Central Bank of Nigeria Communiqué No. 93 of the Monetary Policy Committee Meeting of Monday 20 and Tuesday 21 January, 2014

The Monetary Policy Committee (MPC) met on January 20 and 21, 2014 against the backdrop of uncertainties in the global economy, especially arising from the commencement of the QE3 tapering by the Fed. In attendance were eight (8) out of the ten (10) members following the retirement of Mr. Tunde Lemo, Deputy Governor, on January 11, 2014 and Mr. John Oshilaja, an external member of the MPC, who completed his term on December 31, 2013. The Committee reviewed key global and domestic economic developments in 2013 and re-assessed the short- to medium-term risks to inflation, domestic output and financial stability and the outlook for 2014.

International Economic Developments

The global economy is expected to continue recovering from the global financial crisis, as growth is projected to accelerate in 2014. The International Monetary Fund (IMF) projected global growth at 3.4 and 3.5 per cent in 2014 and 2015, respectively, up from 2.4 per cent in 2013. Some other sources, however, have produced less optimistic projections of global growth for 2014; for example, the United Nations Department for Economic and Social Affairs' (UNDESA) has projected 3 per cent growth. The decision by the US Federal Reserve to reduce its monthly asset purchases from USD85 billion to USD75 billion left most markets stable having already priced-in the development. The quantitative easing measures by the US Federal Reserve had helped to restore momentum to the US economy and also contributed to the improvement of the Eurozone economy in 2013.

Europe is forecast to return to growth in 2014 after two years of contraction. Greece, which has been at the centre of the Bloc's banking and debt crisis, is expected to record its first economic expansion in six years. Emerging markets that were major beneficiaries of cheap money from the Fed stimulus could experience financial market instability as tapering begins, although the US authorities have made it clear that they remain sensitive to the impact of their domestic policies on global markets and will therefore aim to minimise disruptions.

Global inflation is projected to rise to 2.71 per cent in 2014, up from about 2.30 per cent in 2013. Favorable developments in food and fuel supply would moderate upward pressure on prices of major commodities, despite the expected acceleration in global activity. The US recorded inflation of 1.5 per cent in December, up from 1.2 per cent in November, 2013.

Most central banks maintained a cautious posture in 2013, retaining or varying policy rates only slightly. The financial markets expect monetary authorities to continue with policies aimed at supporting growth in 2014. In effect, monetary conditions are likely to remain easy in key advanced economies over the short- to medium-term on the back of the forward guidance that monetary authorities in these economies have given, with regard to the conditions that must be met before any change in policy stance comes into effect.

Domestic Economic and Financial Developments

Output

The National Bureau of Statistics (NBS) estimated real Gross Domestic Product (GDP) growth rate of 7.67 per cent for the fourth quarter of 2013, which was higher than the revised figure of 6.81 and 6.99 per cent recorded in the third quarter, and the corresponding period of 2012, respectively. Overall, growth rate for fiscal 2013 was estimated at 6.87 per cent up from 6.58 per cent in 2012.

The non-oil sector remained the major driver of growth, recording 8.73 per cent in the fourth quarter of 2013. The growth drivers in the non-oil sector remained agriculture; wholesale and retail trade; and services which contributed 1.64, 2.34, and 2.66 per cent, respectively. The relatively robust growth performance despite sluggish global recovery reflected the continuing favourable climatic conditions for increased agricultural production, sustained outcome of banking sector reforms and macroeconomic stability.

Prices

The moderation in inflationary pressure, which began in the fourth quarter of 2012, continued in 2013. The year-on-year headline inflation fell consistently from 9.0 per cent in January to 8.6 and 8.4 per cent in March and June, respectively, before ending the year at 8.0 per cent. Also, food inflation, which constitutes 51.8 per cent of the CPI basket, declined from 10.1 per cent in January to 9.5, 9.6, 9.4 and 9.3 per cent in March, June, September, and December 2013, respectively. However, core inflation initially declined to 7.2 and 5.5 per cent in March and June from 11.3 per cent in January, but rose during the second half of the year to 7.4 and 7.9 per cent in September and December, 2013, respectively. The moderation in domestic price level was largely due to the tight monetary policy stance coupled with the relatively stable exchange rate regime during the period, which resulted in single digit inflation in the three measures for the whole year. This is the first time the country has achieved this since 2007.

The Committee noted with satisfaction that the year-on-year headline inflation remained within the indicative target range of 6-9% in the second half of 2013. However, the Committee noted the underlining pressure on core inflation, which may not be unconnected with the widening spread between official and BDC exchange rates. In order to head off the spectre of rising inflation in 2014, concrete actions will be needed to stabilize the currency and minimize the divergence between the two segments of the foreign exchange market.

Monetary, Credit and Financial Market Developments

Broad money supply (M2) contracted by 4.82 per cent in December 2013 over the level at end-December 2012, in contrast to the growth of 16.39 per cent in the corresponding period of 2012. M2 was also below the growth benchmark of 15.20 per cent for 2013. Aggregate domestic credit (net) grew by 11.11 per cent in December 2013, over the end-December 2012 level. The aggregate domestic credit (net) at end-December 2013 was, however, below the provisional benchmark of 22.98 per cent for 2013. The decline in M2 was due mainly to the decrease in Net Foreign Assets by 5.86 per cent.

Interest rates in all segments of the money market reflected the liquidity conditions in the banking system. At the MPC meeting of November 18-19, 2013, the Monetary Policy Rate (MPR) was retained at 12.00 per cent with a symmetric corridor of +/- 200 basis points, thus effectively maintaining the SLF and SDF rates at 14.00 and 10.00 per cent, respectively. Alongside the existing Cash Reserve requirement (CRR) of 12.0 per cent, the 50.0 per cent CRR on public sector deposits was retained to address excess liquidity in the banking system. Consequently, both the weighted average inter-bank call and OBB rates opened at 11.73 per cent in December 2012 but closed at 10.86 and 10.46 per cent in December 2013, respectively.

The capital market continued its rally with the equities market providing the lead. The All-Share Index (ASI) increased by 47.2 per cent from 28,078.81 on December 31, 2012 to 41,329.19 on December 31, 2013. Market Capitalization (MC) increased by 47.4 per cent from N8.97 trillion to N13.23 trillion during the same period. Improved earnings and investor confidence in macroeconomic management contributed to the rise in stock prices.

