



Central Bank of Nigeria Communiqué No. 94 of the Monetary Policy Committee Meeting, March 24-25, 2014

The Monetary Policy Committee (MPC) met on March 24 and 25, 2014 against the backdrop of challenging monetary policy environment; particularly, in the emerging markets and developing economies; coupled with the unfolding risks to stability in the domestic economy. In attendance were 9 members. The Committee reviewed key developments in both the global and domestic economies up to March 2014, and the outlook for the rest of the year.

International Economic Developments

The Committee noted that the recovery of the global economy could accelerate further in 2014 relative to 2013 as a result of increased domestic demand in the advanced economies and the rebound of exports in emerging markets. The IMF has projected global growth to increase from 3.0 per cent in 2013 to 3.7 per cent in 2014 and then to 3.9 per cent in 2015. In the US, growth is expected to be 2.8 per cent in 2014, compared with 1.9 per cent in 2013, driven by increased domestic demand as well as reduction in the fiscal drag due to the recent deal brokered on the Federal Budget. Although, the euro area has continued to adjust to a high level of indebtedness and financial fragmentation in some countries, growth is expected to recover in the coming years. Thus, growth is expected to rise from 0.4 per cent in 2013 to 1.0 per cent in 2014. This is buoyed by easier credit conditions, increased investor confidence, and expansion in exports. Tight financial conditions since mid-2013 as well as political uncertainty were a drag on growth in most of the emerging markets and developing economies. Notwithstanding, overall growth in this group of countries is expected to increase from 4.7 per cent in 2013 to 5.1 per cent in 2014.

Reflecting the expansion in economic activities, an upward pressure is expected in global price levels in 2014. Global inflation is projected at 2.71 per cent in 2014, representing an increase of about 40 basis points

in relation to the estimates for 2013. It is expected, however, that favorable developments in the prices of food and fuel will help contain the upward movement in the prices of major commodities.

The Committee observed an emerging variance between advanced and emerging market economies (and developing economies) in terms of monetary policy stance since the beginning of 2014. While central banks in a number of advanced economies maintained the cautious posture adopted in 2013 and in Q1 of 2014, the emerging economies and developing countries have apparently switched to more aggressive monetary policy tightening to support domestic currencies and retain foreign investments by raising interest rates. South Africa, Ghana, Brazil and Russia were among countries that tightened monetary policy to address concerns over rising risks to inflation and exchange rate stability.

Domestic Economic and Financial Developments

Output

Growth remains robust. The National Bureau of Statistics (NBS) has estimated real Gross Domestic Product (GDP) growth rate at 7.72 per cent for the fourth quarter of 2013, which was higher than the 6.81 per cent, recorded in Q3, 2013 and 6.99 per cent in the corresponding period of 2012. Thus, in 2013, GDP grew at an estimated 6.89 per cent, up from 6.58 per cent in 2012. In line with recent trends, the non-oil sector continued to be the main driver of growth in Q4, 2013, recording 8.76 per cent. The growth drivers in the non-oil sector in Q4, 2013 remained wholesale and retail trade, agriculture and telecommunications which contributed 2.57, 2.27 and 1.97 percentage points, respectively.

Based on the 2013 favorable performance, output growth has been projected at 7.7 per cent for fiscal 2014. The Committee observed that the relatively robust growth projections, despite the sluggish global recovery, reflected the continuing favorable conditions for increased agricultural production, sustained outcome of the banking sector reforms as well as the initiatives of the government to stimulate the real economy. In particular, the Committee noted with satisfaction the rise by about 10 per cent in the national average electricity generation in

Q4, 2013; a development which provided impetus for improved economic activities during the period.

Prices

Inflation has remained in the target range. The downward trend in inflation, which commenced in December 2012 continued up to February 2014. The year-on-year headline inflation fell consistently from 9.5 per cent in February 2013 to 7.9 per cent in November 2013, but rose marginally to 8.0 per cent in December 2013 and January 2014. In February 2014, however, it moderated to 7.7 per cent. The deceleration was largely due to the moderation in food inflation, which moved from 9.3 per cent in January 2014 to 9.2 per cent in February 2014. Core inflation, on the other hand, exhibited a fair degree of volatility during the period; having declined up to the first half of 2013. It commenced an upward trend in the latter half of the period but declined to 6.6 per cent in January 2014, before inching up to 7.2 per cent in February 2014.

Noting the continued commitment of price stability within the CBN range, the Committee; emphasized the need to maintain the current monetary policy stance. In all, the Committee expressed satisfaction over the sustenance of single digit of all measures of inflation. The Committee, therefore, restated its commitment to sustaining the price stability objective.

Monetary, Credit and Financial Markets' Developments

Broad money supply (M2) contracted by 2.24 per cent in February 2014 over the level recorded at end-December 2013, which, on annualized basis, translated to a contraction of 13.42 per cent as against a growth target of 15.52 per cent for fiscal 2014. Net domestic credit grew marginally by 0.86 per cent in February 2014, translating to an annualized growth rate of 5.15 per cent. The annualized growth in net domestic credit is significantly lower than the provisional benchmark of 28.5 per cent for fiscal 2014. The sluggish growth in aggregate credit was traced mainly to the decline in Federal Government, borrowing which contracted by 2.02 per cent in February 2014 or 12.14 per cent on an annualized basis.

During the review period, money market interest rates remained within the MPR corridor, oscillating in tandem with the level of liquidity in the banking system. The average interbank call rate for the period was 10.17 per cent while the OBB rate was 11.01 per cent. The weighted average inter-bank call and OBB rates which closed at 10.86 and 10.46 per cent in December 2013, respectively, rose to 11.27 and 10.5 per cent in February 2014. Activities in the capital market, however, were bearish as the All-Share Index (ASI) moderated from 41,329.19 at end-December 2013 to 39,269.4 on March 11, 2014 with market capitalization exhibiting similar trends.

External Sector Developments

The end-period exchange rate remained stable at the rDAS window but depreciated at the interbank and appreciated at the BDC segment of the market. The exchange rate at the rDAS-SPT during the review period opened at N157.61/US\$ (including 1% commission) and closed at N157.26/US\$, representing an appreciation of N0.35k or 0.22 per cent. At the Interbank foreign exchange market, the rate opened at N158.83/US\$ and closed at N164.90/US\$, averaging N161.89/US\$, representing a depreciation of 3.68 per cent or N6 for the period. At the BDC segment of the foreign exchange market, the selling rate opened at N173.00/US\$ and closed at N172.00/US\$, representing an appreciation of 0.58 per cent or N1.00k. The BDC segment averaged N170.44/US\$, representing an appreciation of 0.06 per cent.

