



## **CENTRAL BANK OF NIGERIA COMMUNIQUÉ NO 119 OF THE MONETARY POLICY COMMITTEE MEETING OF MONDAY, 23RD AND TUESDAY, 24TH JULY, 2018**

### **1.0 Background**

The Monetary Policy Committee (MPC) held its 262<sup>nd</sup> meeting on Monday, 23<sup>rd</sup> and Tuesday, 24<sup>th</sup> July, 2018 amid fragile improvements in global growth and the domestic economic recovery. The Committee reviewed developments in the global and domestic economic and financial environments, as well as the outlook for the rest of the year. The MPC also assessed the risks to price stability, credit growth, employment creation and financial system stability, in the short-to-medium term. Ten (10) members of the Committee were in attendance.

### **Global Economic Developments**

Global growth momentum remained promising despite rising trade tensions, uncertainties in BREXIT negotiations and scepticism over North Korea's commitment to the denuclearise the Korean Peninsula. Global growth was projected at 3.9 per cent in 2018, compared with 3.7 per cent in 2017, largely driven by the recovery in oil prices, rising asset prices and long term yield on major financial markets as well as a rebound in investment, manufacturing output and trade.

In the Advanced Economies, growth was projected at 2.4 per cent in 2018, the same as in 2017. The growth was expected to be driven majorly by fiscal stimulus in the United States coupled with accommodative financial conditions. In the Emerging

Markets and Developing Economies output growth was projected at 4.9 per cent in 2018, up from 4.7 per cent in 2017, due largely to sustained recovery in global commodity prices (particularly crude oil); rebound in investment, manufacturing and trade as well as the strengthening of domestic consumption.

The downside risks to global output growth remains the build-up in financial vulnerabilities; rising costs of borrowing in the Emerging Markets and Developing Economies; fragile corporate balance sheets; escalating trade protectionism, uncertainties around the BREXIT negotiations; heightened geopolitical tensions; and fiscal sustainability concerns.

Global inflation was projected at 3.2 per cent in 2018, driven by rising energy prices, and currency depreciations in some emerging market and developing economies. In the advanced economies, inflation was projected to increase to 2.2 per cent in 2018, up from 1.7 per cent in 2017, as a result of increases in the cost of transport, housing, energy and food. Similarly, inflation in the emerging markets and developing economies is projected to rise from 4.0 per cent in 2017 to 4.4 per cent in 2018, due to currency depreciations and rising energy prices. The Committee believes that global inflation is likely to remain subdued over the medium term relative to long term trends despite subsisting monetary accommodation in some advanced economies.

### **Domestic Output Developments**

Economic recovery was sustained with a positive outlook over the medium-term, anchored on oil price recovery, fiscal spending and stability in the foreign exchange market. Data from the National Bureau of Statistics (NBS) showed that real Gross Domestic Product (GDP) grew by 1.95 per cent in the first quarter of 2018, compared with 2.11 per cent and a contraction of 0.91 per cent in the preceding and

corresponding quarters of 2017, respectively. The oil sector, which contributed 1.26 per cent in Q1 2018, compared with 0.76 per cent during Q4 2017 was the major source of the growth. The Purchasing Managers Indices (PMI) for manufacturing, and non-manufacturing activities rose for the fifteenth and fourteenth consecutive months to 57.0 and 57.5 index points, respectively, in June 2018. The Committee noted the positive impact of the sustained improvement in foreign exchange supply on the performance of manufacturing and other key sectors of the economy. The Committee welcomed the positive economic growth, but observed that the recovery was still fragile and called for the speedy implementation of the 2018 Federal Government Budget and the Economic Recovery and Growth Plan (ERGP) to strengthen output growth in the Nigerian economy.

