



## **CENTRAL BANK OF NIGERIA COMMUNIQUÉ No. 97 OF THE MONETARY POLICY COMMITTEE MEETING, SEPTEMBER 18-19, 2014**

The Monetary Policy Committee (MPC) met on September 18 and 19, 2014 with all the 12 members in attendance. The Chairman welcomed the new member, representing the Board of the Central Bank of Nigeria, Mr. Stanley I. Lawson to membership of the Committee. The meeting held against the backdrop of the increasingly limited choices for monetary policy, particularly, in the emerging market and developing economies; tapered recovery in the euro area coupled with the social and political tensions in the domestic and global environment, some of which have had fundamental impact on domestic macroeconomic management. The Committee reviewed key developments in the global and domestic economy up to mid-September 2014, and the outlook for the near-term.

## **International Economic Developments**

The Committee noted the slow global growth prospects as the IMF, in July, marked down its projection by 0.3 per cent to 3.4 per cent, reflecting weak economic recovery, particularly in the Euro Area, and a less than optimistic outlook for several emerging market economies. Global growth which moderated more than expected in the first quarter of 2014 regained momentum in the second quarter although recovery remained largely uneven. The United States provided strong tailwinds for growth recovery but fiscal constraints continued to limit robust possibilities. Similarly, economic activity in the United Kingdom maintained a strong momentum in the second quarter, supported by improved household confidence and an impressively recovering housing market. Growth in China also recovered following the fiscal policy stimulus and a surge in credit.

In contrast, growth moderated in Japan after the VAT hike in April, but the quantitative easing programme of the Bank of Japan continues to support recovery. Growth in the Euro area is expected to strengthen to 1.1 per cent in 2014 and 1.5 per cent in 2015, but would remain uneven across the region, reflecting continued financial fragmentation, impaired private and public sector balance sheets, and high unemployment in some EU economies. In the emerging markets and developing economies, growth is projected at 4.6 per cent in 2014, which is 0.2 percentage point lower than the

earlier projection. The sources of growth include strong external demand from the advanced economies; however, tight financial condition is expected to dampen growth in domestic aggregate demand.

Global inflation has remained relatively stable while spare capacity remains large, suggesting no significant inflationary pressures in the short-to-medium-term. The stance of monetary policy has remained unchanged across most advanced and emerging economies in view of the unclear outlook for monetary conditions and financial stability especially in the post-QE tapering era. The expectations of increase in policy interest rate remain in focus in the US and the UK, even though the Fed reaffirmed that it would maintain the current highly accommodative monetary policy stance. The European Central Bank (ECB) and Peoples Bank of China (PBoC) have also announced new monetary stimulus programmes which will moderate the impact of the end of QE3 on frontier markets.

## **Domestic Economic and Financial Developments**

### **Output**

The Committee noted the continued resilience of the economy as real GDP grew by 6.54 per cent in Q2, 2014 compared with 5.40 per cent in the corresponding quarter of 2013. The observed growth rate also surpassed the 6.21 per cent recorded in the Q1 of 2014. The non-oil sector remained the main driver of growth recording 6.71 per cent in Q2, 2014; although lower than the 8.21 and 8.88 per cent

recorded in Q1, 2014 and the corresponding quarter of 2013, respectively. The decline in growth of non-oil GDP was traced to the decline in agricultural output, construction, trade and services relative to the levels recorded in Q1, 2014. The slowdown in agricultural output was attributed to the insurgency activities in the North Eastern axis and some parts of the North Central States which led to displacement of farming communities, thereby limiting agricultural activities and, hence, output from that region.

Growth in the services and industry sectors remained relatively stable compared with the corresponding period in 2013. The Committee commended all levels of government and the general population for the coordinated, prompt and effective response to the Ebola Virus Disease (EVD) in Lagos and Port Harcourt; two cities that are commercial hubs and leading growth axes for the service and industry sectors of the economy.

The oil sector grew by 5.14 per cent in Q2 2014, a marked reversal from the decline recorded in the preceding four quarters. The Committee welcomed the intensification of efforts by government at addressing vandalism of oil facilities and theft of crude oil in the Niger Delta region as well as efforts towards addressing gas supply shortages to the power plants. The Committee reiterated its commitment to continue to support the efforts, in addition to facilitating other measures aimed at promoting inclusive non-inflationary growth.

## **Prices**

Headline inflation rose to 8.5 per cent in August from 8.3 in July 2014. The mild but sustained underlying inflationary pressures were attributable mainly to food production and distribution challenges posed by the insurgency activities. From 9.4 per cent in April 2014, food inflation, measured on a year-on-year basis, rose to 10.0 per cent in August while core inflation moderated consecutively in the last two months since June 2014. In August 2014, the year-on-year core inflation was 6.3 per cent, down from 8.1 and 7.1 per cent in June and July, respectively. The Committee was concerned that the insurgency was forcing a switching from domestic to imported food to meet domestic shortfall with huge impact on external reserves and underscored the need to expedite action to restore normalcy to the troubled region to sustain the tempo of growth. The Committee further reaffirmed its commitment to sustain efforts at ensuring price stability.

## **Monetary, Credit and Financial Markets' Developments**

Broad money supply (M2) grew by 2.94 per cent in August 2014 over the level at end-December 2013 compared with 4.83 per cent in July. The annualized growth of 4.41 per cent in August 2014 was below the growth benchmark of 14.52 per cent for the year. Net domestic credit, however, increased by 5.31 per cent in August relative to the end-December 2013 level. When annualized, net domestic credit rose by 7.96 per cent, compared with the growth benchmark of 28.5 per cent for fiscal 2014. The rather slow expansion

in money supply in August reflected the 10.17 per cent contraction in net foreign assets of the banking system (NFA).

Money market interest rates, however, remained within the MPR corridor as the overnight and collateralized OBB rates moderated from 11.30 and 11.49 per cent in August to 11.08 and 10.62 per cent on 11 September 2014, respectively. The MPC noted that both rates traded around the lower band of the MPR corridor on account of the liquidity surfeit in the banking system.

Activities in the capital market were bearish during the period with the All-Share Index (ASI) decreasing by 4.3 per cent from 42,482.48 on June 30, 2014 to 40,672.94 on September 12, 2014. Market Capitalization (MC) also decreased by 4.3 per cent from N14.03 trillion on June 30, 2014 to N13.43 trillion on September 12, 2014. Market indicators declined owing to the profit taking activities of investors.

### **External Sector Developments**

The average naira exchange rate remained considerably stable in all segments of the foreign exchange market. The exchange rate at the retail-Dutch Auction System Segment (rDAS) was stable at N157.29/US\$, but depreciated at the inter-bank and substantially at the BDC segments between July and August 29, 2014. At the interbank segment, the naira depreciated slightly by N0.32 or 0.20 per cent to \$/N162.40 from \$/N162.08. Similarly, at the BDC segment, the exchange rate depreciated by N2.00 or 1.2 per cent from

US\$/N167.00 to U\$/N169.00. The premium between the rDAS and interbank rates was 3.25 per cent while that between the rDAS and BDC rates stood at 7.45 per cent in the review period. Gross official reserves rose from US\$39.1 billion at end-July to US\$40.7 billion on 17th September, 2014. The current level of external reserves provides approximately 7 months of imports cover.