Gross official reserves as at March 2014 stood at US\$37.83 billion compared with US\$42.85 billion at end-December 2013. The decrease in the reserves level was driven largely by the increased funding of the foreign exchange market in the face of intense pressure on the Naira and the need to maintain stability.

The Committee's Considerations

The Committee unanimously agreed that a continuation of a tight monetary policy was needed to consolidate recent gains. Recent resurgence of core inflation in spite of the downward trend in headline inflation reinforces this position. Thus, prudent monetary stance would also facilitate better reserve and exchange rate management in an

environment where Fed tapering increases pressure on emerging economies financial markets.

The MPC welcomed the growth expectations but expressed concern that the industrial sector has continued to lag behind. The Committee noted that growth remained consistently in favour of the agricultural sector, noting that the continued achievement of relative exchange rate stability and single digit inflation in 2014 given the risks in the horizon will require extra-ordinary measures. The Committee viewed some of the developments as positive optimism by the market relative to other emerging market economies. While tension in Ukraine over Russia's claims to Crimea remained serious, direct trade and financial links between Nigeria and the duo remained largely limited. Thus, the risk premia could come from rising oil and gas prices which were deemed positive shocks.

On the other hand, the Committee noted that the recent pressure in the foreign exchange market was in response to key developments in the US over the Fed's unwinding of its assets purchase programme. In addition, the pressure on external reserves was deemed to be consistent with the seasonal annual payment of dividends to foreign investors. On a positive note, inflation forecasts indicate that food inflation may not grow beyond current levels, especially with bumper harvests expected in 2014. However, core inflation could rise. The Committee noted that frontier markets were positioning themselves to attract higher capital inflows by raising their policy rates to contain inflation and also remain competitive. Oil prices remained relatively high while production was improving, and there were signs of accretion to external reserves. The Committee also expressed concern over the sudden surge in domiciliary account balances which may offset the gains from imposing 75 per cent CRR on public sector funds.

The Committee commended the Bank for its continued commitment to exchange rate stability in the face of undue pressure on the Naira. It noted with satisfaction the calm in the foreign exchange market and the relative stability in the interbank exchange rate after the initial turbulence. The Committee acknowledged that while this stability was

at a high cost, safeguarding short run macroeconomic stability under the circumstance required firm and bold measures.

In the light of the foregoing, the MPC considered the success of Monetary Policy in attaining price and exchange rate stability; the potential headwinds in 2014; the ultimate goal of transiting to a truly low – inflation environment; and the need to retain portfolio flows. The Committee unanimously voted for further tightening of monetary policy but was divided on the instruments. While some voted for an increase in the MPR to retain and attract more inflows, other members felt that such increase could impact access to credit and domestic growth negatively. Consequently, the Committee voted as follows:

- (1) Five (5) members voted to keep MPR at 12%, while four (4) members voted for an increase in MPR.
- (2) Seven (7) members voted to retain the MPR corridor at +/-2%, while two (2) members voted for an asymmetric corridor.
- (3) Seven (7) members voted to increase CRR on private sector deposits by 300 basis points to 15%, while two (2) members voted to retain the CRR on private sector deposits at 12%.

The Committee, therefore, decided by a majority vote of 5 to 4 to hold the MPR and its corridor at current levels but raised the CRR on private sector deposits by 300 basis points to 15 per cent.

Thank you for listening.

Sarah O. Alade

Acting Governor
Central Bank of Nigeria
25th March, 2014

PERSONAL STATEMENT BY THE MONETARY POLICY COMMITTEE MEMBERS:

1.0 ALADE, O. SARAH, AG. GOVERNOR AND CHAIRMAN, MONETARY POLICY COMMITTEE

This MPC is coming at a period of increased uncertainties in most emerging market economies amidst tapering of quantitative easing in the United States. Most emerging market currencies have seen some level of depreciation, and for the BRICS countries, the depreciation has ranged from 0.93 percent in China to about 9.22 percent in Brazil since June 2013. In Nigeria, the Naira has remained relatively stable depreciating by less than 2 percent since June 2013 in the interbank market. These developments coupled with other domestic environment discussed below calls for appropriate policies to safeguard the stability of the economy. Based on the above, I support an increase in Monetary Policy Rate (MPC), maintenance of a 75 percent increase in public sector deposits Cash Reserve Requirement (CRR) and a 15 percent increase in private sector deposits to maintain stability.

There are some uncertainties in the domestic and international market environment. Although some pressure has reemerged in the last couple of weeks, the Central Bank's resolve to defend the currency has brought some level of stability to the market. In addition, the bond yields have seen some improvement, with a positive yield of over 5 percent, making Nigerian assets more attractive. With this development, the expectation is that foreign interest in Nigeria assets will start rising again as the foreign exchange market stabilizes. In advanced economies, some stability in the US with improved unemployment numbers and investors' confidence is directing the pace of tapering even in an uncertain political environment. In the Euro zone, the political disagreement over Crimea Peninsular with Russia could have far

reaching consequences for the economy of the zone, and their trading partners if not handled diplomatically.

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 percent from 2.9 percent projected in the April World Economic Outlook (WEO) citing stronger US economy and return to positive but subdued growth in the euro zone. However, growth in emerging markets could be impacted negatively due to capital reversal on the back of tapering in the United States. As unemployment numbers continue to improve in the US and tapering continues unabated, their effects in emerging market countries are already being felt. Each country will have to find an orderly way to manage the capital reversal, and remaining competitive should be one of the options. This suggests that tight monetary policy stance should be maintained.

Headline inflation softened to 7.7 percent in February compared to 8.0 percent recorded in January 2014. This number is within the Central Bank target of between 6- 9 percent and the goal of single digit inflation. Core inflation rose slightly to 7.2 percent in February from 6.6 percent recorded in January, 2014, while food inflation decreased slightly to 9.2 percent from 9.3 percent recorded in the previous month. The decrease in food index is driven mainly by slowdown in prices of locally produced foods such as potatoes, yams, other tubers, prices of other items such as fruits and vegetables rose at a faster pace. 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 as a result of pre-election spending. Additional risks include reduction of 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 supply seasonality. It is important to note that the downward trend in inflation was achieved as a result of past monetary tightening and other reform measures and letting go of these measures at this time could be counterproductive. Therefore monetary policy should do all it can to safeguard stability.

Like in other emerging markets, the Naira exchange rate has witnessed increased pressure, but some level of stability has returned to the market. As at March 21, 2014, foreign exchange reserves stood at \$37.83 billion, as foreign investors repatriate their investments in the face of improved investment climate in the US. Most emerging market economies have witnessed capital reversal in the last couple of months in the face of sustained tapering from the United States. Nigeria is no exception albeit with less depreciation in the currency when compared to other emerging market currencies. Given these trends; it is important that efforts are intensified at rebuilding the fiscal buffers to forestall the downside risk to the domestic economy through foreign reserve depletion. This is already starting to happen as Government increased the Excess Crude account by \$1.0 billion this month and plans to be building up more buffers in the months to come. Therefore better coordination is all that is required to manage this temporary shock to the macroeconomic stability.