### **Developments in Money and Prices**

The Committee observed that Narrow money (M1), contracted by 4.25 per cent, annualised to -8.49 per cent, relative to the provisional benchmark of 8.04 per cent. Broad money supply (M2), however, grew by 2.79 per cent in June 2018, annualised to 5.58 per cent, compared with the provisional growth benchmark of 10.84 per cent for fiscal 2018. The increase in M2 was mainly driven by Net Foreign Assets (NFA), which grew by 18.15 per cent in June 2018, annualised to 36.30 per cent, compared with the provisional benchmark of 18.15 per cent for 2018. The development reflected improvements in foreign receipts arising from favourable crude oil prices. On the other hand, Net Domestic Credit (NDC) contracted by 1.40 per cent, annualized to -2.80 per cent, compared with the provisional benchmark of 12.45 per cent. The development was driven largely by the decrease in net credit to government, which contracted by 9.74 per cent in June 2018, annualised to -19.48 per cent against the provisional

benchmark of 54.97 per cent. Credit to the private sector similarly contracted by 0.04 per cent, annualised to -0.08 per cent in June 2018, in contrast to the provisional annual benchmark of 5.64 per cent.

A revised and seasonally adjusted money supply aggregate, however, showed an uptick. The new aggregate (M3), which is still being finalised by the Bank, appears to comprehensively capture the liquidity in and outside the banking system, compared with the existing M2. More details about the impact of M3 on macroeconomic variables would be reviewed at future MPC meetings.

Headline inflation (year-on-year) trended downwards for the seventeenth consecutive month to 11.23 per cent in June 2018 from 11.61 per cent in May 2018. Food and Core inflation also fell to 12.98 and 10.40 per cent, from 13.45 and 10.71 per cent, respectively, over the same period. The Committee, however, noted the rise in the month-on-month inflation rate, to 1.24 per cent in June, from 1.09 per cent in May 2018. Food inflation (month-on-month) also increased from 1.33 per cent in May to 1.57 per cent in June 2018, representing an increase of 0.24 percentage point. During the same period, core inflation (month-on-month) also rose by 0.05 percentage point, from 0.98 per cent in May to 1.03 per cent, in June 2018. In view of the trend in rising month-on-month inflation rate, amid the slowly declining year-on-year headline inflation, indications were that inflationary pressures are rebuilding in the domestic economy.

The review of developments in the money market revealed that the average inter-bank call rate fell to 5.0 per cent in June 2018, from 25.43 per cent in May 2018, while the average Open Buy Back (OBB) rate decreased from 18.37 per cent in May 2018 to 10.84 per cent in June 2018. The trend in market rates and the net liquidity position

reflected the impact of the auction of Open Market Operations (OMO) bills, foreign exchange interventions, FAAC allocations to various levels of government, as well as the servicing of maturing CBN Bills.

External reserves stood at US\$47.2 billion on July 23, 2018. The Committee was optimistic and expected further increases in the level of external reserves in the near term, citing the favourable crude oil prices. The Committee, therefore, advised the Bank to sustain its current efforts to maintain investor confidence and ensure accretion to external reserves. The MPC also called on the Federal Government to continue to build fiscal buffers against possible oil price shocks in the future. Noting that the rise in the monthly distribution of revenues at the FAAC portend the danger of the absence of reserve buffers to absorb shocks in the future.

The All-Share Index (ASI) increased marginally by 0.09 per cent to 38,278.55 on June 29, 2018, from 38,243.19 at end-December 2017. Market Capitalisation (MC) also increased by 1.89 per cent to N13.87 trillion on June 29, 2018, from N13.61 trillion at end-December 2017. However, ASI and MC fell by 7.24 per cent, respectively, on June 29, 2018 compared with the level at end-April 2018, due majorly to profit taking activities of investors, and the effect of monetary policy normalization in the United States. The Committee noted with satisfaction, the relative stability in the foreign exchange market and high level of activities, particularly, at the Investors' and Exporters' (I&E) window.

The Committee noted the commencement of the currency swap deal with the People's Bank of China (PBoC) and observed that the availability of Renminbi currency to Nigerian investors would ease pressure in the foreign exchange market. The MPC

called for speedy implementation of the framework of the currency swap and urged the Bank to carry out sensitization programme for the public.