### **The Committee's Considerations**

The MPC expressed satisfaction with the relative stability in the economy while also noting the risks that lie ahead. The key risks include: the possibility of capital reversals as the Fed's Quantitative Easing in the US finally ends in October, amidst dwindling oil output and declining oil prices, domestic security challenges and upward trending headline inflation. The Committee further expressed concern about high banking system liquidity and its potential effects on inflation and the exchange rate. The policy challenges, the Committee noted, would include sustaining the stability of the naira exchange rate, managing the vulnerability to capital flow reversal, building fiscal buffers to insure against global shocks, managing inflation and exchange rate expectations and safeguarding the financial system stability as well as a buildup in election related spending.

The Committee welcomed the efforts by government to address some of the constraints and risks to economic activity like the

insurgency in the North-East and the Ebola Virus Disease epidemic. It noted that as progress is made in these areas and in respect of other constraints like power and improving SME financing, the outlook for growth appears bright and prospects for upward price pressure would be moderated. The Committee further noted that the restrictive stance of monetary policy provided important defenses against structural liquidity in the banking system and also reaffirmed the willingness to play a key role in managing expectations around exchange rate and inflation vulnerabilities. Consequently, adequate consideration would need to be accorded the goal of reining-in banking system liquidity to safeguard the objective of price stability.

The Committee was, however, concerned that banks were holding large excess reserves averaging over N300 billion even when there were ample opportunities for productive and profitable lending to the real sector of the economy. The concern was further strengthened by the reality of injecting an additional N866 billion into the system through the redemption of maturing AMCON bonds in October. Given the apathy to lending, banks may be inclined more to placing these new funds in the SDF or use it to increase pressure on the exchange rate. The Committee advised the Bank to explore ways of encouraging banks to lend such excess reserves to the real sector.

In light of the foregoing and consideration of other key risk factors, the Committee was of the view that the direction for policy in the short- to medium term would be either to retain the current tight stance of monetary policy or further tighten monetary policy.

### **The Committee's Decisions**

In view of these developments, the Committee was split between retaining the current stance of monetary policy and further tightening. Consequently, 6 members voted to retain the current stance of monetary policy. Five members voted to increase private sector CRR while one member voted to increase public sector CRR. In addition, one member voted for an asymmetric corridor around the MPR. Consequently, the MPC decided by a majority vote to:

- (i) Retain the MPR at 12 per cent with a corridor of +/- 200 basis points around the midpoint;
- (ii) Retain the public sector Cash Reserve Requirement at 75.0 per cent; and
- (iii) Retain the private sector Cash Reserve Requirement at 15.0 per cent.

Thank you.

**Godwin I. Emefiele**  
**Governor, Central Bank of Nigeria**  
**19<sup>th</sup> September 2014**

## **PERSONAL STATEMENTS BY MEMBERS OF THE MONETARY POLICY COMMITTEE**

### **1.0 ADELABU, ADEBAYO**

Performance of key macroeconomic indicators suggests a mixed signal. Output growth at 6.54 per cent for the second quarter and projection of 6.75 per cent for the entire F2014 are suggestive of the resilience of the economy. Inflation developments, however, are becoming worrisome. Headline inflation continued its upward trend for six consecutive months, accelerating to 8.5 per cent in August while food inflation is almost at the upper band of the Bank's long run target. Moderation in core inflation in August, however, raises some form of optimism though it adds to the complication of policy decision. Uptick in external reserves that commenced in July continued during the period albeit sluggishly due to both slowdown in inflows and demand pressure.

Examining the issues on case by case basis, the inflation outlook reveals considerable risks in the near to medium term. Election related expenses, depreciation of the exchange rate at the BDC due to current measures, rising global food prices, and seasonal factors portend upside risks to price level particularly core inflation in the near term. Staff forecasts, however indicates that headline inflation would still be within the border of single digit by end-December 2014 which in essence implies that the Bank long run

target is still protected. As a result, I would like to hold the Monetary Policy Rate (MPR) at the subsisting level.

The main risk however is the uncertain global environment which has grave implication for the domestic economy particularly on both the current and capital accounts. Despite geo political conflicts in Russia and Ukraine, crude oil price has been softening on the backlash of rising production in the US and fragile rebound process in the euro zone. This portends grave concerns for fiscal revenue and external reserves. In addition, the US Federal Reserve has indicated the termination of the third quantitative easing by October with implication of reversal of investors' sentiment for developing and emerging economies and the attendant slowdown in accretion to reserves. In fact, the most crucial external consideration for monetary policy makers in emerging markets and developing economies today appears to be how to mitigate negative spillovers from this risk should it crystallize.

As a consequence most emerging economies have been tightening monetary policy stance to retain the existing capital flows and possibly attract new ones. My analysis, however, shows that our Monetary Policy Rate (MPR) is elevated enough in relation to most emerging economies and as such the risk adjusted returns on foreign capital is still good enough to retain existing capital and perhaps

attract new ones. Perhaps, more importantly, further tightening through the MPR or the Cash Reserve Requirement (CRR) would have dire consequence on lending rates which are already above acceptable threshold with implication for quality of banking assets and financial system stability as a whole.

The last issue is the persistence of huge liquidity in the banking system with the potential of exacerbating the pressure in the foreign exchange market. This development is suggestive of some measures of further tightening particularly through adjustment to the Cash Reserve Requirement (CRR). My view is that we should begin to explore some innovative ways to address liquidity surfeit in the system.

I would like to point out that the greater part of the burden imposed on monetary policy are issues requiring active support of the fiscal authority. First, it would be difficult for monetary policy to reduce lending rate to single digit level in the light of the fact that the major drivers of lending rates relate to the competitiveness of the business environment including cost of power and security incurred by the banks as opposed to cost of funds. Secondly, the burden foreign exchange management is derived largely from the skewed structure of the economy because the bulk of the pressure in the foreign exchange markets comes mainly from payments of imports bills

rather than excess reserves of the banking sector. Thus, mopping up excess banking liquidity through adjustment to CRR, as the present monetary conditions implied, would amount to treating the symptoms without addressing the root cause. I think the solution lies in exploring innovative means of deploying excess liquidity in the banking sector to productive sectors rather than considering it as a threat.

As implied in my last statement, we are almost approaching the limit of monetary policy thus requiring considerable structural and administrative measures. Monetary policy independence appears to have been lost mainly due to the weakening external reserve position. In the short terms, appropriate administrative measures must be put in place to curtail the rate of depletion of the external reserves. As a quick win, an urgent review of the list of imported items eligible for official foreign exchange is imperative in addition to revisiting legislations around the exports of dollar in cash. Over the medium to long term, considerable efforts must be made to improve accretion to external reserves from proceeds of crude oil sales as efforts are geared towards improving business environment by building infrastructure that would promote foreign direct investments.