External Sector Developments

The end-period exchange rate remained stable at the w/rDAS and interbank segments but depreciated significantly at the BDC segment. The exchange rate at the w/rDAS-SPT in 2013 opened at N157.33/US$ (including 1% commission) and closed at N157.26/US$, representing an appreciation of N0.07k or 0.04 per cent. The inter-bank selling rate opened at N156.25/US$ and closed at N159.90/US$, representing a depreciation of N3.65k or 2.34 per cent for the period. However, at the BDC segment of the foreign exchange market, the selling rate opened at N159.50/US$ and closed at N172.00/US$, representing a depreciation of N12.50k or 7.84 per cent.

Gross external reserves as at December 31, 2013 stood at US$42.85 billion, representing a decrease of US$ 0.98 billion or 2.23 per cent compared with US$ 43.83 billion at end- December 2012. The Committee noted that the decrease in the reserves level resulted largely from a slowdown in portfolio and FDI flows in Q4 2013 resulting in increased funding of the foreign exchange market by the CBN to stabilize the currency. The Committee again expressed concern over the continued depletion of the Excess Crude Account (ECA) which balance stood at less than US$2.5 billion on January 17, 2014 compared with about US$11.5 billion in December 2012. This absence of fiscal buffers increased our reliance on portfolio flows thus, constituting the principal risk to exchange rate stability, especially with uncertainties around capital flows and oil price.

The Committee's Considerations

The MPC welcomed the sustained stability of the exchange rate and single digit inflation in 2013. It, however, identified four (4) key concerns for policy in the short- to medium-term:

1. Depletion of fiscal buffers following the continuing decline in oil revenue, rundown of reserves and depletion of excess crude oil savings;
2. Falling portfolio and FDI inflows;
3. Widening gap between the official and the BDC exchange rates; and
4. Creeping increase in core inflation.

On the depletion of fiscal buffers, the Committee decried the continuous fall in revenue from oil despite stable price of oil and production in 2013. Although the Committee acknowledged output losses due to theft and vandalism, this could not wholly explain the magnitude of the shortfall in revenue. As a consequence, accretion to external reserves remained low while much of the previous savings have been depleted, thereby undermining the ability of the Central

Bank to sustain exchange rate stability. The Committee therefore, urged the fiscal authorities to block revenue leakages and rebuild fiscal savings needed to sustain confidence and preserve the value of the naira.

The MPC also noted the reduction in portfolio inflows driven by the commencement of the QE3 tapering by the Fed, transition concerns at the CBN and continued depletion of the ECA, thus dampening investor confidence. The reduction of the US stimulus especially, could in addition, trigger capital flow reversals and put greater pressure on the naira exchange rate. The Committee also expressed concern about the widening gap between the official and the BDC exchange rates, noting that this could precipitate speculation and round-tripping. Though, the BDCs represent a small component of the foreign exchange market, the widening spread appeared to have fed into creeping increases in core inflation.

The Committee re-affirmed its commitment to a stable exchange rate regime while urging the fiscal authority to provide support by reducing fiscal leakages, improving controls around oil revenues and reviewing terms around production sharing agreements with oil companies, while awaiting the passage of the Petroleum Industry Bill (PIB). The Committee also noted the necessity for a complementary monetary policy response to ensure sustained exchange rate stability and convergence of rates in various segments. In the light of this, two options were considered:

a) Allowing a depreciation of the currency to avoid further tightening and depletion of reserves; and

b) Maintaining our commitment to currency stability while stressing that monetary policy is almost at its limits and needs support from the fiscal side in the form of excess crude savings if currency stability is to be maintained in the future.

The Committee decided that the costs of a weaker naira far outweigh the benefits to the Nigerian economy and the core mandate of the CBN. It therefore opted to maintain its commitment to currency stability. Furthermore, having looked at all the options, the Committee decided against excessive reliance on external reserves to support the exchange rate and opted for monetary tightening until fiscal buffers are rebuilt.

Decision

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

- All members voted for an increase in CRR on public sector deposits from 50 per cent to 75 per cent with effect from February 4, 2014
- Five (5) members voted for a retention of CRR on private sector deposit at 12 per cent while three (3) voted for an increase in this component to 15 per cent
- One (1) member voted for allowing the currency to depreciate by either shifting the mid-point or widening the band.

The decision is therefore as follows:

1. MPR remains at 12 per cent +/- 200 basis points and liquidity ratio (LR) at 30 per cent
2. Public sector CRR increased from 50 per cent to 75 per cent
3. Private sector CRR retained at 12 per cent
4. The CBN to take immediate step to redress the supply-demand imbalance in the BDC segment while maintaining its focus on anti-money laundering (AML) activities.

Thank you for Listening

Sanusi Lamido Sanusi, *CON*
Governor
Central Bank of Nigeria

21st January, 2014

PERSONAL STATEMENTS BY THE MONETARY POLICY COMMITTEE MEMBERS:

1.0 ALADE, SARAH

This first MPC of the year is coming at a time of some uncertainties in the world economy. The world's four largest economies are currently undergoing transitions with the United State of America struggling to boost growth in a fractured political environment. China is moving from a growth model based on investment and exports to one led by internal demand. Europe is struggling to preserve the integrity of its common currency while resolving a multitude of complex institutional and debt issues, and Japan is trying to fight two decades of deflation with aggressive and unconventional monetary policies. All these have implications for the Nigerian economy, with deep dependency on export earnings and external demand. These development coupled with internal domestic dynamics during an election year, which are discussed below will require careful maneuvering and appropriate policies to safeguard the stability of the economy. Against this background, I support a no change in Monetary Policy Rate (MPC), a 75 per cent increase in public sector deposits Cash Reserve Requirement (CRR) and a review of the exchange rate midpoint to safeguard the economy.

Headline inflation increased slightly to 8.0 per cent in December compared to 7.9 per cent recorded in November 2013. Notwithstanding the slight increase in inflation in December 2013, the goal of single digit inflation was achieved in 2013 with average headline inflation for the year at 8.52 per cent. In the same period, core inflation rose slightly to 7.9 per cent in December from 7.8 per cent recorded in November 2013, while food inflation remained unchanged at 9.3 per cent from the previous month. Despite this downward trend in inflation, there are still pockets of risks in the short term. These include the upcoming planting season and the fiscal risk through increased election spending. Additional risks include reduction to the fiscal buffers and its impact on the investors/consumer confidence and exchange rate stability. Based on this, monetary policy should remain restrictive to forestall the anticipated impact of fiscal risks and food seasonality.