Gross Domestic Product (GDP) although robust is forecasted to improve in 2014. The 2013 fourth quarter GDP is projected to grow by 7.72 higher than 6.87 percent recorded in the third quarter. In addition, the projection for the 2014 at 7.7 percent is expected to be higher than the growth in 2013 due to reforms in the agricultural and power sectors which drove the growth in non-oil sector to 8.76 percent in the fourth quarter. The forecast for 2014 ranged from 6.75 percent to 7.75 percent and will require careful planning and maintenance of stable macroeconomic environment to achieve. Precaution should therefore be taken to safeguard the stability of the currency. This suggests that monetary easing at this time may be premature, therefore, further tightening is required.

Tight monetary policy stance seem to be having effect on liquidity condition in the system as monetary policy rates edged upwards, although persistence pressure in the foreign exchange market continues. Rates at the Interbank and Open Buy Back (OBB) rate rose sharply in February, from 10.54 percent and 10.23 percent respectively as at January 10, 2014 to 17.3 percent and 18.4 percent recorded on March 14, 2014. In addition, lending rates remained high at over 23 percent, suggesting that care must be taken to manage the structural liquidity and the structural impediments to credit growth in the economy. In addition, pressure on the exchange rate window is impacting the foreign exchange reserves negatively; therefore efforts at rebuilding the fiscal buffers must be intensified.

Based on the above, sustained pressure on the foreign exchange and high structural liquidity in the system, I will support an increase in Monetary Policy Rate, the maintenance of 75 percent increase in public sector deposits Cash Reserve Requirement (CRR) and a 15 percent increase in private sector Cash Reserve Requirement.

2.0 BARAU, SULEIMAN

Nigeria witnessed a robust GDP growth in 2013. At a GDP growth rate of 6.89%, in 2013, the economy has demonstrated resilience in the face of security challenges, tight monetary conditions and slow levels of structural reform when compared with 6.58% GDP growth rate achieved in 2012. The growth estimate for 2014 clearly surpassed the average for Sub-Saharan Africa of 5.0% and those of some of the major emerging economies like India and Russia.

Headline Inflation declined relative to its level in January 2014. With Headline Inflation (HI) at 7.7% in February, marginally down from 8% in January, inflation has largely been subdued at single digit over a very comfortable period. The decline in HI was largely as a result of the decline in Food and Non Alcoholic Beverage, Clothing and Footwear, Housing, Water, Electricity, Gas and other Fuel segments. Food Inflation (FI) also showed a decline from 9.27% to 9.21% in January and February respectively. The Core measure however increased over the same period from 6.65% to 7.17%. However, the mixed signals in the different

inflation measures and Staff Report indicating the upside risk to inflation in the medium term is a source of concern.

Money Market rates remained stable during review period. The spread between deposit and lending rates remain a source of concern. The absence of inter-bank call trade since February 2007 till date is a disturbing development. As is sometimes the case, this is perhaps as a result of wrong perception of the financial health of some counter parties particularly due to recent challenges faced by some Discount Houses that were decisively resolved by the CBN.

Declining reserves remain a source for concern. External reserves have continued to come under substantial pressure. It declined from \$42.86 billion as at end December 2013, to \$39.27billion as at March 20, 2014, a reduction of \$3.59billion in three months or 9.14%.

There was sustained pressure on rates at the interbank foreign exchange market. Naira depreciated by ₦5.25 or 3.29% from ₦159.55 to ₦164.80/USD between January 17 and March 20, 2014 respectively. Rates have remained largely stable at the RDAS window. However, the Naira appreciated at the BDC segment particularly following the relaxing of limits on the sale of foreign exchange by Banks to BDCs. Accordingly, BDC rate appreciated by N1.00 or 0.58% to N171 from N173 during the same period.

Global growth forecast for 2014 is optimistic. Global recovery at 2.1% in 2013 was remarkable but growth was also uneven. The

global output is estimated at 2.4% for Q1. The US economy, which grew at 1.9% in 2013, is estimated by the IMF, to accelerate to 2.8% in 2014. Similarly, in the Euro Area, GDP is projected to rise by 1.2% from -0.4% in 2013. In Sub Saharan Africa, the picture is also optimistic with GDP projected to grow by 6.1% in 2014 from 5.1% recorded in 2013.

CHALLENGES

The key challenges requiring the urgent attention of the MPC are as follows;

- Reversing the declining trend in the level of foreign reserves
- Keeping the exchange rate stable
- Managing the upside risk to inflation.

DISCUSSIONS

The key questions to answer relating to declining level of foreign reserves and the mounting pressure on exchange rate of the Naira are broadly two;

- Should the Naira be allowed to radically depreciate/officially devalue?
- Should the depreciation be orderly or measured?

In responding to the first question, I like to restate my earlier position that the pressure on the Naira is largely supported by the existence of substantial liquidity in the system, the tapering of QE in the US and consequent reduction in portfolio inflows, and market expectation that

the Naira would depreciate. These have made end users to bring forward their demand for foreign exchange and currency speculators to see a window for making substantial exchange gains. This has therefore put undue pressure on the level foreign reserves, a development that has further driven market sentiments unfavourably. I am therefore still convinced that developments at our foreign exchange market are not driven by fundamental factors in the economy but by substantial market liquidity and observed change in market sentiment regarding the ability of the Naira to hold out at current rate.

With respect to the second question, I think the time is not appropriate to elicit a radical depreciation. Besides, MPC should ensure orderly and structured depreciation of the Naira that is driven by fundamentals, given its effect on inflation and other macroeconomic variables.

On the issue of the upside risk to inflation, it is important that we take out more liquidity from the system to enable us to keep within the 6-9% target band. MPC has overtime been confronting the effect of several years of unprecedented quantitative easing in Nigeria particularly following the second round effects of the global financial crisis in 2008 and all through to 2011.

This situation has been compounded by the increased fiscal spending over the years. The successive tightening stance of policy since 2012

has been the right prescription aimed at unwinding QE of several prior years.

It is in this regard that I voted for the continuation of the tight monetary measures.

RECOMMENDATION

In the light of the foregoing, I voted for;

- Increase in MPR
- Increase in private sector Cash Reserve Ratio (CRR) to 15%
- Maintaining Public Sector CRR at 75%.
- Maintaining the Corridor at minus and plus 2% around the MPR.
- Maintaining the Net Open Position at current level.