In the light of the foregoing I vote for the retention of all the subsisting measures of monetary policy.

## **2.0 ALADE, SARAH O.**

*Headline inflation increased by 30 basis points to 8.5 percent in August from 8.3 percent recorded in July, 2014. While core inflation decreased to 7.3 percent from 7.4 recorded in the previous month, food inflation increased from 9.9 percent to 10.0 percent during the same period. Fiscal expansion remains muted as revenue fall below budget due to lower oil production and prices. On the international scene, there are mixed development, while growth in the US is improving and tapering is on course to end in October, authorities in Europe, Japan and China are still on the stimulus course. The full impacts of these actions on the economy are yet to materialize, thus the need to carefully monitor their impact. Additionally, the presence of excess liquidity in the banking system suggests the need for some action to avoid undue pressure on inflation and the foreign exchange market. In view of these developments, I am inclined to support a hold in Monetary Policy Rate (MPR) but an increase in Private Sector Cash Reserve Requirement (CRR).*

**Headline inflation continues to trend upwards as food inflation increased to 10.0 percent in August.** Headline inflation increased to 8.5 percent in August from 8.3 recorded in July. The increase is driven mainly by increase in food inflation which rose to 10.00 percent from 9.9 percent on the back of increases in processed and imported food items. Core inflation however decreased to 7.3 percent from

7.4 percent recorded in July, suggesting that inflationary pressure is largely coming from food. In a normal situation, this upward shift would suggest further monetary tightening, however, in period of global uncertainty and given that food inflation which is driving the high inflation is volatile and short-lived.

***The banking system liquidity continues to be high, suggesting that some measure is needed to reign in the excess liquidity.*** Banking system deposits at the CBN deposit lending facility has consistently been high reaching N600 billion on some days during the review period. Even with OMO operations, Interbank and OBB rate during the review period have traded below the standing deposit facility rate, thus there is need to sterilize some of these liquidity through increase in cash reserve requirements to avoid distortion in the system and to minimize the feedback effect on inflation. In addition, the anticipated AMCON injection of N866 billion into the economy at the end of October will also add substantial liquidity to system.

***Gross Domestic Product (GDP) is showing strong momentum, although risks remain.*** The 2014 second quarter GDP grew by 6.54 percent as against 5.40 per cent recorded in the corresponding quarter of 2013, and also higher than the 6.21per cent recorded in the first quarter of 2014. The non-oil sector grew by 6.71per cent in the second quarter of 2014, although a decline of 2.17 percentage points from the 8.88 per cent growth recorded in the corresponding

quarter of 2013, but it still remains the main drivers of growth. The decline in non-oil sector growth was traced to decline in agriculture as a result of insurgent activities in the North East part of the country which has affected agricultural productivity. The oil sector grew by 5.14 percent in the second quarter of 2014 owing mainly to government's effort to curtail pipeline vandalism and oil theft. Although growth is trending up, the increasing inflationary pressure calls for a caution at this time to avoid inflationary growth.

***Reduced oil production and declining oil prices is bound to put pressure on fiscal operations of the government and budget implementation.*** The low oil production due to pipeline vandalism and oil theft coupled with increased production of Shale oil in the US is affecting government revenue. In addition the surge in Shale oil has prompted OPEC to cut its production quotas. The implication is that there will be revenue shortfall which will not only affect government revenue, but will also affect external reserve build up. To cover this shortfall, government may resort to increased borrowing at higher interest rate which will crowd out private sector and constrain growth.

***Global economic environment is improving, but growth is still teetering.*** The Bank of England at its meeting on September 18, 2014 decided to keep rate flat based on little or no domestic inflationary pressure well into 2015, and the failure of wages to rise above the

rate of inflation. In the United States, the market added 142,000 jobs mainly in the health care, professional and business services sectors, bringing unemployment rate down to 6.1 percent in August. Although second quarter GDP grew by 4.2 percent, the outlook for U.S. growth remains cautiously positive. Strength in the housing market, exports to emerging markets and increased domestic oil production is hampered by some uncertainties, including the geopolitical uncertainties in the Middle East and Eastern Europe. In the Euro area, growth is expected to strengthen to 1.1 percent in 2104, but would remain uneven across the region.

In emerging market and developing countries growth projection is slightly lowered to 4.6 percent from 4.8 percent previously projected on the back of tight financial conditions from the US, and possible capital reversal. Under these uncertain conditions, monetary policy at this time should be focused at minimizing the downside risks and safeguarding the economy.

***Against this background,*** I support a hold on Monetary Policy Rate, an increase in Private Sector Cash Reserve Requirement (CRR) and retention of 75 percent of Public Sector Cash Reserve Requirement (CRR) to ensure macroeconomic stability.

### **3.0 BALAMI, DAHIRU HASSAN**

#### **Global Economy**

Macroeconomic data at the global level for major trading partners of Nigeria shows that economic growth was firmly a little stronger in the second half of the year than it had been in the first despite the political situation in Russia and Ukraine. In the US, growth in economic activity rebounded in the second quarter. It is expected that US will grow at 2.9 percent moderated from 3 percent. For now, the GDP has slightly increased by 1 percent and fall in output in the first quarter has been raised to 0.5 percent. Labour market condition improved with unemployment rate declining. Household spending appears to be rising moderately and business fixed investment is advancing. However, recovery in the housing sector remain slow.

In the Euro zone economic growth had not fully picked up; for example GDP rose by only 0.6 percent, with fall in output in Italy, weak industrial output in Germany, France and expectation that output in Japan to contract. There is weakens in inflation in the Euro zone activity. Real inflation for July had fallen to 0.4 percent. Inflation in many core economies is likely to stay below 2 percent and slack still remaining. This implies that the process of rebalancing and restoring competitiveness in the periphery might well prove a greater and persistent drag on Euro-area activity.

## **China/ Emerging Economies**

GDP growth in China had risen from 7.4 in Q1 to 7.5 percent in Q2. Targeted stimulus measures were implemented by Chinese authorities since spring would be sufficient to keep growth close to the government's 7.5 percent target for the rest of the year. In China the rapid growth in credit and vulnerabilities associated with shadow banking system, remain a risk to the outlook for Chinese economy.

## **Brazil**

Expected growth is to improve over the coming twelfth months as overseas demand recovered. This had led to pick-up in business investment. CPI inflation had risen from 1.5 percent in May to 1.9 percent in June, rather strong than Bank staff and other economist had expected. Note that high inflation rates generates distribution that lend higher risk and depressed investment shortening the planning horizon of household, companies and government as well as distortions of business confidence.

