Central Bank of Nigeria Communiqué No. 96 of the Monetary Policy Committee Meeting, July 21-22, 2014

The Monetary Policy Committee (MPC) met on July 21 and 22, 2014 against the backdrop of continuing QE3 tapering by the U.S Federal Reserve which has resulted in the slowing of inflows to emerging markets and frontier economies; and the attendant uncertainties in the outlook for monetary policy and financial stability in the post-tapering period. The meeting was attended by 10 members. A new member, Prof. Dahiru Hassan Balami, whose appointment had recently been confirmed by the Senate, was also in attendance. The Committee deliberated on key external and domestic economic developments and considered the Banking Stability Report since the MPC meeting of May 2014 as well as the outlook for the rest of the year.

The global monetary policy environment appears to be further complicated by risks posed by continued currency crisis and fragility in Europe, geo-political tensions in the Middle East and a number of emerging and developing economies. Domestically, the policy challenges remain. These include the uptick in inflation, anticipated increased spending towards the general elections and the possible effects of US tapering on the domestic market.

International Economic Developments

The Committee noted that the rebound in global economic activity strengthened in the first half of 2014; although at levels lower than previously projected. The tapered growth arose mainly from the emerging and developing economies owing to the rising real interest rates and geo-political crisis. On the whole, the effects of the global financial crisis have continued to wane even as the issues of rising income inequality, unemployment and poverty appear to be gaining prominence; engaging the attention of the monetary authorities. These latest projections indicate that the euro area is gradually coming out of recession, as growth projection for 2014 is positive for all member countries albeit with significant variation. Growth is expected to be stronger in the core EU countries while high debt and financial fragmentation continue to weigh on aggregate domestic demand in the peripheral countries. For the entire euro zone, there is a risk of low inflation or outright deflation which could result in higher real interest rates that may constrain output expansion.

In the emerging and developing economies, growth is projected at 5.0 per cent in 2014 from 4.7 per cent in 2013, buoyed by stronger external demand from the advanced countries. The key downside risks in the developing and emerging economies include: political uncertainty, exchange rate realignment in response to changing fundamentals, further monetary tightening to address emerging currency crisis, and tighter external financing conditions arising from the rapid normalization of the US monetary policy. Inflation is projected to remain subdued in 2014 and 2015, partly reflecting the significant output gaps in the developed economies, weaker domestic demand in developing and emerging economies, and sliding commodity prices, especially fuels and food. In the advanced economies, inflation is currently below target and its return to the long run trend could take a while due to the slow pace of economic recovery. Likely depreciation in currencies, domestic demand pressure, and capacity constraints could pose upside risks to inflation in the emerging market economies.

The Committee noted that the stance of monetary policy could diverge across regions over the medium term on account of variations in risks and other challenges confronting various economies. The US is expected to commence tightening by the second half of 2015 as inflation hits the long run target and unemployment rate falls to the threshold level. The euro area and Japan are expected to continue with supportive monetary policy due to low inflation including threat of deflation in some countries, weak recovery, weakness in bank balance sheets, and strong demand for their bonds as a result of low sovereign risk.

Majority of the central banks remained cautious with regard to the stance of monetary policy. While most advanced economies are likely to maintain an accommodative stance for monetary policy for the rest of the year to firm up aggregate demand and employment, the major impetus for monetary policy adjustments in the emerging markets and developing economies could come from the effects of the US Fed's tapering of QE3 on their currencies and the financial markets.

Domestic Economic and Financial Developments

Output

The National Bureau of Statistics (NBS) reported revised growth numbers from 2010 to 2013 and the first quarter of 2014, as part of the GDP rebasing exercise. Accordingly, the estimated growth rate for 2013 now stands at 5.49 per cent, compared with 5.31 and 4.21 per cent recorded in 2011 and 2012, respectively. Similarly, the revised estimate of 6.77 per cent for the fourth quarter of 2013 was an

improvement over the 5.17 and 3.64 per cent in the previous quarter and the corresponding period of 2012, respectively. In the first quarter of 2014, real GDP growth was 6.21 per cent, which was higher than the corresponding quarter of 2013. In line with the trend, the non-oil sector was the main driver of growth in the first quarter of 2014, recording 8.21 per cent growth. The key growth drivers in the non-oil sector in the first quarter of 2014 remained industry, agriculture, trade, and services which contributed 1.77, 1.26, 1.26 and 3.15 per cent, respectively. The oil sector continued to record improvements in performance with its growth rate improving from -9.36 and -11.40 per cent, respectively, in the fourth and first quarters of 2013, to -6.60 per cent in the first quarter of 2014.

The Committee welcomed the impressive growth performance but noted that the country has the potential to do better with appropriate supportive macroeconomic policies. The Committee, therefore, stressed the imperatives for monetary policy to sustain efforts aimed at supporting non-inflationary growth in key sectors of the economy. The Committee also emphasized the need for government to sustain and deepen tax revenue and enhance efforts aimed at fast-tracking the structural transformation of the economy with a view to making it resilient to adverse shocks as well as creating the necessary platforms for reducing unemployment, income inequality, and poverty in the country.