Although there is likelihood of heightened fiscal spending as the electioneering season commence, the late passage of the bill give room to maneuver in the first quarter. The 2014 national budget submitted to the National Assembly has a deficit of 1.9 per cent, which is lower than 2.17 per cent recorded in 2013 and even lower than the 3 per cent stipulated in the Fiscal Responsibility Act. The late passage of the bill will mean that expenditure would be delayed suggesting dampened risk for front-loading of expenditure in the first quarter. Monetary policy will have to expect an increased spending later in the year due to electioneering activities.

There has been intense pressure on exchange rate as the spread between the official and Bureau de change (BDC) rates has widened. As at December, 2013, foreign exchange reserves stood at $42.85 billion, mainly on the back of foreign inflows and reduced government revenue. Government oil revenue declined throughout 2013 on the back of oil theft and pipeline vandalism, resulting in the depletion of Excess crude Account (ECA) and pressure on the exchange rate. In the face of planned sustained tapering from the United States, it is important that an appropriate exchange rate policy is adopted to balance the objective of stable currency without unduly depleting the accumulated reserves. Effort should be intensified at rebuilding the fiscal buffers in anticipation of exit as cheap money dries up. Otherwise, the exit could pose downside risk to the domestic economy through exchange rate pressure and reserve depletion if not managed properly. Already, available data suggest that Gross Foreign Direct Investment (FDI) and portfolio inflows decreased significantly in the last quarter of 2013. Given that monetary policy is approaching its limit, there is need to allow for more flexibility in the exchange rate.

Gross Domestic Product (GDP) although robust is trending below forecast. The 2013 third quarter GDP grew by 6.81 and the projection for the fourth quarter is expected to be higher due to reforms in the agricultural sector which drove the growth in non-oil sector to 7.95 per cent in the third quarter. The oil sector's contribution to GDP declined by -0.58 per cent in the third quarter attributable to oil theft and pipeline vandalism in the Niger Delta that have resulted in the shutdown of some oil wells and reduced oil production. Although National Bureau of Statistics (NBS) projections suggest a GDP growth of 7.27 per cent for 2014, its achievement will require careful planning and maintenance of stable macroeconomic environment. Precaution should be taken to safeguard the Naira, suggesting that monetary easing at this time is premature, however to guarantee growth, increasing rate could dampen the projections. It is therefore important to manage the inflation-growth nexus in the face of high level of poverty in the country. Base on this, focus must be on striking the right balance between interest rate and flexible exchange rate in the management of inflation.

The banking system continues to show high level of liquidity, suggesting that monetary easing at this time may be counterproductive. Banking system deposits at the CBN deposit facility has consistently been high. Even with OMO operations, Interbank and OBB rate still traded below the standing deposit facility rate at 10.54 per cent and 10.23 per cent respectively as at January 10, 2014. However, lending rates remained high at over 23 per cent, suggesting that care must be taken to manage the structural liquidity and the structural impediments to credit growth. In addition, pressure on the exchange rate window is impacting the foreign exchange reserves negatively. Therefore, a balance between defending the naira and saving the reserve must be struck for economic stability.

Global economic growth projection is showing some improvements boosted by recovery in major economies especially in the United States. The IMF upgraded the global economic outlook to 3.6 per cent form 2.9 per cent projected in the April World Economic Outlook (WEO) citing stronger US economy and return to positive but subdued growth in the euro zone. The Federal Reserve Quantitative Easing (QE) have helped channel cheap funds to emerging markets such as Nigeria helping to drive equity market growth and reserve build up. However, the Federal Reserve policymakers decided last month to cut the monthly bond purchases to $75 billion from $85 billion and suggested it would further trim its buying in future meetings if conditions continue to improve. Most analysts are of the opinion that economic conditions are positive enough to suggest that the Fed will continue reducing its bond purchases in 2014. This has implications for foreign inflows, reserve build up and exchange rate stability in emerging countries. There is also a possibility that as the cheap money from quantitative easing dries up, foreign investors could exit the country with consequences for the domestic economy. Therefore to remain competitive and attract foreign investors, tight monetary policy stance should be maintained.

Based on the above, with benign inflationary outlook, high structural liquidity and sustained pressure on the foreign exchange, I will support a no increase in Monetary Policy Rate, a 75 per cent increase in public sector deposits Cash Reserve Requirement (CRR) and a review of the midpoint in exchange rate band.

2.0 BARAU, SULEIMAN

i. REVIEW OF SIGNIFICANT DEVELOPMENTS

- **The estimated GDP growth rate of 6.87 for 2013 is impressive** and is an indication of a rebound in growth statistics as it is higher than 6.58% recorded in 2012. The 7.67% recorded in Q4 2013 did not only show a very strong rebound over growth performance in earlier quarters of 2013 but it is also higher than 6.99% recorded in corresponding period (Q4) of 2012.
- **The robust growth recorded in 2013 is inspite of the tight monetary measures** implemented by the CBN. A point may be made that this is below Nigeria's potential but we must also state that this development shows that what is required to spur radical growth in the real sector is the implementation of significant reforms that would make credit to gravitate towards that sector. The second point to make is that Nigeria's GDP growth is taking place at a time that other emerging economies such as India have not reversed

recent trends in GDP decline effectively since the beginning of the global financial crises. Finally, Nigeria's **GDP growth is substantially and consistently higher than Sub-Saharan African estimate of 5% in 2013**.

- **The global economy is showing strong signs of recovery**. The IMF expects global growth to accelerate from 2.9% in 2013 to 3.6% in 2014. While the US economy has shown signs of strong growth going into 2014, China and other emerging market economies are projected to continue to grow at levels that are higher than those of the advanced economies. Europe is also forecast to return to strong growth in 2014 after over two years of crisis. Overall the rebound in global growth would on balance be positive to developing economies including Nigeria.

- **Financial markets around the world were not significantly jolted by the "tapering"** announcement of December 18, 2013 by the US Federal Reserve System reducing monthly Asset Purchase program from $85 billion to $75 billion monthly. This is because markets had anticipated and largely factored in the expected "tapering". Latest job figures released in the US shows that targets have been missed and informed opinion suggest that ''tapering'' would continue to be gradual perhaps in magnitude of $10 billion reduction until end2014. What is very clear is that the Quantitative Easing measures of the Federal Reserve have helped the strong rebound of the US, reversal of slide in Europe and have supported recent modest growth in developing and emerging economies.