## **Africa**

In Africa, the growths remain strong for most countries. However countries like South Africa witnessed weak growth and widening output gap and negative employment outlook due partly to strike in platinum.

## **Finance**

The financial market in Euro-zone remained relatively resilient despite a number of significant events during the month of August. The European Central Bank cut interest rates to new record lows from 0.15 percent to 0.05 thereby lowering costs to try to lift inflation of 0.3 percent which was far below the ECB target of just bottom levels and support stagnating Euro-zone economy, lowered the rate on Bank overnight deposit to - 0.20 percent meaning Banks to pay part of funds at Central Banks. The ECB cuts its marginal lending facility or emergency borrowing rate to 0.30 percent.

## **Prices**

There has been little change in most commodity price. Price of agricultural commodities had generally fall a little. Oil prices were also slightly lower, despite the conflict in Iraq and renewed turmoil in Libya. The threats to Nigerian oil Revenue exist due to US Shale oil and gas and the preference for Angolan crude to that of Nigeria and other countries.

## **Domestic Economy**

The GDP growth rate and prospect remains strong in Nigeria. In the Q1 of 2014 is about 6.21 percent which is an improvement over 2013 despite the higher base. The growth prospect of the economy is bright due to government supportive policies in various sectors of the economy like agriculture, energy and manufacturing. The oil price though has slide downward slightly but overall it has been stable. The

service sector and other sub-sector in the non-oil sector are the major drivers of growth. The country's overall domestic economic environment remained stable backed with single digit inflation as well as stable foreign exchange market and prices. It should be noted that lending to Nigeria's private sector climbed to 9.2 percent #17.25 trillion a year ago an indication that credit to the private sector is rebounding. Money supply (M2) also grew 3.12percent month-on-month in July, faster than the 0.13 percent increase in June due in part to increase lending to the private sector.

### **Major Challenges to Growth in the Nigerian Economy**

Insecurity in the north east of Nigeria, high unemployment level particularly graduate, fall in the level of agricultural output due insecurity in the northeast and flood problem, rising level of food inflation, poverty and inequality, lower level of oil output due oil theft and vandalism of oil and gas infrastructure except in June, Risk to political tensions in the run-up to election in 2015, pervasive corruption which undermines growth, rising level of poverty and income inequality, challenges in the foreign exchange and reserve, and infrastructural gap.

### **Foreign Exchange Rate**

The foreign exchange rate has remained stable partly due to strategic sacrifice of monetary policy independence for exchange rate policy stability at the risk of medium term macro and financial system stability. In month of August it was relatively stable at rDAS

segment but appreciated at the interbank and BDC segment indicating effectiveness of monetary policy, gradual of foreign investors to Nigerian market, and introduction of more complimentary measures to speculative demand.

### **Capital Market**

There is decline in equities and this was attributed to the impact of the global financial market. The decline in equities was in response to quantitative easing tapering in the US. Despite this the capital market is fairly stable.

### **Inflation**

Inflation declined steadily from 9.0 percent in January 2013 to 8.00 and 7.8 percent in February and March 2014 respectively. Food inflation, a major driver of core inflation declined consistently from 9.5% in 2013, to 9.2% in February 2014 before increasing to 9.3% in March and 9.4% in August 2014. However all measures of inflation are single digit.

### **Interest Rate**

Although the financial system remained stable the interest rates are still high particularly the gap between deposit and lending rates. The inter-bank call rate fell from 10.75% in February 2014 to 10.5 percent in May 2014. However in August, Nigeria's inter-bank lending rates climbed 25 basis points to an average of 10.75 on Friday 29/5/2014

after funding for Foreign exchange purchase and issuance of treasury bills to curb market liquidity.

The open-buy-back (OBB) rate fell from 10.52 to 10.32 in March and May 2014. It climbed to 10.75 percent from 10.5 percent the previous week, 1.25 basis points below central banks bench mark interest rate of 12 percent. Overnight placements also increased 50 basis points to 11 percent from 10.5 percent the previous week.

### **Fiscal Operation**

Government fiscal operation has been largely directed towards recurrent expenditure rather than capital which undermined growth prospects.

I vote to retain the current tight monetary stance because on the basis of the current situation a reduction on interest rate will assist in triggering higher inflation, lower our reserve due to hot money likely to jet out leading to increased pressure on the Naira. This may call for devaluation. At the same time food inflation is likely to be on the increase because of low agricultural output due to insecurity in the northeast region. The months coming ahead are in electioneering period with consequence of rise in the level of government expenditure which will lead to rise in inflation. It should be noted that 89 percent of US domestic oil demand is met internally, leaving only 11 percent leading to fall in demand for Nigerian oil. Out of this 11 percent, Angola's oil is favored over Nigerian supply.

## 4.0 BARAU, SULEIMAN

### Summary of Recent Developments

The estimated Gross Domestic Product (GDP) growth for the second quarter of 2014 at 6.54% was strong; higher than 6.21% in Q1 and 5.49% in 2013. However, inflation, particularly Headline Inflation (HI) is on upward trajectory in the last 6 months closing at 8.5% in August 2014. Exchange rate is stable at the rDAS and interbank markets but there has been increasing pressure on BDC rate. Foreign reserve level has been stable closing at \$39.7b on September 17, 2014.

Therefore, monetary Policy meeting is taking place at a time of heightened risk to the current policy stance arising from global and domestic developments.

### On the Global Scene:

**There has been heightened geo-political tension arising from developments in the Middle East particularly Iraq and Syria.** The recent activities of ISIS and response by the US and its coalition countries could affect the demand/supply balance for crude oil and ultimately its price in the international market.

**Oil prices have recently been showing a declining trend due to the effect of shale oil production among other reasons.** Brent and Bonny Light closed at \$96.9 per barrel (pb) on September 9th, below the psychological resistance level of \$100/bp. The OPEC reference basket price also closed at \$97.00 per barrel on September 9th. This

portends danger for government revenues, foreign reserves, exchange rate and ultimately the effectiveness of monetary policy.

The US Federal Reserve's Federal Open Market Committee (FOMC) released its decision after the September meeting as summarized below;

- It reduced the monthly assets purchase programme under QE3 to \$15 billion monthly.
- It will continue its assets purchase program and employ other tools as appropriate until the labour market improves substantially in the context of price stability, but while maintaining that accommodative stance remains appropriate, asset purchases paces will be consistent with labour market and inflation developments.
- If information about labour market and inflation developments move toward long run objective, it will end its asset purchases at its next meeting.

The conclusion I reach from these carefully worded release imply that asset purchases will for now continue albeit at a slower pace until labour and inflation long run objectives are met.

Should this happen, it will make emerging markets assets less attractive, elicit reversal of flows, impact foreign reserves, exchange rate and inflation. Meanwhile, global recovery particularly from the

developed (particularly Euro area) and some emerging economies continues to be slow and this will no doubt compound Nigeria's potential problems in the context of the impending deterioration in the demand and supply balance for oil in the international markets, reduce accretion to foreign reserves and put pressure on the Naira/US\$ exchange rate.