3.0 DANIEL-NWAOBIA, ANASTASIA

Developments in 2013 indicated that the domestic economy recorded an impressive growth of 6.87 per cent during the year, up from 6.58 per cent in 2012, despite continuing security challenges, and weak external environment. The 2014 Federal Government Budget Proposal was based on a projected GDP growth rate of 6.75 per cent, and the IMF projected a strong growth forecast of 7.4 per cent for 2014, indicating the continued resilience of the Nigerian economy.

The moderation in inflationary pressure, which began in the fourth quarter of 2012, continued in January and February, 2014 indicating the effectiveness of sustained tight monetary policy of the Bank. However, inflation outlook remains high in the coming months given the liquidity surfeit in the banking system and the pressure on the Naira exchange rate with its potential for exchange rate transmission on imported finished goods.

The fear being expressed on possible increased government spending in this pre-election year may be misplaced after all. Sequel to the dwindling Government revenue induced by both global and domestic factors, the Government has developed a tight 2014 Budget aimed at optimizing value for its spending and controlling the cost of governance. The planned net borrowing for 2014 (N571.99 billion) is lower than that of 2013 (N577.07 billion). Consequently, the implication of the 2014 Budget for liquidity management may be similar to that of 2013 which is supportive of the monetary policy stance of the Bank.

Furthermore, the Federal Government has earmarked \$1 billion for the implementation of a comprehensive programme to check crude oil theft and vandalism of oil and gas infrastructure. Further action is being taken to enhance the security of pipelines and other oil industry infrastructure. The programme will undoubtedly address fiscal leakages, increase Government revenue, help rebuild the fiscal buffers and impact positively on accretion to the external reserves. The Government is also making efforts at diversifying the economy with the recent reforms in key sectors of the economy such as Agriculture, Solid Mineral and Manufacturing in order to reduce reliance on the oil sector and broaden its revenue base.

The naira exchange rate generally remained stable, giving credence to the effectiveness of the current exchange rate policy. However, giving the rising demand in the foreign exchange market in recent times; the slow accretion to foreign reserves; the high inflation outlook coupled with the inflation target of 6-9% adopted by the Bank, it is advisable to sustain the current policy stance.

1. In view of the above, I vote as follows:

- (i) The Monetary Policy Rate (MPR) to be retained at the current level of 12% and corridor of +/- 2% for the intervening period in order to maintain price stability.
- (ii) The Private Sector CRR to be increased from 12% to 15% in order to strengthen the tightening measures.

- (iii) The current policy on foreign exchange (midpoint and exchange rate band of N155/US\$1 +/- 3%) should be sustained for the next two months when another review will be due for consideration in order to consolidate the relative stability achieved thus far in the market. The Federal Government is already making efforts at rebuilding the fiscal buffers required to sustain the exchange rate stability.

4.0 GARBA, ABDUL-GANIYU

At this March 2014 MPC, five key issues were critical for me: (1) implementation effectiveness; (2) policy impacts (general equilibrium, macro and game theoretic -strategic response of players to AMCON payments and 75% CRR on Public Sector Deposits); (3) initial conditions and outlook (national and global); (4) short-term and medium term policy issues (national and global) and (5) implications of the monetary policy framework MPC has committed itself to. My vote is anchored in (1) the empirical evidence on implementation and impacts; (2) analysis of key short term and medium term issues and (3) cost-benefit analysis of policy options.

The initial conditions and the analysis of outlook (national and global) indicate that tightening is necessary. This is because of (1) the *AMCON effects* that is, the increase in liquidity due to the payments of one trillion Naira for matured AMCON Bond in December 2013, (2) the response of banks to the AMCON effects and to the 75% CRR on Public Sector Deposits and (3) the short to medium term consequences of the responses of the key players.

The key issues generated by the responses of banks to the AMCON effects and to the 75% CRR on Public Sector Deposits are: (1) decreased activities in the interbank market, (2) uptick in Standing Deposit Facility (SDF) placements, (3) some growth in loans albeit to non-growth driving sectors and (4) negative growth in money supply

(M1, Quasi Money and M2) and in the money multiplier. Because the increased liquidity is not raising money supply, it is not inflationary. Neither is it growth or employment generating. Moreover, it is not enhancing the proper functioning of Nigerian financial markets.

I am convinced therefore, that an increase in CRR is the most effective and least costly policy option relative a hike in the MPR. A rate hike has negative implications for short and medium term Financial System Stability. A rate hike will also increase the direct costs of monetary policy. Moreover, because interest on Treasury Bills is paid up front, a rate hike creates its own liquidity -an MPC colleague drew my attention to.

Given that the interbank rate is the operating target, an active interbank market is critical to the effectiveness of monetary policy. However, an SDF rate of 10% has been progressively crowding-out the interbank market. Adjusting the incentive in favour of the interbank market is therefore imperative. I have argued in previous personal statements for an asymmetric corridor based on the evidence and the analysis that suggested that reduction in the SDF rate is necessary to (1) the growth of the interbank market and (2) to strengthening the transmission mechanism and effectiveness of monetary policy.

The data suggests that the **pressure on the Naira is not driven by fundamentals**: net exports, current account balances and net financial flows are all positive despite the negative growth in portfolio flows in recent months. The evidence is indicates that a significant part of the demand for forex is speculative and that it is this speculative component that is volatile. Devaluation is not the right response in the circumstance of Nigeria for at least two reasons. First, it easily becomes a self-fulfilling prophecy hence, self-propelling. Second, devaluation will not solve an institutional problem. Rather it will simply shift the problem to a new band. The fundamental problem I believe is institutional. The key solution therefore, is to eliminate the arbitrage opportunities being

exploited by rational agents. The appropriate response obviously is mechanism re-design as a key part of a creative package.

These are challenging times for all monetary authorities all over the world primarily because the world is in unfamiliar territories in which unconventional monetary policy instruments have been deployed in the post-2007 global financial crisis by the most powerful Central Banks. In the process, they have created financial and economic challenges of unprecedented depths, scope and length. While some monetary authorities face a *low interest rate/quantitative easing trap*, others face a *high interest rate trap*. Fortunately, the two traps are linked as I have argued in previous personal statements. Unfortunately, many global players do not (1) see the linkages and the medium term strategic implications and/or (2) have no interest in the **global commonwealth**. For such short-sighted players, exploiting the asymmetries at the nexus points is fair game (rational) regardless of the resulting turbulence and the social, political and economic consequences. Yet, unless many Central banks and market players see, understand and submit to the good of the global commonwealth, the turbulence in the global economy and its disturbing consequences will persist for a very long time to come. A beggar thy neighbour policy environment is **globally inferior** to a mutually beneficial cooperative environment.