- **Domestic inflation remains largely subdued**. All measures of inflation remained at single digit. Headline Inflation (YoY) inched up marginally to 8.0% from 7.8% in December and November respectively. The Core measure continued its marginal upswing from 7.75% to 7.87% in November and December respectively. However Food Inflation moderated to 9.25% in December compared to 9.31% in November. It is important to highlight that month on month measures for the three broad measures of inflation have shown increasing tendencies.

- **Money markets rates were relatively stable during review period.** With average interbank call rate at 12.24% and OBB at 11.98%, rates were largely within the corridor throughout 2013. However, the sustained high spread between deposit and lending rates remain a source of concern for policy.

- **Exchange rates remained largely stable** particularly in the Wholesale/Retail (w/r) DAS and Interbank segments. The rate at w/r DAS witnessed appreciation of 0.04 in 2013 while interbank and BDC rates depreciated by 2.34% and 7.84%. Of concern is the premium between rDAS and BDC rates which has widened to 9.38% due largely to measures taken to check the uncontrolled outflow of funds at the BDC window.

- **The level of external reserves declined to $42.85 billion but they remain largely at decent levels**, capable of supporting over 10 months of import. There has been substantial downward pressure on the reserves due to a combination of declining revenues from sale of crude oil due to leakages and increased demand that is driven by the liquidity in the system.

ii. CHALLENGES/RISKS

The following (not in any particular order of importance) are the key pressure points facing the MPC;

- **Keeping inflation at single digit** in view of the forecasts for 2014 and the upward trend of the Core Inflation measure.

- **Reversing the declining levels of foreign reserves** particularly in view of the observed reduction in and likely reversal of foreign portfolio inflows following reversal of QE by the Fed of the USA.

- **Containing demand and supply issues at the Foreign Exchange market.** The supply issues are largely as a result of reduced revenues due to oil theft and other possible sources of leakages. Demand pressure is driven largely by the evidence of sustained liquidity, fiscal spending and market sentiment.

- **Checking the premium between rDAS and BDC rates**. The immediate cause for the sharp rise in premium is traceable to the recent measures taken by CBN to curb money laundering. This was aggravated by activities of clients who may have been forced to recourse to the use of foreign currencies to avoid charges associated with Naira cash withdrawals.

- **Preparing for the effect of capital outflows/''tapering''** The newly appointed US Fed Chief Yallen's statement that QE will continue through 2014 is a good development. The pattern of tapering is still a source for concern. A sudden and drastic reversal will lead to massive reversal of portfolio flows. It is gratifying that a survey of financial experts in the US suggests that ''tapering'' may be in monthly equal amounts of N10b.

- **Narrowing the spread between Deposit and Lending rates**. While market rates have remained stable, the spread between deposit and lending rates have remained disturbingly high. The shared services initiative of the banking industry when fully implemented would help to narrow spreads. Nigerian banks also have one of the highest costs of doing business but the weak state of the fixed income segments of the capital market, have also reduced options available to borrowers and this has led to the distortion in pricing the cost of capital by banks who now literally play in quasi-oligopolistic market scenario.

- **Pre—election year/fiscal spending** – liquidity injection is expected to be stepped up. This is perhaps responsible for the recent substantial reduction in the Excess Crude Account (ECA) balances. Further depletion of the ECA will increase the liquidity risk to the system and impact price stability negatively.

- **Oil price/international oil demand/global growth in oil production**; staff reports indicating that growth in production will marginally outstrip demand growth in spite of the shale oil developments make the oil price outlook, at least in the short run, to be positive. The crises in South Sudan and Syria though unfortunate, appear helpful. Strong oil price forecast should help or at least reduce the effect of oil revenue leakages and will impact portfolio flow risk but oil price collapse is still a risk we must keep in view given the volatile current state of the global economy.

iii. FOREIGN EXCHANGE, MARKET STABILITY AND FISCAL ISSUES

- Out of the above challenges, the issue of currency stability (exchange rate and smooth functioning of the foreign exchange market) should now take the centre stage in view of recent commentary advocating some form of depreciation or devaluation to address the strong demand and exchange rate premium between rDAS and BDC rates. I have the following comments on this matter;
- I am aware of the recurring debate as to whether the Naira is overvalued or not at the moment. The jury is still out there on this matter.
- The increased foreign exchange demand we have witnessed recently is driven by established high level of liquidity in the system which itself is caused by past accelerated fiscal spending.
- Depreciation of the Naira will have significant pass through effect on domestic prices and obviously wipe out the gains we have made in taming inflation. Besides, being an import dependent economy, depreciation will not benefit the economy unless we see structural reforms that will help diversify the economy, make our products/exports internationally competitive and stimulate exports.
- The aggravated demand for foreign exchange (for transfers/Letters of Credit, valid) that we have seen in 2013 is largely in the area of invisibles which has increased by 23.8% from 2012 to 2013 or 24% ($13.3b) and 48.2% ($26.1b) of total outflows.
- Total Demand for Foreign Exchange in 2013 was $35 billion while total accretion to reserves from purchase of foreign exchange from Government excluding autonomous sources was $45billion. At current estimated level of supply and demand, it is difficult to justify a depreciation. In this regard, it is difficult to rationalize market sentiment beyond saying that we should depreciate simply

because other emerging economies, with less strong market fundamentals, have also depreciated.

- In assessing the Naira/ dollar exchange rate, there are two levels of analysis that is required. Whether the demand/supply interplay is driven by fundamental or technical factors. In my view demand is not driven by fundamental but by technical factors and market sentiments which we could address. The second level is whether our response should be strategic or tactical. In terms of strategy, I recommend that currency stability is important given the consequence of depreciation on the economy unless it is absolutely necessary. We have a large number of tactical measures that we could take to contain some of the demand/supply pressures and by extension, the exchange rate. These have started and should be sustained. In addition to these, we need to take out further liquidity from the system so as to reduce the demand pressure. We should consider depreciation after these measures have failed.

iv. RECOMMENDATIONS

It is in view of the foregoing issues, challenges and pressure points that I voted as follows;

- That we maintain the current tight policy regime
- That we increase Cash Reserve Rate (CRR) to 15% and Public Sector CRR to 75%
- That we keep Monetary Policy Rate (MPR) at 12%
- That we maintain the corridor around MPR at plus and minus 2% on the Standing Lending and Standing Deposit Facilities.
- That we keep minimum Liquidity Ratio at 30%
- That we keep the Net Open Position limit at 1% of Shareholders Funds

3.0 GARBA, ABDUL-GANIYU

MY VOTE

i. I vote for (i) an increase in the CRR on public sector deposit from 50% to 75% and (ii) holding CRR on private sector deposit at 12%; MPR at 12% and the asymmetric corridor of ±2%.