### **From the Domestic Scene:**

#### **There is evidence of sustained liquidity in the banking system.**

Liquidity ratio remains at 12% above the minimum prescribed ratio. In addition, a monitoring of the average daily balance at the Standing Deposit Facility (SDF) window remains a source for concern in the context of need to increase lending to the real sector. The reasons for the sustained liquidity are not farfetched. Firstly, there has been the reluctance of banks to increase lending to the real sectors given the attractive yield from investment in government securities and indeed from the SDF window. Secondly, even though the stance of policy has been tight for sometimes in the recent past, liquidity injection from prior year QE by CBN following the global economic crises and subsequent creation/funding of the Asset Management Corporation (AMCON) is still substantially out there. The disturbing liquidity outlook from the impending repayment of maturing obligations by AMCON in October, CBN's intervention activities and likely increase in fiscal spending as we head into election year, as

well as security related spending should be of significant concern to monetary policy.

The YoY Headline Inflation has been on upward trajectory in the last six months. HI increased to 8.5% in August compared to 8.3% in July. The Food measure also increased to 10.0% in August from 9.90% in July. The Core measure however decreased to 6.26% in August compared to 7.10% in July. In spite of the fact that the HI is within 6 – 9% targeted band and its six months staff outlook estimated to remain within the band, I am disturbed that the liquidity outlook may drive the HI beyond the band. This will no doubt hurt the reputation we built over the past one year in containing inflation.

**In the management of foreign exchange rate, there have been some recent disturbing trends as well.** Overall, we have recorded successes in building foreign reserves, and in ensuring exchange rate stability in rDAS. **However, there has been a build-up of pressure on the BDC and interbank market rates.** BDC sell rate closed at 169/\$ in September compared to 168/\$ in August. We also witnessed a marginal depreciation of 0.07% in the interbank rate from 162.78/\$ in August compared to 162.9/\$ in September. We had to step up intervention in the interbank window to contain similar pressure and to ensure stability. The pressure on these segments relates to change in market sentiment and demand for hajj related activities amongst other internal and external factors. The outlook for the exchange rate in the light of these factors and particularly the external sector

threats stemming from the uncertainty regarding QE3 in the US and its effect on portfolio flows is a major pressure point going forward.

Apart from the above developments which influenced the way I voted, it is important to discuss some other issues that guided me in reaching my conclusion.

**Other Significant Issues:**

**There have been calls recently on MPC to reduce the MPR and by extension change to an accommodative stance in policy.** This is consistent with the clamour for the reduction in lending rate. Maximum Lending Rate (MLR) at 26.07% in June and July remained unacceptably high. Even the average Prime Lending Rate at 16.44% in July is high in relative and global contexts. This situation could justify the clamour for lowering of rates and the call for a downward review of MPR and reversal of stance from tight to a more accommodative policy stance.

However, in the light of the recent pressure points earlier mentioned, it is difficult to justify a change in stance at the moment. Besides there are two other considerations;

As I have always said, recent research studies initiated by MPC have proven lack of a clear relationship between MPR and credit growth in Nigeria. Desirable as it may be to some, there is no evidence to show that a reduction in MPR will be accompanied by any

significant growth in private sector credit and real sector growth at least in the short-run.

This confirms our earlier position that what is needed to spur radical growth in credit to the private sector is the much talked about structural reforms. Credit will subsequently flow into the real sector.

It is important to mention that inspite of the GDP rebasing and the current regime of interest rate, we continued to record strong real GDP growth rates. Given this fact, the risk of easing in the context of high systemic liquidity, declining oil price and pressure on foreign reserves and exchange rates can be more costly and should be delayed at this time.

### **Recommendations:**

**It is in the light of the foregoing that I voted as follows;**

- That we maintain the tight stance in policy;
- That we maintain MPR at 12%;
- That we maintain the Systemic Corridor of plus and minus 2% around the MPR for SLF and SDF respectively. But I am also open to a migration to asymmetric corridor if that will help to stimulate growth in private sector credit as we make the SDF less attractive to the Banks;
- That we maintain the NOP at 1% of Shareholders Funds;
- That we maintain Minimum Liquidity Ratio (MLR) at 30%.

## **5.0 DANIEL-NWAOBIA, ANASTASIA**

The outlook for the domestic economy output in the coming months is positive. The real GDP grew by 6.54 per cent in the second quarter of 2014 with the oil sector growing by 5.14 per cent. The positive growth in the oil sector during the second quarter of 2014 was a marked reversal from the negative growth recorded in the previous four quarters. This was attributable to the outcome of Federal Government's intervention in the Niger Delta area which has reduced the vandalism of oil production facilities and theft of crude oil.

Year-on-year headline inflation accelerated to 8.5 in August 2014 from 8.3 per cent in July, 2014 driven by the rise in food inflation. Staff projections indicate that, the year-on-year headline inflation would remain within single digits in the next six months with the end-December, 2014 rate projected at 8.8 per cent. The positive inflation outcome is partly attributable to fiscal prudence, policy measures that have increased domestic food production as well as restrictive monetary policy stance.

The exchange rate continues to maintain relative stability in the three segments of the market (RDAS-SPT, Inter-bank and BDC), supported strongly by the external reserves. The level of gross official reserves as at August 29, 2014 stood at \$38.70 billion which could

finance 8.52 months of import. As at September 16, 2014, gross official reserves had increased to \$40.7 billion, reflecting the conscious efforts by the Government to build the external reserves. Reduction in market interest rates as well as ensuring the flow of credit to the real economy continued to be key policy challenges. In particular, credit expansion, domestic investment and real sector growth have been hampered in view of the continued high interest rates of the Deposit Money Banks. Consequently, strategic efforts need be made towards addressing the issue of high interest rates as well as ensure the flow of credit to the real economy in order to engender growth and create employment.

Notwithstanding the relative stability in the domestic macro-economy, I am not unmindful of some global economic developments which could adversely affect our expectations in the medium to long term. For instance, the continued increase in oil and gas output in the US could lead to uncertainties in the export of Nigeria's oil and hence revenue and foreign reserve accumulation; while the possibility of foreign investors redirecting their investments interest to the advanced economies following the improved growth and employment conditions in these economies could result in lower foreign exchange inflows or increased outflow of foreign capital; however, the positive economic profile of the country has helped in attracting foreign direct investment (FDI) in sectors such as

Petrochemicals, Cement, Sugar and Agro processing, making Nigeria, for the second year running, the preferred destination for FDI in Africa. Furthermore, Government efforts at reducing the vandalism of oil production facilities and crude oil theft would minimize the effect of possible capital reversals.

Given the current macro-economic stability coupled with positive outlook in near to medium term, I will advise that the current tight monetary policy stance be maintained in order to sustain the relative stability achieved thus far.