The two traps demand (1) a forward looking monetary policy **process** within a broader space-time horizon and (2) greater mutually beneficial policy coordination between monetary and fiscal authorities and between Central Banks regionally and globally. Otherwise, **exiting the abnormalities of the last few years will be painful for most and unsettling for all.**

The main implication for Nigeria is the urgency of monetary-fiscal policy coordination. This is critical to minimizing the short to medium term trade-offs (between inflation, growth and employments) and the scope and length of disinflation policies and the adverse

consequences –the sacrifice of growth and employment. Even more fundamentally, fiscal-monetary coordination is urgent to prepare Nigeria for the global turbulence that may be generated by (1) the ending of stimulus and (2) particularly from a shift from easing to disinflation policies by the US Fed, the European Central Bank and the Bank of England. There is already conversation about the likely effects of various options for disposing the toxic assets (mortgage backed securities) that the US Fed has accumulated on its balance sheet. Every option is fraught with dangers for monetary policy, for global financial markets (asset prices, interest rates and yields), for the housing markets and for growth and employment. Apart from building buffers, **fiscal-monetary policy coordination** will link fiscal policy and monetary in ways that improve the effectiveness of both monetary and fiscal policies in Nigeria.

It has been repeatedly argued that a **Treasury Single Account** (TSA) has the potentials to make public finance more efficient and more effective and to lower public deficit, debt and debt service as well as reducing the crowding-out effects (fiscal and monetary) of public debt which from the first quarter of 2002 has been doubling within 12 to 13 quarters. By reducing public debt, a TSA is likely to promote the functioning of financial markets as deposit money banks improve their intermediation roles of mobilizing the private savings and channeling the savings to viable investment outlets.

It has been suggested that with the required liquidity ratio at 30% and a public deposit CRR at 75%, banks have a net liquidity of -5% on public sector deposit. This implies that it is already costly for banks to hold public sector deposits. With about 22% spread between maximum lending rates and savings, I expect to see some signs of a restructuring in the deposit structure in favour of private savings and time deposits. At this time, therefore, I believe it is reasonable to keep the CRR on Public Sector Deposit at 75% to allow banks to respond rationally and orderly.

My vote therefore is for:

1. A 15% increase in the CRR on private deposits.
2. An asymmetric corridor of -5 and +2 for Special Deposit Facility and Special Lending Rate respectively.

In addition, I am convinced of the critical need for greater fiscal-monetary policy coordination to build the needed buffers, to improve the financial intermediation roles of financial institutions and financial markets; to re-connect finance with real sector activities and to enhance access of real sector players to relatively low cost capital needed to create jobs and generate growth. I am also convinced of the urgency of **mechanism re-design** to eliminate arbitrage opportunities in the financial markets more especially, in the forex market.

5.0 MOGHALU, KINGSLEY CHIEDU

Considerations

The following considerations are relevant in arriving at a decision on monetary policy at this time.

- **Global economic climate.** The global economic climate at this time is marked by the impact of continued tapering of the quantitative easing programme of the U.S. Federal Reserve Bank and the negative implications of this trend for investment and capital flows to emerging and frontier market economies such as Nigeria's. Continued tapering has led to marked declines in portfolio inflows and increased outflows as investors move their money to what they perceive to be safer markets. Combined with a projected rise in global inflation to 2.71% in 2014 (IMF) and indications that the outlook for the global economy will be one of tight monetary conditions over the medium term, it becomes

clear that there is a competitive context in which several emerging markets are tightening monetary policy in order to contain or prevent massive reversals of capital flows. Ghana has raised its monetary policy rate to 18% while its inflation rate is 14%, South Africa's MPR was increased to 5.5% while inflation is 5.9%; Kenya's MPR has remained at 8.5% since May 2013, Brazil raised its MPR to 10.75% in February 2014 from 10% in January 2014. India raised its policy rate to 8% in February 2014 while inflation is 4.68%.

- **Foreign reserves and exchange rate pressures.** Nigeria's foreign reserves have suffered a sharp decline over the past three months, dropping from US\$42.85 billion at end – December 2013 to US\$37.83 billion as of March 20, 2014. This erosion has been brought about by pressures on the naira and the determination of the Central Bank of Nigeria to maintain foreign exchange stability through repeated interventions in the forex market. This pressure on the naira has been sustained for several months now, raising questions about whether or when the currency should be officially depreciated, ideally through adjustments to its trading band.
- **Leadership transition in the CBN.** This consideration has also contributed to a certain nervousness in the global investor community in the wake of the suspension of the Governor of the CBN. However, while it raises the stakes for consistency in monetary policy, the Bank's senior management has successfully calmed investors' nerves through communication and policy actions that suggest a strong institutional continuity and consistency in monetary policy that is based less on individual actors than many investors had perceived. This therefore, is a time for the MPC to demonstrate clearly its commitment to stability, a tight monetary policy, and its independence, in a clear and decisive manner.

- **Fiscal outlook.** Revenue leakages from oil theft have continued, and uncertainty remains over the fate of the yet-to-be adopted Petroleum Industry Bill. The Excess Crude Account has been severely depleted in recent months, resulting in marked domestic and international concerns over the absence of safety buffers for the Nigerian economy in the event of any shocks. The factors are balanced, however, even if tentatively at this time, by higher oil revenues and new inflows to the ECA, accompanied by increased crude oil production by 30,000 barrels per day in February 2014 to 1.928 million barrels per day compared to 1.898 million barrels per day in January 2014. These increases would have to be sustained over a significant period if confidence levels are to be restored.
- **Domestic Inflation.** While headline inflation in February 2014 fell to 7.7 % from 8% in January 2014, core inflation has inched higher from 6.65% in January 2014 to 7.17% in February 2014. Moreover, staff estimates project headline inflation at a range between 8% and 10% over the next six months, based on factors including fiscal spending and the impact of the planting season. This projection clearly indicates that an inflationary threat remains real, and the beast of inflation is yet to be slain decisively. The policy implication is that the MPC must maintain a tight monetary policy at this time. This is more so when we consider the global conditions noted earlier.
- **Expectations.** This is a vital consideration, in particular at a time such as this. Considering the transition in the CBN leadership and the recent demand pressure on forex combined with weak fiscal savings and falling reserves, there clearly is an expectation that the naira will depreciate in the near-to-medium term. But, given

the absence of any change in fundamentals in light of the price of crude oil, this expectation need not become a self-fulfilling prophecy. Rather the MPC should confront and reverse these expectations with strong policy actions that attack the basis for such expectations. This means policy action that makes Nigeria's economy an attractive destination for capital, in the medium term, while attracting not just hot money but more real investments in the economy that should reduce the country's reliance on portfolio flows in the longer term. Dealing effectively with expectations means, as I see it, going beyond merely maintaining the status quo in monetary policy.