JUSTIFICATION

ii. Given the structure of the Nigerian economy and, the inflation process in particular, a stable exchange rate is critical to the primary goal of price stability. Available evidence links the downward trend of the headline inflation from 12% in December 2012 to 8% in December 2013 to a stable exchange rate regime.

iii. Yet, a stable exchange rate regime has been achieved by sacrificing monetary policy independence a point that is theoretically obvious from the *impossible trinity* thesis. Ideally, the maintenance of stable exchange rate regime ought to make fiscal policy a more potent instrument for achieving growth and employment goals. However, the fiscal policy regime is yet to take advantage of the stable exchange rate and price stability to develop national economic competitiveness. Also, a non-forward looking and non-strategic management of oil and gas resources is failing to sustain inflows of forex revenue to support monetary policy in stabilizing the exchange rate with minimal tightening.

iv. It is clear to me that (i) a *forward looking* fiscal policy regime is critical to the attainment of macroeconomic goals in Nigeria; (ii) a *forward looking* fiscal policy depends on a commitment to the fiscal rules in the Fiscal Responsibility Act of 2007 and (iii) a strategic and forward looking management of oil and gas resources is critical to building the forex reserves required to support a stable currency.

v. The macroeconomic management in Nigeria as I indicated in my last personal statement faces two key *structural challenges* that need urgent attention. The first is the global challenge that is rooted in the *low interest rate and quantitative easing trap* that the major western economies have dug themselves into. The trap has (i) weakened the transmission mechanisms of policies (monetary and fiscal) and (ii) distorted financial-real economy relationships while causing financial markets to malfunction in the allocation and pricing of financial assets. As a consequence, global financial flows are threatening the financial and economic stability of emerging markets. The danger is acute for economies committed to exchange rate stability and free capital flows. This is because the monetary policy of such an emerging market could easily be trapped in a high interest rate regime because easing in such a regime will exert downward pressures on the exchange rate. A stable exchange rate and price regime could very easily unravel.

vi. To the extent that exchange rate stability is necessary for the attainment of the primary goal of price stability, and given the pressures that rising yield in developed economies are exerting on an expanding set of emerging countries, monetary policy has to be forward looking. Therefore, a monetary response to emerging dangers is necessary.

vii. I have always argued consistently for a *creative mix of policies and institutional changes* because institutions and the incentives they embed are critical to the strategies and outcomes of the games that economic agents play in Nigeria. For instance, while simplistic analysis will narrow policy options to that defined by the impossible trinity, creative analysis expands the choice set and enables a not only an informed choice but, a wise one. We now know from past experiences and evidence that a creative mix of policies works. We also know from studies and past experience that a regime of (i) lowering supply to BDC and (ii) rDAS creates arbitrage opportunities that rational players exploit and widens regardless of the fundamentals. Whereas, a positive current account balances and a positive balance on the financial flow account should lead to upward pressures on the exchange rate appreciation, arbitrage opportunities works contrariwise. In 2011, we confronted a similar situation that was effectively checkmated by appropriate reaction functions –policy/institutional.

viii. Of the options evaluated, the CRR on public sector deposits has proven to be very effective as an instrument of monetary policy. As we have argued since the July MPC, the increase in the CRR on public deposit is a game changer for monetary policy, for fiscal policy, for Nigerian financial markets and, for Nigerian banks.

Personal Statements have been providing forward guidance about the policy direction on public deposit. Forward looking fiscal policy operators ought to be working speedily towards a Treasury Single Account (TSA) while forward looking deposit money banks ought to be changing (i) their business model hence, (ii) the composition of their liabilities and assets.

ix. The increase in public sector CRR to 50% in July 2013 was complemented by financial system stability supportive measures. We now know as anticipated that the rise in OBB and interbank rate was short-lived. Also, that the short term interest rates (maximum and prime lending rates) were flat while the treasury bills rate has trended downwards. In addition, the composition of the deposits of the DMBs has been shifting significantly in favour of public sector deposits which rose by 148% to ₦5.9 Trillion by ending of December 2013.

x. In voting to increase the CRR on public sector deposit to 75%, I expect the fiscal authorities to speed up the process towards the Treasury Single Account (TSA) which I have consistently argued is "indispensable (i) to avoiding a high interest rate trap and (ii) to preparing the economy to soften the likely adverse effects of the low interest rate trap imploding."

xi. I have also anchored my vote on the premise that with "a more efficient and effective cash management that a Treasury Single Account will facilitate; the federal government would be a net lender to the economy. This will have several positive effects: (i) less dependence of DMBs on government securities; (ii) improved efficiency in the pricing and allocation of credit; (iii) transition from crowding-out effects of borrowing to crowding-in effects of government lending; (iv) rise in money multiplier through increased intermediation by DMBs; (v) potentially lower interest rates; (vi) less dependence on portfolio flows; (vii) more efficient pricing and allocation of financial assets and (viii) reduced risks of financial contagion."

4.0 MOGHALU, KINGSLEY CHIEDU

The Monetary Policy Committee meets at a time of significant uncertainty in which the immediate horizon for monetary policy is faced with strong challenges. In arriving at my vote I have taken into consideration the following factors:

- The role of fiscal factors in the current difficulties, marked by a severe decline in the Excess Crude Account over the past year, thus leaving the country dangerously vulnerable to external shocks as a result of the lack of fiscal savings. There is no indication that this situation will change in the near to medium term.
- Sharp declines in Foreign Direct Investment and portfolio inflows as a result of the commencement of a tapering of quantitative easing (QE) by the United States Federal Reserve Bank, but also partly owing to the depleting ECA.
- The difficulties that have buffeted the naira as an anchor of price stability, with the increased gap in rates between the official and parallel markets owing to bottlenecks in supply to bureau de change.
- The rise of core inflation, headline inflation, and staff projections of inflation heading upwards in the next six months. These forecasts are based largely on BDC rates for the naira, net credit to the government, and on the quantum of reserve money.