Prices

Developments in the aggregate price level suggest an underlying inflationary pressure since January 2014. The year-on-year headline inflation steadily inched up marginally from 7.9 per cent in April to 8.0 per cent in May 2014 and further to 8.2 per cent in June. The up-tick in June was, however, largely attributed to the rise in food inflation which rose from 9.7 per cent in May 2014 to 9.8 per cent in June while core inflation, on the other hand, rose from 7.7 per cent in May 2014 to 8.1 per cent in June. The Committee noted that all measures of inflation have witnessed progressive upward trend since

February 2014 and agreed that this trend should be monitored closely to achieve a reversal.

Monetary, Credit and Financial Markets' Developments

Broad money (M2) rose by 1.66 per cent in June 2014 over the level at end-December 2013, indicating an annualized growth rate of 3.31 per cent. The annualized growth rate was considerably lower than the growth benchmark of 15.52 per cent for fiscal 2014. For the same period, net domestic credit increased by 0.88 per cent compared with the growth rate of 15.39 per cent over the corresponding period of 2013. When annualized, net domestic credit rose by 1.77 per cent, compared with the growth benchmark of 28.5 per cent for fiscal 2014. The expansion in aggregate domestic credit was mainly due to the increase in claims on the private sector which increased by 2.75 per cent in June 2014, which was however, moderated by the contraction in net credit to Government.

Meanwhile, money market rates remained within the MPR corridor during the review period. The monthly weighted average OBB rate was 10.38 per cent in May 2014 but it increased by 14 basis points to 10.52 per cent in June. The uncollaterized overnight rate was 10.50 per cent in June 2014, compared with 10.63 per cent in May 2014. Overall, both the OBB and overnight call rates were trading closer to the lower bound of the MPR corridor on account of liquidity surfeit in the banking system. Activities in the capital market were bullish during the period with the All-Share Index (ASI) increasing by 2.8 per cent from 41,329.19 at end-December 2013 to 42,482.48 at end-June 2014. Market capitalization also moved in the same direction.

External Sector Developments

All the segments of the foreign exchange market witnessed a considerable degree of stability during the period. The exchange rate at the retail-Dutch Auction System Segment (rDAS) of the market was flat at N157.29/US$ in the review period. At the inter-bank

market, the selling rate opened at N162.20/US$ and closed at N162.95, representing a depreciation of N0.75 or 0.46 per cent. Conversely, at the BDC segment, the exchange rate opened at N167.00/US$ and closed at N168.00/US$, representing a depreciation of N1.00 or 0.6 per cent.

Gross official reserves rose to US$40.20 billion by 18 July from US$37.31 billion at end-June 2014. The increase in reserves was mainly due to increased accretion and moderation in the rate of depletion.

The Committee's Consideration

The Committee was satisfied with the relative stability in the macroeconomy as reflected in the impressive growth rates, stable consumer prices and exchange rate as well as increased external reserves. It was however concerned about the weak translation of stability to microeconomic gains in employment and access to finance especially by small and medium scale businesses. It, therefore, emphasized the need for the MPC decisions to take into account the long run impact on employment level, wealth creation and growth of businesses.

The Committee noted the potential of the power sector to stimulate output growth through enhanced investment and the spill-over effect in employment generation if the challenges confronting the sector are effectively and appropriately addressed. Specifically, it noted that gas-to-power has remained a binding constraint in reaping the benefits of the recently-concluded power sector reforms; urging for the collective efforts of government, private investors and the banks to resolve. Other pressure points include the underlying pressure from food/core inflation and the risks that could emanate from the likely increase in aggregate spending in the run up to the 2015 general elections. The Committee was also concerned about the implications of the on-going QE3 tapering for inflows and external reserves. The Committee recognized the necessity of sustaining a stable naira exchange even as it has to deal with the delicate balancing of the need for a low interest rate regime. The Committee

noted that portfolio flows were not employment generating but were essential in the absence of adequate fiscal buffers.

The Committee welcomed the moderation in the rate of depletion in external reserves in recent months, noting that reserves accretion needed to improve much faster to provide a strong and more resilient buffer to fiscal operations. The Committee, however, noted that a gradual reduction in the country's import bills through domestic production of some of the major food imports should be a key element in the overall reserves accretion strategy. It welcomed the decision of the Bank to collaborate with other stakeholders in this regard.

The Committee further expressed concern about the liquidity level and the trending uptick in inflation which may not be unconnected with the poor harvest in some agricultural producing areas, particularly in the north eastern and central states of the country. It however, noted that other reform measures could dampen food prices in the short to medium term and restore inflation to a sustainable long-run path. Overall, the Committee noted that the

policy direction of inflation, exchange rate and interest rate must be seen not only in the context of price and financial stability but also in enhancing the quality of life of Nigerians and promoting employment generation.

The Committee's Decisions

In view of these developments, the Committee decided by a unanimous vote to retain the current stance of monetary policy with one member voting for an asymmetric corridor around the MPR. Consequently, the MPC voted to:

(i) Retain the MPR at 12 per cent with a corridor of +/- 200 basis points around the midpoint;

(ii) Retain the Liquidity Ratio at 30 per cent;

(iii) Retain the public sector Cash Reserve Requirement at 75.0 per cent; and

(iv) Retain the private sector Cash Reserve Requirement at 15.0 per cent.

Thank you.

Godwin I. Emefiele

Governor, Central Bank of Nigeria

22nd July 2014