- **Financial Stability.** It is important always to weigh the impact of monetary policy actions on the banking system if financial stability is not to be sacrificed at the alter of price stability. This means that, while I will vote for continued tightening, the question is: how do we do so without maiming the banks? The path to balance is not to continue to raise the Cash Reserve Ratio on public sector deposits beyond the present 75%, but rather to focus on tightening liquidity through the private sector CRR and addressing the concerns about the level of reserves and the exchange rate through the MPR.
- **Conclusion.** The Nigerian economy remains a promising one in the longer term when structural reforms reach a more advanced stage based on a deepening of the power sector reforms and the construction of private sector refineries – and perhaps even new possibilities that may arise from the ongoing National Conference that may have far-reaching economic implications. For now, however, while we work on the longer term, we need to maintain price and forex stability in the face of recent challenges. I note the simulated options for the MPR contained in the report of

the CBN Macroeconomic Model of the Nigerian Economy (CBN MAC II) prepared by the Center for Econometric and Allied Research (CEAR) at the University of Ibadan, Nigeria, and the “Policy Simulation for MPR and CRR” prepared by the CBN Research Department.

The CEAR study demonstrates the impact of MPR increases of differing steepness on both output growth and on lending rate. As is always the case with monetary policy, hard choices have to be made by the MPC between achieving exchange rate appreciation or at least ensure stability, or lowering the lending rate. I believe the focus at this time should remain that of attracting and retaining foreign capital and maintaining a healthy level of foreign reserves. The CEAR study also indicates that even the most radical hike in MPR would have only a marginal impact on output growth, which in itself is a valid concern, but one wrongly understood by many in terms of the correlation between policy rates and output growth rates. I continue to believe that, while high lending rates are a Faustian bargain to achieve a tight monetary policy that remains essential for now, and that lending rates need to move downward in the medium to longer term, infrastructural and other constraints are a more important restraint on real sector activity and output growth in the Nigerian economy.

Vote

Against the backdrop of all the foregoing, I vote to:

- Increase the MPR
- Maintain symmetric corridor of plus or minus 2%
- Increase the private sector CRR by 300 basis points to 15%;
- Maintain the public sector CRR at 75%; and
- Maintain the Liquidity Ratio at 30%.

6.0 ORONSAYE, STEPHEN OSAGIEDE

Figures from the National Bureau of Statistics (NBS) indicate that our domestic economic outlook remains healthy in the face of certain risks to development in emerging economies across the globe. According to the NBS statistics, Gross Domestic Product (GDP) grew at an estimated 6.89 per cent in 2013, compared to 6.58 per cent in 2012. The Bureau indicated that the non-oil sector retained its status as the main driver of growth in Q4, 2013, recording 8.76 per cent. Relying on these figures, the Bureau has projected a 7.7 per cent growth for the 2014 year.

The decrease in Nigeria's foreign reserves from US\$42.85 billion at end-December 2013 to the current levels of US\$37.83 is attributed to the increased funding of the foreign exchange market in the face of intense pressure on the Naira and the need to maintain stability. As it was in January, there is still an enormous disparity between the official exchange rate of the Naira and the rate at Bureaux de Change (BDCs). The question remains: how long can the CBN continue to bridge this gap in defence of the Naira?

The MPC noted that inflation has remained within single digit due to the moderation in food inflation. While this is commendable, the risks posed by structural challenges, which I noted during the last MPC in January, remain potent triggers of inflation. These structural challenges need to be addressed because the crude oil prices remain relatively high and there is no reason why there should not be accretion to the foreign reserve. One is, however, hopeful that there will be accretion to the reserves as crude oil production is reported to be improving.

Even though there is pressure on the exchange, this is not the time to cause devaluation on the currency. With Government now determined to implement the Treasury Single Account (TSA), the question of increasing the Cash Reserve Requirement (CRR) on deposits from the Public Sector does not arise at this time.

Despite these challenges, it is critical that we support moves to sustain the health of the Naira through effective and resolute policy implementation. It is in the light of this that I do not think it is right to devalue the Naira.

As a Committee, we agreed on the point that a tight monetary policy was greatly required to consolidate recent gains made by the CBN. This is particularly so as we have witnessed a rise in core inflation despite the headline inflation decreasing. Although we have held MPR at 12% and achieved stability, I still think that we need to further tighten liquidity to build on the successes recorded in that regard. Therefore I am of the view that we increase MPR.

On the Cash Reserve Requirement (CRR) on deposits from the Public Sector, I do not see the reason for any increase at this time considering the fact that the fiscal authorities have concluded on implementing the Single Treasury Account. The Committee also expressed concern over the sudden surge in domiciliary account balances which may offset the gains from imposing 75 per cent CRR on public sector funds.

Votes

Based on the foregoing, I voted for the following:

- a. Increase in the MPR;
- b. Increase in the Cash Reserve Requirement (CRR) for deposits from the private sector from 12% to 15%; and
- c. Retention of the Cash Reserve Requirement (CRR) on deposits from the Public Sector at 75%.

7.0 SALAMI, ADEDOYIN

At 7.7percent in February 2014 – declining from 8 per cent the previous month, the average value for Headline inflation in the 1st two months of 2014 is 265 bps below the same period last year. For the other measures of inflation, the rate of increase in Food prices eased only marginally, from 9.3 per cent to 9.2 per cent, over the same period.

Core inflation, unlike the other two measures, accelerated from 6.6 per cent to 7.2 per cent.

By commencement of the MPC meeting for March, the implications of easing inflationary pressure in February had been drowned out. The background for this meeting had been framed by the noise generated from a potent combination of factors – the on-going leadership transition at the Central Bank; devaluation of the Naira since the meeting in January; diminished Forex Reserves as inflows declined whilst outflows rose very sharply; and continuing currency substitution.

I had noted in my Personal Statement at the end of the meeting in January that the direction of monetary policy in Nigeria this year would be shaped by, amongst other factors, the pace of tapering of Quantitative Easing (QE) by the Federal Open Markets Committee (FOMC) of the US Federal Reserve and our reaction to it. Although, I had at that point, expected that further reduction in the FOMC's Asset purchase programme would come at the end of Q1-2013, there has been additional reduction since our last meeting – in other words, unwinding QE has gathered pace. Furthermore, the outlook is tilts towards further acceleration in tapering.

The import of QE tapering is its anticipated impact on portfolio flows, commodity prices, reserve strength and exchange rates as US yields rise. As data shows, the impact of QE tapering is already being felt by Nigeria. In the opening two months of 2014, at US\$1,886mn, portfolio inflows amounted to 44percent of what it had been in the same period the previous year. Net Foreign Exchange Cash-flow through the Central Bank continues to worsen – touching a new low of \$-3,815mn in Feb., 2014. In addition, FOREX Reserves have diminished 12 per cent from the 2013 year end to \$37.83bn. It is pertinent to note that while the monthly average price of Bonny Light crude eased 2.8 per cent in the same period - dropping to US\$111.34/barrel, the outlook, provided by NYMEX Forward prices, is for further easing in oil prices.