Against this background, the options before the MPC appear to be mainly between an intervention in monetary conditions through the Monetary Policy rate and\or the Cash Reserve Ratio by increasing either of both, or depreciating the naira while maintaining monetary conditions.

In favour of a currency depreciation we have the argument that the difference between the official and parallel rates has persisted for the past few months, and the CBN has spent significant amount of reserves to maintain the value of the currency, suggesting that perhaps the exchange rate may be artificial and there is a need to “bite the bullet” of depreciation. This is especially so when we consider that the CBN has for the last few years defended the value of the naira not in terms of seeking a fixed exchange rate but of a predictable band within which the naira can be traded, thus facilitating effective currency planning by economic actors. In this context the question becomes not if, but when will the CBN depreciate the naira – most likely by moving the mid-point of the band.

But the other side of this debate is question of whether, beyond the gap between the parallel and official markets, caused mainly by supply-side factors owing to controls imposed by the CBN on the importation of US dollars and restrictions on sales by banks to BDCs, there has been any change in the economic fundamentals to support a depreciation of the naira. In this context I note that the price of oil, the most important factor, has remained strong. And the role of the naira as an anchor of stability and its characteristic as a major pass-through channel of inflation, the need to manage expectations for the year 2014 - a sensitive year in Nigeria's political economy- and the unpredictability of the fallout of a naira depreciation, all argue for a response through monetary conditions and not the exchange rate at this time. In the absence of a fundamental change of circumstance in the fundamentals that support the value of the naira, a depreciation of the currency is not called for at this time and devaluation should be a last option.

Monetary tightening through the CRR will help control liquidity and contribute further to structural reform of bank lending to the real sector instead of the pursuit of public sector deposits. It will also help conserve declining foreign reserves. Here, however, it is important to keep concerns about financial stability in mind, as banks and bank borrowers have long borne the brunt of fundamental structural problems in the decision-making paradigm of the MPC.

Based on the foregoing considerations, I vote to:

- Increase the CRR for public sector deposits from 50 per cent to 75 per cent, and the CRR for private sector deposits from 12 per cent to 15 per cent.
- Maintain the MPR and the minimum Liquidity ratio at their present levels of 12 per cent (with the corridor at plus or minus 2 per cent) and 30 per cent respectively.

- Maintain the present band of the naira exchange rate and take administrative measures to close the gap between the RDAS and BDC rates of exchange of the naira.

5.0 ORONSAYE, STEPHEN OSAGIEDE

Statistics from the National Bureau of Statistics (NBS) since the last Monetary Policy Committee (MPC) meeting in November 2013 projected fourth quarter Gross Domestic Product (GDP) for 2013 to grow by 7.67 per cent compared to 6.58 recorded in the corresponding period of 2012.

Although all measures of inflation remained within single digit, headline inflation appears to be on the rise. The Naira has continued to enjoy a great deal of stability because of the intervention of the CBN, however, the Bank may not be able to sustain this for a long time unless certain structural challenges are addressed

There is huge disparity between the official exchange rate of the Naira and the rate at Bureaux de Change (BDCs), which needs to be addressed to avoid the pass-through inflation. Therefore, we need to take appropriate steps to check the wide gap in the exchange rates. While we must remain committed to a stable exchange rate, I do not support depreciation in the value of the Naira. For me, the fundamentals on ground do not support such a move: oil prices are still high and there are no threats presently. I believe that the cost of a weaker currency far outweighs the benefits to the economy.

The MPC noted that Broad money supply (M2) shrunk by 4.82 per cent in December 2013 compared to the growth of 16.39 witnessed during the corresponding period of 2012. We also noted that the aggregate domestic credit at the end of December 2013 was below the provisional benchmark of 22.98 per cent for 2013. The decline in Broad money supply is attributable to a fall of 5.86 per cent in the country’s net foreign assets. This calls for greater fiscal discipline and monetary tightening.

The bulk of public sector funds are still in Deposit Money Banks (DMBs) and I do not think there is any reason why all public sector funds should not be back to the CBN. I am of the view that the CBN should have a deliberate constructive engagement with the Federal Ministry of Finance in order to address areas of concern, if any.

We have consistently held MPR at 12% and achieved stability. Those conditions for maintaining the rate at that figure have still not changed. Therefore I support the view that we do not tamper with the rate at this point in time.

On the Cash Reserve Requirement (CRR) on deposits from the Public Sector, I think that the impact has been positive on the financial system. Consequently, I am persuaded to support an increase in the CRR on public sector deposits from 50% to 75%.

Votes

Based on the foregoing, I voted for the following:

a) Holding the MPR at 12%;
b) Retaining the symmetric corridor of 200 basis point around the MPR;
c) Retaining the Cash Reserve Requirement (CRR) at 12% for deposits from the private sector;
d) Increasing the Cash Reserve Requirement (CRR) on deposits from the Public Sector from 50% to 75%; and
e) Maintaining Liquidity Ratio at 30%.

I also voted that the Central Bank of Nigeria urgently addresses the imbalance in the BDC segment while also stepping up its anti-money laundering (AML) activities.

6.0 SALAMI, ADEDOYIN

Headline inflation in December 2013 ended the year at 8 per cent, which, though marginally higher than the 7.9 per cent reported for the previous month, took the average for the year to 8.5 per cent a position much better than the 12.2 per cent average for 2012.

Notwithstanding the continuous deterioration in Core inflation from its mid-year low of 5.5 per cent to 7.9 per cent at year end, its average for the year of 7.7 per cent also marks an improvement on the 13.9 per cent in the previous year. The satisfaction of that position is however slightly undermined by realization that Core inflation continued to edge higher since July 2013.

The nature of challenges to confront monetary policy making in Nigeria this year began to define themselves last year. It had already been apparent before the close of 2013 that the key factors to take shape the direction and nature would include –

- Pace of and reaction to the tapering of Quantitative Easing by the Federal Open Markets Committee of the US Federal Reserve;
- Fiscal Dominance arising from dwindling revenues and its implication for Reserves and currency management;
- The dynamics and impact of risks related to the electoral cycle.