Consequently, 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 inter-meeting period.
- (ii) The Private sector CRR should also be retained at 15 per cent, given the current banking system liquidity profile.
- (iii) The current policy on foreign exchange (mid-point and exchange rate band of N155/US\$1 +/- 3%) should be retained, while the CBN continues to intervene to stabilize the rates, when necessary.

## **6.0 GARBA, ABDUL-GANIYU**

I voted for a forward looking policy stance that is consistent with (1) current monetary policy strategy, (2) current and expected domestic pressures and (3) anticipated global pressures. The real macroeconomic data for the second and third quarter of 2014 indicates good performance: 6.54% in the second quarter and about half a million jobs created in the first two quarters of 2014 albeit with more than three quarters in the informal sector. The financial data (inflation, money supply, the capital market indexes, forex market data), fiscal data and external data indicate the pressure points in the economy. The developments in the global economy particularly the separation between the Euro-zone and the United States in terms of economic performance and monetary policy stance indicate a great likelihood of instabilities in financial markets particularly foreign exchange markets in the fourth quarter of 2014 and through 2015.

The impacts of maturing AMCON Bonds in the fourth quarter (October, 2014) on liquidity demand proactive actions to sterilize "inverted intermediation liquidity". Staff forecast that inflation is likely to overshoot the upper bound of 9% in the fourth quarter even without accounting for AMCON effects strengthen the case for sterilization of inverted intermediation liquidity.

I vote for tightening of liquidity by raising private sector CRR while keeping MPR fixed at 12%, liquidity ratio at 30%. In addition, I vote for asymmetric corridor of -5 and +2 around the MPR. I have consistently justified the asymmetric corridor on the “market functioning” argument.

The vote for tightening is a vote to sterilize “inverted intermediation liquidity”. Were excess liquidity channeled to high employment elasticity sectors of the economy, tightening will be unnecessary. Indeed, I am convinced that if excess liquidity were channeled to high employment elasticity sectors of the economy, interest rates will most likely fall especially if the SDF rate is significantly reduced. As is, Deposit Money Banks have found it more rational to hold excess liquidity for the secure and attractive returns from the game of inverted intermediation. It is clear to me that the Standing Deposit Facility (SDF), government securities and currency substitution are weakening market functioning and destabilizing key nominal anchors for monetary policy. It is necessary to sterilize such liquidity particularly, because they are inherently and structurally destabilizing given their likely effects on price stability.

Market functioning remains a major challenge for efficient allocation of financial assets and for a stronger transmission mechanism of monetary policy which has weakened and become more asymmetric globally in the aftermath of the global financial crisis.

Much of the expansion in the balance sheets of Central Banks in the aftermath of the global financial crisis has had limited effects on real variables, stronger effects on asset prices and adverse effects on income distribution with the top 1% the top gainers and the low and middle classes the most losers.

Without significant “market-function-improving”, it will be difficult to strengthen the transmission mechanism of monetary policy and empower it to support the sectors of the economy and businesses that have high employment elasticity of growth.

Available data point to more activities in the interbank market in the last two months. A significant reduction in the incentive for the high “inverted intermediation liquidity” in the SDF window will support the interbank market. Tightening of CRR simultaneously with significant reduction in SDF rate will further spur activities in the interbank market.

Far too much is expected of monetary policy today. However, faced with *impossible trinitities* (exchange rate stability, independent monetary policy and capital account liberalization) and possible but *malfunctioning trinity* of policies (monetary and fiscal) and politics, it is important to stress that monetary policy is not a panacea (a cure all). It has to be complemented by market-function-improving

institutional changes, more effective monetary-fiscal policy strategic coordination as well as sound macro-prudential and micro-prudential regulations and implementations. The greater challenge for economic management (monetary, fiscal and political economy) is that of steering the economy seamlessly through the coming turbulence of a post quantitative easing era. Monetary policy must, remain forward looking.

## **7.0 LAWSON, I. STANLEY**

### **Global Economy**

The global economy has continued on a path of weak economic recovery as evidenced by the IMF's mark down of its growth projections by 0.3% to 3.4%. The US however continues to provide considerable tail wind as its economy expanded by 4.2% in Q2 up from a contraction of 2.1% in Q1. Unemployment fell from 6.2% in July to 6.1% in August, while YoY inflation rate is reported at 1.7% in August (BLS).

Due to improving macroeconomic performance, the US is gradually moving from a regime of easing which will end in 2014 to a regime of tightening which will commence in 2015. This action by the US will have far reaching implications and consequences for emerging market economies. Global growth may however be further depressed by various existing and escalating regional conflicts.

Global inflation has remained relatively stable with little inflationary pressures in the short to medium term. Inflation in the US, UK, Europe and China have remained lower than policy goals. The announcements by the European Central bank and the Peoples Bank of China to introduce new monetary stimulus programs have left expectations high that the US and the UK will probably announce an increase in policy interest rates.

International crude oil prices have commenced a southward trend due to diminishing demand by the US, increased supply by the US and other countries, and the US proxy war with Russia. All of these will gradually have a direct negative impact on Nigeria's foreign reserve. Staff research shows that growth in African countries continues to be strong but may be dampened by tight financial conditions.

### **Domestic Economy**

The domestic economy has remained strong with a real GDP growth of 6.54% in Q2. The main sectors contributing to the growth are service, agriculture and trade. Gross official reserves rose to 40.7 billion in September, up from 39.1 billion in July thus revealing a slow but steady reversal of the previous decline trend. This is attributable to a number of measures taken by the CBN to sanitize the BDC

market and a steady rebuilding of fiscal buffers by the fiscal authorities.

The subtle but steady upward trending of headline inflation to 8.5% in August from 8.3% in July is a cause for concern but does not at this time call for drastic measures as it is still at single digit and within the bank's target band of 6-9%. Production and distribution challenges occasioned by the insurgency and insecurity in the North-Eastern part of the country have led to increasing food prices and this is overly responsible for the underlying inflationary pressures on the headline inflation. Food inflation measured on a YoY basis increased from 9.4% in April 2014 to 10% in August. It is important to keep a close tab on this as it could lead to a gradual switch from domestic food to imported food in order to meet domestic food shortfalls. This will create a consequential huge impact on external reserves. Year-on-year core inflation has shown a steady decrease over the last three months to 6.3% in August, down from 8.1% and 7.1% in June and July respectively.

Interest rates and liquidity continue to be high as staff research reveals an average lending rate of about 22% and deposit money banks holding over 300 billion naira in reserves. While the high lending rate is worthy of note, a decrease in the policy rate at this time may lead to an accelerated worsening of headline inflation,

increased pressure on the foreign exchange rate, and an acceleration of reverse capital flows especially on the back of the Fed's Quantitative Easing, billed to end finally in October. Also an increase of the policy rate at this time will potentially push lending rates to unacceptable levels thus further crowding out the already deprived productive sector from the credit loop of deposit money banks.