Domestic parameters paint a mixed picture. While projections for output growth in 2014 remain around 7 per cent, liquidity – irrespective of definition – continues to contract while credit to the private sector,

annualized at current year-to-date basis, continues to grow slower than inflation. While growth in Quasi Money continues largely flat, Demand Deposits continue to contract. Having alluded to currency substitution earlier, Domiciliary Account balances now account for 20.59 per cent of total deposits. Retail lending rates remain in the range between 16-26 per cent. Whilst it would have been convenient to explain the sharp reduction in both volume and value of transactions at the interbank window to overhang of liquidity from AMCON payments at the end of 2013, however, the volume of patronage of the CBN's Standing Lending Facility (SLF) and Standing Deposit Facility (SDF) may be a reflection of confidence issues amongst operators.

Shifting focus back to our principal mandate of price stability and noting that Monetary Policy strategy requires currency stability as a tool towards attaining and sustaining price stability, the Naira's weakness at the Bureau de Change (BDC) segment and the widening premium between BDC and official segments of the currency market continue to be a source for concern. It would appear that while the measures taken at the MPC meeting in January saw the Naira strengthen almost 3 per cent, by mid-February. In the BDC segment, it has since then weakened. Indeed, the gap between these two market segments, which narrowed 380bps to 6.8 per cent in mid- February, has gained 190bps since Valentine's Day.

Since we know that irrespective of where foreign currency is procured, BDC rates form the basis for pricing, it is not surprising that worsening currency rates provide part of the explanation for deterioration in inflation Outlook by Bank Staff. The six-month Outlook for inflation has Headline inflation steadily deteriorating to 10 per cent by August. In the same manner, food inflation is now expected to accelerate to 11.5 per cent over the same period. While Core inflation is expected to worsen from 6.8 per cent in March to 8.3 per cent by June; improving thereafter to 7 per cent in August.

An outlook which projects lower oil prices, faster tapering of Quantitative Easing resulting in Capital Outflows, prospect of rising deficit as revenues continue to slip, further currency substitution and worsening inflationary pressure points to the need for further restriction

in the monetary policy regime. Though the direction of policy is clear, I am less sure about the appropriate choice of instrument.

Reduction in liquidity by raising the Cash Reserve Ratio (CRR) is clear enough – though a blunt instrument, it has the added advantage of being cost-efficient. Having started down the route of imposing differential CRR on various deposit classes, should we simply fully sterilize Federal Government Deposits by raising CRR on this class of deposits to 100? New, we hope more effective, effort by the Federal Government to ensure effective implementation of the Treasury Single Account coupled with operational challenges that will attend the imposition of 100 per cent CRR on public sector deposits rules that out for the time being. This leaves raising the CRR on private sector deposits as the avenue for restricting available liquidity.

I am not unaware that the value of maturing bills will almost neutralize the impact of the higher CRR imposed on non-government deposits. I expect that the process of policy implementation will ensure effectiveness of the measure. The option of raising the Monetary Policy Rate (MPR) is one I have been unable to support on this occasion. Whilst an increase in MPR, by raising the sovereign rate, will make government bonds attractive and **may** serve to improve our chances of slowing the outflow of 'hot money', I am increasingly of the view that this is the time to deal with causes rather than symptoms. **The case for adjustment by rebuilding eroded fiscal and forex buffers is uncontested.** If we are not to raise costs thereby undermining the competitiveness of our economy, fiscal consolidation – however difficult – offers the most suitable option.

The challenge of trying to stem capital outflow arising from an inability or is it unwillingness to rebuild fiscal and Forex buffers. The logic behind the decision to 'invite' 'hot money' was to buy time for rebuilding fiscal and forex buffers. As it is, our Forex Reserves are back to where they were in August 2010 despite average price of Bonny Light of US\$103.56/barrel, export earnings of approximately US\$323bn and gross foreign portfolio inflows of almost US\$39bn.

Raising MPR in the absence of a **credible** basis – such as an announced timetable for accretions - to believe that the fiscal policy authorities can, or will, deliver on the oft-repeated statements of intention to rebuild buffers is, in my judgment, an exercise in futility. If we are buying time, it makes sense to be clear how much time is being bought and at what cost. Competing with other Emerging Market and Frontier Economy nation's countries for retention of portfolio inflows leads us into a high interest rate trap which will be difficult to handle.

Having noted the increased patronage of the SDF window in preference to the Interbank Market, I conclude that there may be a 'flight-to-safety' in progress. In such a circumstance, I expect that deposits will come to the SDF provided there is a positive return – hence my vote in support of the option to make the corridor around the MPR asymmetric.

In summary, I have thus voted in favour of raising the CRR on non-government deposits to 15 per cent. In addition, I also voted in favour of an asymmetric corridor around the MPR with SLF and SDF at 14 per cent and 5 per cent respectively.

8.0 UCHE, U. CHIBUIKE

In my view, the March 2014 MPC meeting was a very difficult one. Evidence before the Committee showed that interest rates, exchange rates and our national reserves all came under immense pressure after the January 2014 MPC meeting. Although some of these pressures may be based on economic fundamentals, I am convinced that most of it was as a consequence of recent developments in the Nigerian financial system. This has led some investors to question the continued commitment of CBN [and the Government of Nigeria] to macroeconomic stability. Thankfully, as the statistics on capital flows demonstrate, such noises have started to quieten down in the last couple of weeks. Despite this, the dangers of depending on foreign capital inflows, especially portfolio flows remain real for monetary stability. This is especially so because the incentive structure behind the

deployment of such funds is purely their ability to earn short term returns rather than cause real sector economic development in recipient countries.

Although I am sympathetic to the argument that under the current circumstances, and in the light of the higher interest rates offered by some developing countries for their debt instruments, there is need to raise the MPR with the prime objective of encouraging such foreign capital to stay within our shores, I am not convinced that such a move will yield any substantial benefit. In the first place, there is no guarantee that a hike in MPR will ensure that such capital are retained in Nigeria. This is because, the determinants of the decision making behavior of portfolio investors go beyond our MPR rate. Political and economic factors in both developed and developing nations have a major role to play in this direction. Equally important is the fact that I am also not convinced that the future of our real sector and banking system should be sacrificed on the altar of speculative capital and its attendant short term benefits.

Just as I do not support the raising of the MPR, I also do not support the devaluation of our currency at the present time. This is especially because doing so makes little sense in a mono product rentier economy like ours. The inflation consequences of such a move in an import dependent economy will further complicate monetary policy at the present time. Having ruled out currency devaluation and a hike in MPR, we must find other ways of tightening money supply if we are to successfully cushion the current pressures on inflation, reserves and exchange rates. In this direction, I will strongly recommend that we continue in our path of employing monetary policy instruments, which also have the potential of influencing fiscal behavior of government, to tighten money supply.

