CENTRAL BANK OF NIGERIA COMMUNIQUÉ NO 120 OF THE MONETARY POLICY COMMITTEE MEETING OF MONDAY 24th AND TUESDAY 25th SEPTEMBER, 2018

Background

The Monetary Policy Committee (MPC) met on the 24th and 25th of September, 2018 and evaluated developments in the global and domestic economic and financial environments in the first eight months of 2018, as well as the outlook for the rest of the year. Ten members of the Committee were in attendance.

Global Economic Developments

The Committee noted the uneven expansion in global output amidst growing trade tension, rising oil prices and debt levels as well as currency depreciation in most of the notable emerging markets and developing economies. These developments notwithstanding, there was evidence of resilient financial markets and output growth in the advanced economies led by the United States, which experienced sharp improvements in output growth. In the Euro area, United Kingdom and Japan, the pace of growth was moderate but steady, while in the Emerging Markets and Developing Economies (EMDEs), growth was sluggish and relatively uneven.

Growth in the advanced economies was projected to remain at 2.4 per cent in 2018, same as in 2017, led by the US which grew by 4.1 per cent in Q2 2018 and is projected to grow by 2.9 per cent in 2018. The Euro area and Japan, grew by 0.4 and 0.7 per cent, respectively, in Q2 and are projected to grow by 2.2 and 1.0 per cent, respectively, in 2018. In the EMDEs and Developing Economies, growth is expected to remain strong at 4.9 per cent in 2018 compared with 4.7 per cent in 2017. Growth in the EMDEs is expected to be led by India and China, which are projected to grow by 7.3 and 6.6 per cent, respectively, in 2018.

On average, the momentum of the global economy remained on track towards achieving the 2018 growth projections of 3.9 per cent as financial conditions remain broadly favourable with limited spill over of trade tensions amongst the general political sentiments. However, the recent episodes of large-scale flooding in major areas across the globe could pose some threat to growth.

Accordingly, the MPC believes that rising oil prices, tighter financial conditions, higher yields in the advanced economies and capital flow reversal from the EMDEs, resulting in pressure on currencies of some countries with fragile conditions, as well as growing trade tensions between the US and China, would continue to shape developments in the EMDEs in the medium term.

Domestic Output Developments

Available data from the National Bureau of Statistics (NBS) showed that real GDP growth declined by 45 basis points as the economy grew by 1.50 per cent in the second quarter of 2018, down from 1.95 per cent in the preceding quarter, but higher than 0.72 per cent in the corresponding quarter of 2017. The growth slowdown was traceable to contraction in the oil sector in the second quarter of 2018, compared with the previous quarter. The Committee noted that non-oil real GDP grew by 2.05 per cent, reflecting the strong performance of construction, services and agriculture, which grew, by 7.66, 4.19 and 1.19 per cent, respectively. Furthermore, the non-oil sector was similarly supported by the stability in the foreign exchange market, continued implementation of the 2017 capital budget and the on-going interventions of the Bank in the real sector of the economy.

The MPC was of the view that even though growth remained weak, the effective implementation of the 2018 FGN capital budget and policies that would encourage credit delivery to the real sector of the economy would boost aggregate demand, stimulate economic activity and reduce unemployment in the country.

Developments in Money and Prices

The Committee noted that relative to the level at end-December 2017, Broad Money (M2) grew by 2.98 per cent in August 2018, annualised to 4.47 per cent, but below the provisional benchmark of 10.48 per cent for 2018. The growth in M2 was largely driven by growth in Net Foreign Assets (NFA) of 18.63 per cent in August 2018, annualised to 27.94 per cent and above the provisional growth benchmark of 18.15 per cent for the year. Net Domestic Credit (NDC), however, contracted by 4.18 per cent, annualized to 6.27 per cent, in contrast to the growth benchmark of 12.45 per cent for 2018. The contraction in NDC was attributed to the 34.68 per cent contraction in net credit to the Government in August 2018.