There are genuine fears that the high liquidity levels of banks may worsen with the anticipated redemption of AMCON bonds in October 2014. It is my candid opinion that the CBN can and should, through several other means at its disposal, encourage the deposit money banks to channel a good portion of their excess liquidity to the growth and employment generating sectors of the economy. This productive sector of the economy which is known to have an almost insatiable appetite for credit, is unfortunately presently outside the credit loop of the banks due to the inherent risks associated with the sector, the high operating costs of the sector arising from the absence of adequate basic operational enablers like power and security, and most importantly, due to the existing high interest rates in the market.

Redirecting banks' high liquidity positions to credit extension in the productive sector will have the triple effect of addressing the excess

liquidity scenario, reducing the pressure on the exchange rate, and further enhancing growth through production and employment creation.

### **Conclusion**

I am reasonably satisfied with the relative stability in the economy while also being mindful of the existing and potential key risks and challenges. These risks and challenges which are diverse in content and effect, include the upward trending headline inflation, high interest rates which negatively impacts credit extension to the real sector, high bank liquidity, declining oil prices, domestic security challenges with its attendant impact on food inflation, increasing pressure on the exchange rate, and capital reverse flow challenges especially in the face of the Fed's Quantitative Easing. Nevertheless, I am reasonably persuaded that these risks and challenges can at this time be better mitigated using avenues other than monetary policy adjustments. Also because the apex bank has both monetary and financial system stability responsibilities, it is expedient to always keep an eye on both responsibilities in discharging our duties.

I therefore vote as follows:

- (i) To hold the MPR at its current level of 12% with the symmetric corridor of +/-2%.

- (ii) To maintain the CRR on public sector deposits at the current level of 75%.
- (iii) To maintain the CRR on private sector deposits at the current level of 15%.

## **8.0 MOGHALU, KINGSLEY CHIEDU**

In the face of gradually rising inflation and excess liquidity pressures, with staff estimates, pointing to inflation ticking up in the next six months owing to anticipated growth in reserve money and accelerated food inflation, the imminent injection of over N800 billion liquidity into the financial system through the October 2014 bond-redemption by the Asset management Corporation of Nigeria (AMCON), pressures on the naira and the imminent end of quantitative easing by the United States Federal Reserve Bank, the question that faces the MPC at this time appears to be not that of whether to tighten monetary policy further, but when.

And in the face of apparent ideological differences of view of at this meeting of the MPC, with what is desirable – on which we all virtually agree – increasingly confronted with what is necessary, the Committee may be walking towards a perfect storm that can only be deferred but not avoided.

Questions have been raised about how the Committee can tackle rising inflation but without hurting growth, jobs and productivity. Should the Committee stick with the traditional approach of straight forward tightening in the face of present and medium term future economic conditions, or should it shift strategy to addressing how the excess liquidity in the banking system can be deployed to more productive ends? Should we indeed, reach out to unconventional wisdom?

Perhaps we should, but not now. If the MPC is to abandon the implicit inflation targeting it has pursued for the past three years, it needs to consider three important factors. First, any strategy course correction can only be a medium to long term affair, not a short term one in the face of the monetary conditions and market dynamics the Committee is confronted with in the short to medium term. Neither this meeting nor at least the next two to three meetings of the Committee will, in my view, be auspicious for a fully growth oriented Keynesian, as opposed to monetarist approach to monetary policy to be unfolded.

Second, it is important to note that in countries where inflationary growth has been pursued, it had required strong capacity of the fiscal authorities to provide the financial resources that in Nigeria the Central Bank of Nigeria has been constrained to provide, partly as a

result of fiscal challenges, for essential interventions to unblock reform bottlenecks such as the recent N213 billion loan facility provided by the Bank to defray successor debts owed to gas suppliers by the newly privatized power generation and distribution companies.

In other words, the Bank cannot fully perform alone as a normal business practice economic functions that ideally belong to other arms of government. It is certainly permissible to do so in circumstances where a strategic intervention can make a fundamental difference to achieve price stability that supports economic growth and transformation. After all, the QE embarked upon by the U. S. Federal Reserve. Bank remains unprecedented.

Third, I believed it is in fact necessary to consider the credibility of the CBN and its MPC as the Committee considers possible scenarios for monetary policy activity in the months ahead. Expectations will have to be managed carefully. Strategic communication and appropriate forward guidance remain essential.

I am persuaded that, as I noted in my statement on the July 2014 meeting of the MPC, we have cause for concern but no reason to be alarmed about inflation and liquidity trends in the economy. Thus, I am willing, in the face of present trends to give room for an attempt

at strategies to incentivize deposit money banks to deploy excessive liquidity to the real economy, failing which the MPC will have to tighten monetary policy at its November 2014 meeting. The constraints that will face this quest to incentivize increased bank lending to deflate liquidity include the historical experience and empirical evidence that Nigerian banks have not responded to incentives to lower lending rates and reduce the wide gap between lending and deposit rates. Moreover, this approach may require more time to work.

There is a larger debate that needs to take place in the MPC at this time, and that is that of what type of monetary policy is best suited for a developing country such as Nigeria. The monetarist approach, which the CBN has adopted for the past several years, is based on the Quantity Theory of Money which focuses on the influence of money supply as a factor in both inflation and GDP growth. This approach, with the late Milton Friedman as its great advocate, has delivered price stability in Nigeria through tight monetary policy in its current phase, and is also what has given impetus to the unconventional method of QE which the Federal Reserve adopted in the wake of the financial crisis to reflate the US economy. But tight monetary policy, while containing inflationary pressures, is seen as restricting growth because it has made access to credit difficult for businesses with the potential to generate increased productivity. We

certainly need to think beyond merely maintaining price stability, which is nevertheless essential because the cost of the absence of stability is high, to how to think about how transformational growth potential in the economy can be unlocked.

While monetarism has gained traction over the past 35 years in monetary policy and has come to be seen as conventional wisdom, it was not always so. The advanced economies that practice monetarism today powered their economies through a markedly different monetary paradigm in different, past eras, and that was through Keynesian, growth-stimulating government spending (frequently financed by central banks). This calls into question what the role of central banks is, and the real answer is that there is no set answer. Developmental conditions and strategies can dictate the answer to this question.

The real question is whether Nigeria is ready or able, and the time is ripe, to move away from monetarism towards a Keynesian pro-growth monetary policy. Two factors point to why timing is critical in addressing this question. The first is that the productive base of the Nigerian economy is still relatively weak, largely because the structural conditions to drive a massive boost in manufacturing output is constrained by the huge gap between need, potential and availability of electric power that would not only drive productivity,

but also drive down the cost of doing business including the cost of credit. This suggests that the best timing to pursue an explicit pro-growth monetary policy might be when this foundational condition is addressed.