It was already clear that 2014 would be a challenging year for making monetary policy. Whilst the questions already suggested themselves, the most pervasive being around currency rates and the implications for policy credibility, there were few answers. The wall of data provided for this meeting provided cold comfort.

The first conclusion from the data is a worsening outlook for inflation. Six-month forecasts provided by Bank Staff for the meeting in November suggested would drop from 8.3per cent in December 2013 to 7.2 per cent in March 2014 before rising to 8.1 per cent the following month. Bank Staff now expect Headline inflation to be 8.4 per cent in April 2014 and further increase to 9.2 per cent by June 2014. A similar trend is expected for Core and Food inflation. Indeed, the rate of increase in food prices is expected to cross into 'double digits' in May 2014.

Beyond the worsening prospects for inflation, available data show a continuing deterioration in fiscal performance. A sharp increase in expenditure, especially ahead of an election, is the typical fear on the fiscal side. Available data shows continuing revenue weakness. Data from the Office of the Accountant General of the Federation (OAGF), the Central Bank of Nigeria (CBN) and the National Bureau of Statistics (NBS) show that between 2011 and 2013, average crude oil prices and production dropped by 1.02 per cent and 5 per cent respectively. In the same period the average annual decline in revenue from Crude oil dropped almost 12 per cent. In consequence of this, our fiscal savings, represented by the Excess Crude Account, dropped from NGN1.551trn in Dec 2012 to NGN0.434trn in Dec 2013. A continuation of this trend almost certainly implies higher levels of government borrowing putting worsening the challenge of ‘crowding out’ amongst others.

Failure to rebuild fiscal buffers is also reflected in the FOREX Reserve data. At US$43.8bn in mid-Jan 2014, forex reserves are almost 10 per cent lower than the 2013 high of US$47.8bn in March. Furthermore, the Federation Reserves component, which represents Excess Crude savings, amounted to US$42.48bn – down from US$11.46bn in December, 2012. The deterioration in Foreign Reserve position also reflects a slowdown in inflows from Foreign Portfolio investors (FPI). Whilst FPI inflows, at US$19.182bn in 2013, accounted for approximately 82 per cent of capital importation in 2013, there was a noticeable slowdown in the Q3-2013. Indeed, both FPI and Foreign Direct Investment (FDI) slowed significantly. It is not unlikely that QE tapering by the US Federal Reserve is a contributory factor in the slowdown of FPI flows.

Recent pressure on the Naira at the Foreign Exchanges reflects a combination of restricted supply to the Bureau de Change (BDC) segment of the market and heightened expectations of currency depreciation. From the perspective of economics theory, a persistent surplus on our current account, resulting from high oil price, should see the Naira strengthen. However, the failure to build reserves has resulted in strengthening expectation of that the Naira will lose value. This expectation has been manifested in a continuing switch from Naira to foreign currency denominated deposits – a trend I had previously described as ‘retail hedging’.

Unless the Fiscal side shows significant improvement imminently, the options for monetary policy may become glaringly inconsistent with the objectives and policy direction for the economy in Nigeria. For monetary policy, the challenge of managing the internal and external value of the Naira is a core element of its mandate. Achieving inflation rate of 6-9 per cent in 2014 requires a stable currency. The model articulated, in various documents, for the growth and development of the larger economy in Nigeria is predicated on Import substitution. Similar to attainment of the mandate that the Central Bank of Nigeria (CBN) achieve price stability, import substitution requires a stable, even strong currency!!

Given the data and information laid before my colleagues and I on this occasion – in particular, the immediate and emerging build-up of banking system liquidity, it is clear that there is a need to respond to the pressure on the currency and forestall the build-up of further pressure. The measures which I have supported, further sterilizing government deposits by raising the Cash Reserve Ratio to 75 per cent and easing the constraint on supply to the BDC segment of the forex market, should, in the short term, achieve the objectives set. However, it is increasingly clear that we are approaching the limits for using the cost of credit as a management tool without inflicting damage on the growth and development aspirations of the economy.

7.0 UCHE, U. CHIBUIKE

In previous MPC meetings, I have consistently argued that poor fiscal management remains the major impediment to the promulgation of effective monetary policy in our country. In the past, such poor fiscal management practices which include increasing levels of oil theft and excessive and sometimes unnecessary borrowings have contributed materially to monetary tightening by MPC. While such tightening may have helped achieve the desired single digit interest rate which has lasted for some time now, the fact remains that this has to a great extent been done at the cost of growing the real sector of the economy. Government has for instance increasingly, directly and indirectly, crowded out the private sector in the market for loans and advances. The primary goal of monetary stability, which is the promotion of real sector economic development, has therefore been subordinated to funding government fiscal indiscipline. At the November 2013 MPC meeting, for instance, I explicitly asserted thus:

> The danger fiscal policy poses to development of effective monetary policies in Nigeria becomes stark when one considers the

mechanism of cash management by government. For over one decade, all parties are in agreement that a Treasury Single Account (TSA) will provide the most effective platform for managing government funds. At the very least, the incessant practice of unnecessary borrowings at high interest rates while simultaneously holding huge balances in non interest yielding deposits will be greatly curtailed. Despite this simple logic, government is yet to implement the TSA. This has led to widespread allegations that private interests within government policy making circles are colluding with banks and benefitting handsomely from the status quo through the receipt of deposit brokerages.

It was because of my above view that I voted for an increase in CRR on public sector deposits at the said meeting. Although I was in the minority at the time, I still believe that this is the way to go. Available evidence from our decision to increase CRR on public sector deposits to 50 per cent in July 2013, for instance, show that this is one form of monetary tightening that has led to increased lending to the real sector by banks. This is so because the incentive for banks to earn rent income by simply colluding with government officials to privately place government deposits in such banks has been reduced. Banks have therefore been forced to focus more on their intermediation function which is what leads to economic development.

Another way of making the above point is to argue that increasing CRR on public sector deposits will reduce the incentive for government officials to make suboptimal decisions in the management of government funds for personal interests. In other words, increasing CRR on public sector deposits will have a direct impact on government fiscal management. An obvious consequence of the above will be the reduction in government debts.

I am aware that some stakeholders are very critical of the use of CRR because of its blunt nature and direct impact on the cash-flow of banks. It is however important to note that the use of CRR on public sector deposits is in itself an anomaly. If, for instance, a TSA is in place and all government deposits domiciled in the CBN which is the official banker to Government, the issue of using CRR on such public sector deposits will not arise in the first place.

