Index for Emerging Economies (GBI-EM) had largely dissipated as yields soon adjusted to their pre-announcement levels' adding that there may be second round effects over the next two months as the economy adjusts to that decision. The Committee reiterated its unwavering commitment to naira exchange rate stability despite the pressures. Mindful of the possibility of diversion of any extra liquidity to the foreign exchange market, the Committee urged the Bank to closely monitor the nature and sources of demand pressure in the foreign exchange market to ensure that funds were not diverted to demand for foreign exchange but applied to specific growth-enhancing asset creation lending by banks. It further noted that sectors such as agriculture and MSMEs were sectors for rapid generation of productive employment and wealth creation, and must therefore, be painstakingly encouraged.

On inflation, the Committee was optimistic that as harvests progress in the coming months, pressure on food prices would gradually recede, while growth enhancing measures would over the medium term have some moderating effect on food prices.

Overall, the Committee expressed optimism that business confidence would continue to improve as the Government continues to unfold its economic plans. In addition, some of the reassuring measures of the administration including efforts aimed at resolving fiscal challenges at the sub-national levels, and the fight against corruption and improving the business environment would unlock the inflow of foreign direct investment. The Committee also underscored the imperative of growing and protecting the country’s foreign reserves and building fiscal buffers in the process of strengthening confidence in the economy, which is essential for promoting growth and stability. The MPC also observed that despite the TSA, banking system liquidity ratio remained moderate. Consequently, the Committee advised on the urgent imperative of banks to aggressively support the efforts of government at job creation by channeling available liquidity into target growth enhancing sectors of the economy such as agriculture and manufacturing. This is with a view to promoting employment creation through conscious efforts aimed at directing lending to the growth enhancing sectors of the economy. The Committee considered that the Bank and deposit money banks, must strive to reverse the slowing GDP trajectory by actively stepping up their efforts in catalyzing the economy with substantial new loans to the target sectors earlier highlighted.

The Committee's Decisions

In consideration of the underlying fundamentals of the economy, particularly the declining output growth, rising unemployment, evolving international economic environment as well as the need to properly position the economy on a sustainable growth path, the MPC decided by a vote of 7 to reduce the Cash Reserve Requirement (CRR) from 31 per cent to 25 per cent while 3 voted to hold. By a unanimous vote, the MPC voted to retain the MPR at 13 per cent.

In summary, the MPC voted to:

(i) Reduce the CRR from 31 to 25 per cent;

(ii) Retain the MPR at 13 per cent;

(iii) Retain the symmetric corridor of 200 basis points around the MPR; and

(iv) Retain the Liquidity Ratio at 30 per cent.

Thank you.

Godwin I. Emefiele

Governor, Central Bank of Nigeria

22nd September 2015