## **2.0. The Overall Outlook and Risks to the Domestic Economy**

The forecasts of key macroeconomic indicators point to positive economic growth in the second half of 2018. The expectation is premised on the implementation of the 2018 budget, sustained stability in the foreign exchange market, as well as increase in crude oil production and prices. The MPC, cautioned that the downside risks to the growth outlook include: continuing delay in the implementation of the 2018 budget; worsening farmer-herdsmen conflicts in some parts of the country; continued non-payment of workers' salaries and pensions in some states; rising sovereign debt, as well as uncertainties surrounding the direction of trade, including the external demand for Nigeria's oil.

Inflation forecast for the near term points to further moderation in price level in the short term. However, the downside risks to inflation include: the impact of excess liquidity that could arise from the implementation of the approved N9.12 trillion 2018 FGN budget; pre-election spending; anticipated review of salaries and wages; security challenges; and monthly FAAC injections. Although these could boost aggregate demand, it would equally exert upward pressure on domestic prices for the rest of the year. The Committee, therefore, called for a co-ordinated fiscal, monetary and exchange rate policies to stem the upward build-up in price pressures.

The Committee observed that rates in the foreign exchange market have remained relatively stable in near term, supported by continued intervention in the market by the Bank, sustained increase in the price of crude oil in the international market, as well as positive developments in the external sector.

### **3.0. The Considerations of the Committee**

The MPC noted with satisfaction the fourth consecutive quarters of growth in real GDP and the positive growth outlook in the domestic economy. This is shown by the sustained improvement in the Manufacturing and Non-manufacturing Purchasing Managers' indices in the second quarter of the year. The MPC commended the approval of 2018 Federal Government budget and called for an accelerated implementation to further support the fragile growth recovery. The Committee also called for sustained implementation of the Economic Recovery and Growth Plan (ERGP) to further stimulate output growth. The Committee was, however, concerned about the liquidity impact of the 2018 expansionary fiscal budget and increasing FAAC distribution, arising from rising prices of crude oil as well as the build-up in election related spending.

Notwithstanding, the positive direction of the outlook, the MPC reviewed the effects of the sustained monetary policy normalization in the US with implications for capital flow reversals, exchange rate and domestic price pressures, as well as other challenges to growth during the second half of 2018.

The Committee took note of the sustained moderation in inflationary pressures, especially headline inflation, as well as stability in the foreign exchange market, but expressed concern on the threat posed by incessant herdsmen-farmers crisis in some key food producing states and the negative impact on food supply chains which would continue to exert upward pressure on food prices. The Committee, therefore, called on the Bank to continue to build on the progress already made to sustain the moderation in inflation.

The MPC also observed with satisfaction high level of activities in the Investors' and Exporters' (I&E) window of the foreign exchange market which continued to supply liquidity in foreign exchange market, narrow exchange rate premium, and reduce speculative activities in the market.

The MPC noted the continued improvements in the performance of deposit money banks and expressed optimism that the moderation in the levels of non-performing loans in the industry would continue. The Committee, therefore, called on the Federal Government to accelerate the settlement of outstanding contractor debts and also encourage the Bank to ensure strict compliance prudential guidelines.

In discussing the economic report presented to the members, it was observed that as the prices of crude oil rose in 2017 and 2018, the monthly allocation to various levels of government also increased, suggesting that the Federal Government may not be saving adequately for the future. The Committee, therefore, advised the fiscal authority to build-up buffers, especially now that the price of crude oil is relatively high.

#### **4.0. The Committee's Decisions**

Informed by the developments in the global and domestic economic and financial environments, the Committee painstakingly reviewed the policy options available. In particular, the Committee considered the sustained positive growth in real GDP over the last quarter, stability in the foreign exchange market and high level of accretion to the external reserves.