It is also pleasing to note that the tightening of monetary policy through increasing CRR on public sector funds at the present time is unlikely to attract further speculative foreign capital. This is especially so given the fact that available statistics suggests that recent international developments have already ensured a slowdown in the inflow of such speculative capital. Despite this, I find it prudent to continue to express my concern about speculative capital. This is because the vulnerability of the value of our currency in recent times has at least in part been as a consequence of the unstable nature of such speculative FDI. The earlier we begin to discourage such capital flows, the better. Admittedly, this has to be gradually and skillfully done to prevent sudden capital flight. While FDI is desirable, it only makes sense when it is invested in the real sectors of our economy.

As already mentioned, increasing CRR on public sector deposits will make banks to focus more on their intermediation function. An obvious consequence of this will be enhanced competition amongst the banks which will at least in the medium term begin to reduce the unacceptable wide spread between deposit and lending rates in the country.

Another issue of concern for me is the widening gap between the r/wDAS exchange rate and the Bureau de Change exchange rate for the Naira. This creates huge incentives for banks and regulators to exploit the system and earn arbitrage profits. This is even more troubling in an import dependent economy like ours where the BDC rate is gradually becoming the benchmark for prices of imported commodities. This might explain why core inflation is gradually inching up. I therefore believe that the time has come for us to rethink our BDC policies with the objective of reducing the gap between BDC and r/wDAS exchange rates. Surely there must be effective ways of curtailing money laundering in our economy without materially affecting the supply of foreign exchange to Bureau de Changes.

In conclusion, I am convinced that the greatest threat to effective monetary policy in the country is the way government conducts its fiscal policy. Government fiscal management problems have increasingly made it difficult for monetary policy to be effective. Thankfully, monetary policy is not altogether helpless. Using monetary policy to force government to implement the TSA will, at least to some extent, help improve government fiscal policy management. Equally important is the fact that it will help to refocus banks on their intermediation function which is central to promoting economic development.

In the light of the above factors, I hereby vote as follows: (1) to retain MPR at 12 per cent with interest rate corridor of + 200/- 200 basis points; (2) to retain CRR at 12 per cent but increase CRR on government deposits from 50 per cent to 75 per cent; and (3) to retain Liquidity Ratio at 30 per cent.

8.0 SANUSI LAMIDO SANUSI, GOVERNOR AND CHAIRMAN, MONETARY POLICY COMMITTEE

Barely a few weeks before this MPC meeting, one was looking forward to a very routine meeting at which we would review the economic environment and outlook, congratulate ourselves for a job well-done, and leave everything unchanged. The sense of calm is not entirely without basis.

GDP growth has remained robust in spite of high interest rates. Inflation remained firmly in single-digit range for the entire year 2013, the first time this has happened since 2007. The equity market is doing extremely well and is performing almost as well as it did before the financial crisis. AMCON has reduced its indebtedness by about N1trillion. As we predicted, there was no disruption to the market despite the unfounded but understandable alarm raised by many analysts.

Yet, complacency and self-congratulation are extremely dangerous and if unchecked could turn stability into the calmness before a storm. Our task is to always look out for red flags and anticipate the possible impact on stability.

The most obvious red flag is the fiscal space. In January 2014, we are yet to have a budget approved, and there is no end in sight to high recurrent spending. The Federation has squandered its Excess Crude Savings, from $11.5billion at the beginning of 2013 to under $2.5billion today. This, moreover, has happened in a period of high and stable oil prices and high levels of production and crude lifting, in spite of losses due to oil theft and vandalism. Clearly, huge fiscal leakages continue to exist in the oil sector as will become manifest at the conclusion of on-going debates around NNPC remittances to the Federation Account. To compound the problem, we saw in Q4:3 a significant collapse in portfolio and FDI flows as a result of QE tapering in the US, concerns over leadership transition at the Bank and alarm at the rate of depletion of fiscal savings. As a result of the above, the Bank has had to increase funding of the forex market to avoid currency depreciation. But this has also meant a return to the era of attrition of foreign exchange reserves.

On the monetary side, measures aimed at curbing money laundering disrupted the equilibrium in the BDC market through curbs on supply, leading to the emergence and widening of a gap between exchange rates in the inter-bank and BDC segments. The weak naira at BDC has fed into costs and creeping inflation and threatens to reverse some of the progress made in the recent past. The BDC rate is also not helped by ill-advised tariff regimes which force eligible demand onto the parallel market thus compounding the shortage in that segment.

It is therefore not entirely surprising that exchange rates, reserves and fiscal leakages formed the fulcrum for our discussions these past two days. We have had to deal with a number of difficult questions: Do we need a monetary response now, or do we wait until next MPC? If we chose to respond, should we allow the Naira to depreciate or reaffirm our commitment to keeping it stable within current range? If we opted for the latter in the wake of declining foreign currency inflows and savings, how could we best defend the Naira? Do we deplete our reserves and expose the economy to greater risk; or tighten money at the risk of a big public and political outcry? These decisions are never easy.

My position is as follows:
On the exchange rate, I continue to maintain that stability must continue to be the lodestar of monetary policy and a weak naira will wipe out investor profits, lead to a bearish run on the stock exchange, stoke up inflation and ultimately result in even more extreme tightening without offering any tangible benefits. For me, letting the naira depreciate is an absolute last resort after all attempts at stabilizing it have failed, or where the cost of supporting the currency becomes unbearable.

I also do not see any wisdom in depleting reserves to support the currency. In any case, this strategy fails once reserves fall to a level where investors believe we do not have the ammunition to support the currency.

I have never believed we were at the end of our tightening cycle. Pushing up interest rates may not be a priority given the already high yields in our market and given that only about 10% of portfolio flows are in fixed income instruments. But we need to continue attacking the structural liquidity surfeit in the system. By tightening monetary conditions and increasing the supply of dollars to the BDC segment we can stabilize the currency and achieve convergence.

My vote is

i. To increase CRR on Public Sector to 75% for now, with a view to getting to 100% if need be later in the year;
ii. I also vote with the minority for increasing Private Sector CRR to 15% as this reduces incentive for arbitrage and adds bite to the tightening measures;
iii. I support retention of MPR and LR at current levels;
iv. Administrative measures should be taken to restore equilibrium to the BDC segment. I vote accordingly.