Conversely, credit to the private sector grew marginally by 0.81 per cent in August 2018 from a contraction of 0.13 per cent in July 2018, annualized to 1.21 per cent, against the annual benchmark of 5.64 per cent.

The MPC observed that despite the under-performance of key monetary aggregates, headline inflation (year-on-year) inched up to 11.23 per cent in August 2018, from 11.14 per cent in July 2018. The rise in headline inflation was from food, while core inflation declined, indicating that supply side factors were driving the price increase. The near-term upside risks to inflation remained the dissipation of the base effect, expected 2019 election-related spending, continued herdsmen attack on farmers and the current episodes of flooding which has destroyed crops and would affect food supply and prices. In this regard, the Committee urged the fiscal authorities to ensure sustained implementation of the 2018 budget to relieve the supply side growth constraints, as well as address the flooding incidence which has become perennial, on a permanent basis.

The average inter-bank call rate declined from 9.0 per cent in July 2018, to 4.0 per cent on September 20, 2018. Similarly, the average Open Buy Back (OBB) rate declined from 11.44 to 4.72 per cent over the same period. The relative decline in market rates reflected the increased statutory allocations to states and local governments and maturing securities. The development did not significantly transmit to retail interest rates as average maximum lending rates marginally declined to 30.93 per cent in August from 31.09 per in July 2018. Similarly, average prime lending rate decreased to 16.65 per cent in August from 16.83 per cent in

July 2018. The weighted average deposit rate also declined to 4.57 per cent in August from 4.79 per cent in July 2018, widening the spread between the average lending rate and weighted average deposit rate to 26.36 per cent in August 2018 from 26.30 per cent in July 2018.

The Committee noted the decrease in external reserves to US$44 billion on September 20, 2018 from US$45 billion at the end-July 2018. Total foreign exchange inflow through the economy fell by 38.34 per cent to US$6.00 billion in July from US$9.73 billion in June 2018. The Committee believes that accretion to external reserves should strengthen in the last quarter of 2018, with crude oil price remaining above the budget benchmark price of US$51.00 per barrel and oil production increasing to 2.3 million barrels per day.

The Committee, noted the relative stability in both the Investors' and Exporters' (I&E) window of the foreign exchange market, which was sustained by autonomous inflows and measures taken by the Bank to deepen the foreign exchange market and curb speculative practices.

The MPC expressed concern at the decline in major capital market indices. The All-Share Index (ASI) decreased by 14.99 per cent to 32,540.17 on September 21, 2018 from 38,278.55 at end-June 2018. Similarly, Market Capitalization (MC) decreased by 14.33 per cent to N11.38 trillion on September 21, 2018 from N13.87 trillion at end-June 2018. The development was due largely to sustained profit-taking by portfolio investors and capital reversals as foreign yields become increasingly more attractive.

The Overall Outlook and Risks

Available data and forecast of key macroeconomic indicators show a positive outlook for the economy in the third quarter of 2018. The Committee expects that sustained implementation of the 2018 budget, improvements in the security situation and sustained stability in the foreign exchange market will stabilize prices and strengthen economic growth. Growth in the non-oil sector, especially agriculture, manufacturing, services and light industries are expected to drive output growth over the medium term. The Committee, however, identified the downside risks to the outlook to include: the impact of increased monetary policy normalization in the advanced economies and the strengthening US dollar. Others are: the late implementation of the 2018 budget, weakening demand and consumer spending, build-up in contractor debt, low minimum wage, impact of flooding on agricultural output and other economic activities, continuing security challenges across the North-East and North-Central zones, and growing level of sovereign debt.

The outlook for the year, however, remains positive as the economy is projected to grow by 1.75 per cent in 2018, anchored on continued stability in the foreign exchange market, sustained high price and production of oil and improved electricity supply.