The MPC deliberated on the rise in food inflation, impact of the expected liquidity from expansionary 2018 FGN budget and rising FAAC disbursement in the second half of the year along with the build-up in pre-election year spending. The Committee strongly



considered the option of tightening believing that tightening would curtail the threat of a rise in inflation, even as the injection from the fiscal authorities would still provide the economy with substantial liquidity. Notwithstanding the deceleration in headline inflation, the current double digit inflation rate remains above the Bank's 6-9 per cent target range. In addition, the Committee was of the view that tightening would help stem the tide of capital flow reversals in the face of sustained monetary policy normalization in the US. This, the Committee believed would rein-in inflationary pressure and moderate inflation rate to single digit, increase real interest rate, build investor confidence with attendant positive impact on capital inflows and further stabilize the country's exchange rate.

On the contrary, the Committee was of the view that raising interest rate at this time would weaken consumption and raise the cost of borrowing to investors in the domestic economy. In addition, the policy would trigger the re-pricing of financial assets by deposit money banks, thus further constrict credit to the real sector, and that would promote non-inclusive growth.

In considering the option of loosening, the Committee assessed the potential effects of stimulating aggregate demand through lower cost of capital. This could stimulate consumption and aggregate demand. The Committee, however, considered its potential relevance, taking into account the expected liquidity injections from the 2018 budget, increased FAAC disbursements and election related spending ahead of the 2019 general elections. If these crystalize, it would exacerbate inflationary and exchange rate pressures as well as return the real interest rate into negative trajectory. Moreover, lowering the policy rate may not translate to an automatic reduction in market rates due to poor transmission mechanism owing to structural rigidities. The Committee was also of the view that loosening could reverse the gains already made

on reduced importation which has strengthened the current account balance. It would also lower banks risk appetite and possible rise in NPLs which could negatively impact on the banking industry stability.

In the discussion for a hold, it was noted that risks to the macroeconomic and financial environment appears fairly balanced with improvements in output growth and inflation. Holding policy at the current stance would support growth and further moderate inflation. The Committee, however, noted the preference of the public for loosening, concerns that the MPC had held the MPR at 14 per cent since July 2016 and also considering the dynamic nature of the market, the MPR may have lost its signalling effect to the market. The argument in favour of maintaining the current policy stance is to monitor the magnitude of the liquidity impact of the fiscal injections and election-related expenditure ahead of the 2019 general elections.

Overall, the MPC was of the opinion that, while it is difficult to encourage job creation in an environment with deficit infrastructure, the Committee believes that the Bank should continue to encourage deposit money banks (DMBs) to increase the flow of credit to the real economy to consolidate economic recovery. In this regard, the Committee believed that a heterodox approach to reform the market in order to strengthen the flow of credit would be appropriate at this time. Consequently, credit constrained businesses, particularly the large corporations are encouraged to issue commercial paper to meet their credit needs and the Central Bank of Nigeria may, if need be, buy those instruments to complement the efforts of the DMBs. In addition, as a way of incentivise deposit money banks to increase lending to the manufacturing and agriculture sectors, a differentiated dynamic cash reserves requirement (CRR) regime would be implemented, to direct cheap long term bank credit at 9 per cent, with a minimum tenor of seven (7) years and two (2) years moratorium to employment

elastic sectors of the Nigerian economy. Details of this framework are being worked out by the Banking Supervision, Monetary Policy and Research Departments of the Bank and would be released soon.

In consideration of the foregoing, therefore, the Committee decided by a vote of Seven (7) members to retain the Monetary Policy Rate (MPR) at 14.00 per cent alongside all other policy parameters. Two (2) members, however, voted to increase the MPR by 50 basis points, while one (1) member voted to increase the MPR by 25 basis points.

Consequently, the MPC voted to retain the:

- (i) MPR at 14.0 per cent;
- (ii) CRR at 22.5 per cent;
- (iii) Liquidity Ratio at 30.0 per cent; and
- (iv) Asymmetric corridor at +200 and -500 basis points around the MPR.

Thank you for listening.

Godwin I. Emefiele

Governor, Central Bank of Nigeria

24th July, 2018