For some time now there has been consensus among MPC members that fiscal policy remains a major threat to the promulgation of

effective monetary policy in Nigeria. Poor fiscal management and excessive borrowings by government have resulted in financial repression. In other words the more we tighten the more the real sector of the economy is crowded out of the credit market by government and its agencies. The consequence of this is that although monetary policy tightening has consistently achieved single digit inflation for some time now, this has been to the detriment of the real sector of our economy. Thankfully, monetary policy is not altogether helpless in tackling poor fiscal management policies and practices of government.

One area where monetary policy has proved potent in the past is with respect to the government attitude towards the Treasury Single Account (TSA). Although Government for about a decade now has been consistent in voicing out its decision to implement the TSA, in reality, there has been little progress in this direction. The consequence is that it is not uncommon for some government agencies to place huge sums of money in low or no interest yielding deposit accounts while at the same time borrowing from banks at market interest rates. The fact that this makes little economic sense has fuelled allegations that such perverse behavior by some government managers is as a consequence of pecuniary personal gains derived by such officers from such practices. The fact that Government has thus far not exhibited the political will necessary to stop such a senseless practice has added fodder to such speculations. It was in light of the above background that we, at the January 2014 MPC raised the CRR on such government deposits to 75 percent. The simple objective of this was to increasingly sterilize such government funds which in the first place should normally be outside the commercial banking system.

So far, our strategy has yielded encouraging results. Available statistics however show that some banks are now taking advantage of the fact that we have thus far not applied CRR on public sector deposits held in foreign currency domiciliary accounts. The result is that government

domiciliary account deposits have increased sharply. This no doubt is a constituent part of the pressure that is increasingly being applied on our Naira exchange rate. The above has influenced my view that there is now need to block this emergent arbitrage loophole. In reaching this decision, it is important to reiterate that the charging of CRR on public sector deposits is an explicit anomaly. This is so because, by law, the Central Bank of Nigeria is the banker to the government. If, as is normal, all government funds are domiciled in the CBN, the issue of CRR on government deposits will never arise in the first place.

In moving in the above direction, I strongly recommend that we continue to proceed with caution. This is because of the possible implications of introducing CRR on public sector domiciliary account deposits for the health of some banks that are over exposed to such government deposits. While our objective is to eventually eliminate the arbitrage opportunities created by the charging of differential CRR on local currency and domiciliary account deposits of government agencies, this must be pursued in a gradual fashion.

In the light of the above factors, I hereby vote as follows: (1) to retain MPR at 12 percent with interest rate corridor of + 200/- 200 basis points; (2) to retain CRR at on private sector and government deposits at 12 percent and 75 percent respectively; (3) to introduce CRR on government domiciliary account deposits and (4) to retain Liquidity Ratio at 30 percent.

9.0 YAHAYA SHEHU

I vote to hold the MPR at its current level of 12%, along with the symmetric corridor of 2% and the CRR on public sector deposits at the current level of 75%. However, the CRR on private sector deposits should be increased to 15%.

My decision is mainly predicated on the need to promote stability in the foreign exchange, capital and money markets, and to stem inflationary pressures from international and domestic sources.

Tapering of QE3 represents the most palpable challenge to the management of monetary policy in developing countries and in Nigeria. Already it has triggered substantial reverse flows of capital from developing countries to US and Europe. Prospect of further tapering, particularly if done in an accelerated fashion, will impact further on capital flows, stock markets, reserves and put considerable pressure on the foreign exchange market in developing countries.

On the positive side, growth in the world economy and in the main trading partners of Nigeria shows a positive trend- stronger in the US and UK, weaker, but still positive in the Euro area, stable in China and low but positive in Japan. The growth prospects in Africa, particularly Sub-Saharan Africa, remain strong.

The world price of oil also appears to be fairly stable in the short run, with forecasts indicating that prices are likely to remain above USD 100/barrel, well above the USD 79/barrel used as the budget benchmark in the country.

With respect to inflation, it is expected that global price levels, including in the US, Eurozone and Japan, will increase a bit, but not sufficient to pose significant pressures on imported inflation.

For the domestic Nigerian economy, GDP is estimated to have increased slightly in 2013 to 6.89% compared to 6.58% in 2012, with most of the growth being led by the non-oil sector, including agriculture. This is despite the persistent low level of bank lending to the real sector (except for power and gas and oil).

At the fiscal level, government revenue targets for 2013 were not fully met, but there was also restraint from the fiscal authorities, so that the budget deficit for 2013 was only slightly higher than the figure for 2012.

Concerns regarding government spending relate mainly to the very low share of capital expenditure (less than 20%), which will negatively affect future growth. The second concern is the relatively low level of mobilization of domestic revenue. This is a critical issue in view of the threats to future demand and revenue from the sale of Nigerian oil and gas emanating from the shale oil production in the US, tar sands oil from Canada and oil and gas discoveries in a number of African countries. Furthermore the prospects for an elevated level of spending in the next one year due to the impending elections pose concerns for inflationary pressure.

Price levels have been moderating for much of 2013 and the year-on-year headline inflation was 7.7% in February 2014, which is the lowest ever in many years. This was mainly driven by declines in food inflation, particularly farm produce. Moreover, money aggregates are all growing at lower than the target rates, so there is little risk of inflationary pressure from this source. Nevertheless, CBN estimates indicate that inflation is likely to rise in the next one year period, possibly up to double digits, unless the right policy measures are implemented.

In summary, output levels in the economy are likely to remain on a positive trajectory; oil earnings are likely to remain stable in the short run (despite the medium term challenges); there is little risk of significant imported inflation. The main challenges to the economy with respect to monetary policy emanate from the net capital outflows which threaten foreign reserves levels, pressures on the Naira exchange rate and the risk of excess demand from rises in fiscal spending.

In consideration of the above, it is necessary to act to try and stave off pressures on the foreign exchange market, with its inflationary implications.

Available information suggests that the increase in CRR on public sector deposits decided in previous MPC meetings and implemented since August 2013 has had some effect in reducing excess liquidity.

However, part of this effect was muted by currency substitution of public sector deposits into foreign currency. It is therefore proposed that the CRR for all private sector deposits should now be increased to 15%. This should help stem liquidity and ease pressure on the foreign exchange market without impacting too much on banking sector liquidity ratios.

Admittedly, the CRR will impact mainly on domestic liquidity. It will do little to reverse net capital outflows, which will be more affected by domestic interest rates and therefore the MPR. However, the use of this instrument also has implications for growth, jobs, NPLs in the banking sector, provisioning and capital adequacy. On this issue therefore, it is judged prudent to observe the direction and speed of the quantitative easing in the US and then deploy the necessary instruments to address the challenge.