Inflation outlook suggests a mild resurgence of inflationary pressure in the economy, traceable largely to cost-push factors, election related spending, amongst other domestic factors. The moderating factors to the outlook would include; improved power supply, increased expenditure on capital projects and improved security conditions, all of which may exert downward pressure on consumer prices in the near-term.

The Considerations of the Committee

The Committee appraised the macroeconomic environment and noted that at its July meeting, modest stability had been achieved in key indicators, including inflation, exchange rate and external reserves. In particular, relative stability had returned to the foreign exchange market, buoyed by a robust level of external reserves with inflation trending downwards for the 18th consecutive month. These gains so far achieved appear to be under threat of reversal, following new data which provides evidence of weakening fundamentals. The Committee identified rising inflation and pressure on external reserves created by capital flow reversal as the current challenges to growth. It noted that inflationary pressures have started rebuilding and capital flow reversals have intensified as shown by the bearish trend in the equities market even though the exchange rate remains very stable.

The Committee was concerned that the exit from recession may be under threat as the economy slowed to 1.95 and 1.50 per cent in Q1 and Q2 2018, respectively. The Committee noted that the slowdown emanated from the oil sector, with strong linkages to employment and growth in other key sectors of the economy. In this regard, the Committee urged government to take advantage of the current rising oil prices to rebuild fiscal buffers, strengthen government finances in the medium term and reverse the current trend of decline in output growth. The MPC also called on the fiscal authorities to intensify the implementation of the Economic Recovery and Growth Plan (ERGP) to stimulate economic activity, bridge the output gap and create employment.

The Committee noted that disruptions to the food supply chain in major food producing states due to the combined effects of poor infrastructure, flooding and the on-going security challenges resulted in a rise in food prices, contributing to the uptick in headline inflation. The Committee was, however, 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 impact on food prices.

The MPC expressed concern over the potential impact of liquidity injections from election related spending and increase in FAAC distributions which is rising in tandem with increase in oil receipts.

The Committee was concerned with the rising level of non-performing loans in the banking system, traced mainly to the oil sector and urged the Bank to closely monitor and address the situation. It also expressed concern over the weak intermediation by Deposit Money Banks and its adverse impact on credit expansion and investment growth by the private sector.

In view of the above developments, the MPC noted that the economy was still confronted with growth headwinds and inflationary pressures. It reiterated the need for synergy between monetary and fiscal policies as a viable option for macroeconomic stability. The Committee, therefore, identified two likely policy options as tightening or maintaining the status quo ante. Tightening would tame inflationary pressures, stem the reversal in portfolio capital, improve the external reserves position and maintain stability in the foreign exchange market. Conversely, the MPC felt that raising rates would further weaken growth as credit would become more expensive, NPLs would increase further, leading to a deceleration in output. In the Committee's opinion, the upward adjustment would not only signal the Bank's commitment to price stability but also its desire to maintain positive real interest rates.

A decision to hold all policy parameters constant would sustain gradual improvements in output growth, maintain the current monetary policy stance and await a clearer understanding of the quantum and timing of liquidity injections into the economy before deciding on possible adjustments. The MPC, however, called on the government to fast track the implementation of the 2018 budget to help jumpstart the process of sustainable economic recovery, and to facilitate passage of the Petroleum Industry Bill in order to increase the contribution of the sector to overall GDP.

The Committee's Decision

In light of the above, the MPC decided by a vote of seven (7) members to retain the MPR at 14 per cent. However, three (3) out of these seven (7) members voted to raise the Cash Reserve Requirement (CRR) by 150 basis points, an indication that left to them, we should have tightened. The other three (3) members voted to tighten by raising the MPR by 25 basis points.

In summary, the MPC voted to:

I. Retain the MPR at 14 per cent;
II. Retain the asymmetric corridor of +200/-500 basis points around the MPR;
III. Retain the CRR at 22.5 per cent; and
IV. Retain the Liquidity Ratio at 30 per cent.

Thank you.

Godwin I. Emefiele
Governor, Central Bank of Nigeria

25th September 2018