The second is that the revenue tax base of the fiscal authorities is still relatively weak and needs to improve in order for the government to finance growth at a more optimal level beyond the vagaries of exogenous factors such as the fluctuations in the price of crude oil. Beyond this, the only alternative scenario that can support a sustained decrease in rates or a general loosening of policy stance would be bountiful external reserves and increased fiscal savings. While, at approximately \$40 billion, the country's reserves are stable, this is still way off from the level where it would have to be for the Bank to undertake a radical shift in policy stance and have the ammunition to manage the inherent risk if structural reforms in the economy have not yet bedded sufficiently.

Another factor to consider is that, while tight monetary policy may constrain growth potential, inflation, which the prevailing monetary policy stance has successfully contained in Nigeria, is the most regressive tax on the poor, the vast constituency that Keynesian monetary policy asserts to support. Rising inflation, without real productivity as a possible policy trade-off, would hurt the poor far

more than high interest rates. It can be argued, of course, that the growth that is achieved in a high interest-rate regime is often not inclusive growth that can lift the poor out of poverty and enable them create wealth. Lower policy rates will make investments in Treasury Bills and other instruments, as well as the CBN Standing Deposit Facility less lucrative for banks and thereby possibly stimulate lending by banks. But, is the wider environment conducive to guaranteeing this outcome? This is doubtful.

The reality thus remains that if ongoing structural economic reform continue with success, in another three to five years the conditions will exist in the real economy to support an unabashedly pro-growth monetary policy in which the exchange rate can be supported by endogenous factors rather than merely exogenous ones such as foreign portfolio investment and the price of crude oil because increased power generation, distribution and transmission will trigger more robust productivity from manufacturing and the establishment of private sector petroleum refineries will exert less pressure on our import bill and on demand for foreign currencies. This, by the way, is an important justification for targeted developmental interventions by the CBN that can contribute to achieving this goal, where the Bank's balance sheet allows.

I am also persuaded by the need to weigh the implications of further tightening at this time on financial stability. Against this background, while we watch the situation carefully and take the required administrative and strategic actions calculated to reducing interest rates in the medium to longer term, I will vote for a hold at this time, without prejudice to the possibility of further tightening in the short term should monetary conditions warrant it.

I therefor vote to:

- i. Hold the Monetary Policy Rate at 12%
- ii. Hold corridor in a syndetic stance at plus or minus 2%
- iii. Hold the Cash Reserve Ratio at 75% for public sector deposits and 15% for private sector deposits
- iv. Hold the Liquidity Ratio at 30%.

## **9.0 SALAMI ADEDOYIN**

The prelude to this meeting saw the release of data showing the sixth monthly rise in aggregate prices. Even though, at 0.5percent, the Month – on – Month change in aggregate prices in August was the lowest since February, 2014, the outlook provided by Bank Staff show that prices will continue rising until year-end. Indeed, with Headline

Inflation for December 2014 projected at 8.8percent, the possibility of missing the target band looms large!

My inability to support the majority of my colleagues in deciding to leave the stance of policy unchanged stems from the following –

- A worsening global and domestic outlook; and
- The need, in the face of worsening outlook, to preserve the credibility/reputation of the Central Bank with regard to its inflation mandate;

My perspective on the outlook for the global economy is that it is largely unfavourable to Nigeria. Easing oil prices, despite continuing uncertainty and conflict in the Middle East, coupled with OPEC's announcement of cutbacks in Oil production Quotas – albeit in effective 2015 – in my view, poses a challenge to our fiscal balance. Beyond oil prices, announcement of the end of Quantitative Easing by the Federal Open Market Committee (FOMC) of the US Fed. Reserve has potentially disadvantageous implications for Nigeria.

A stronger US dollar resulting from rising American interest rates will challenge our FPI dependent build – up in Forex reserves – how badly will be revealed in time. In passing, having noted easing oil prices, the impact of the anticipated strengthening of the US\$ on oil

market dynamics – quantity and then prices – is an issue which, though not for immediate consideration, should not be ignored.

On the domestic front, rising food prices show that beneficial impact of easing international food prices have not ‘passed through’ to the food price index. Indeed, the suspicion is that increasingly expensive locally produced food is overwhelming any ‘pass through’ of international food prices. While monetary policy affords no solution to rising food prices, there are number of non-food issues including –

- i. The build-up of banking sector liquidity;
- ii. Rising CBN intervention in FOREX market which is indicative of growing pressure on the currency;
- iii. Continuing portfolio allocation decisions against the Naira which suggest to me that tighter monetary policy is appropriate at this time.

The growing level of liquidity will be exacerbated by the imminent redemption of a further tranche of AMCON Bonds. The forward-looking nature of Monetary Policy convinces me that now is the time to tighten. Perhaps most significant issue from my perspective is that care MUST be taken not to convey the impression that the MPC has lowered the priority it accords inflation management.

## **10.0 UCHE, CHIBUIKE U.**

This MPC meeting was a very difficult one for me especially given the fact that most of the economic indices that determine the health of the Nigerian economy are pointed in the wrong direction. The decline in both oil prices and oil production in our mono product economy continues to put enormous pressure on our foreign exchange rates and reserves. Increasing demand for foreign exchange, growing food shortage which is mainly as a consequence of the crisis in the North East geopolitical zone and political uncertainties which are in part a consequence of the upcoming 2015 elections have also not helped matters. In fact, a number of critical inflation indices have continued to creep upward for some time now.

It is based on the above troubling factors that I have come to the careful conclusion that there is now again the need to further tighten money supply. Although I have consistently argued that the monetary stability mandate of monetary policy is not an end in itself, to do nothing at this stage will in my view send a strong signal to speculators and foreign investors that indeed the CBN may soon throw in the towel in defending the exchange rate of the Naira. While tightening money supply will increase interest rates, which will be detrimental to the interest of the productive sectors of our economy, the inflation and possible devaluation consequences of

doing nothing will in my view be even more detrimental to the said sectors of our economy.

It is also important to note that both maintaining the status quo and tightening money supply at the present time portend danger for financial system stability. Available statistics for instance show that tightening money supply at this stage may cause a few banks to fail critical financial stability ratios. On the other hand, the uncertainties and possible inflationary and exchange rate consequences of doing nothing, in my opinion, pose even greater danger for our country's financial system stability both in the short and medium term. This is because any major devaluation at this stage, given our peculiar mono product economy, will likely distort the productive base of our economy, discourage long term investments and attract more short term investors and currency speculators.

Based on the above analysis, the critical question for me at this MPC meeting is therefore not whether to tighten but what type of money tightening instrument(s) to use. In reaching a decision, it is important to point out that since I joined the MPC in January 2010, few have disputed the fact that fiscal indiscipline has been a major impediment to effective monetary policy formulation in Nigeria. It was as a consequence of this that we introduced discriminatory CRR on public sector deposits. The fundamental reasoning for this policy

action was the appreciation of the fact that charging CRR on government deposits is in itself an anomaly. This is so because the Central Bank of Nigeria is by statute the banker to government. The maintenance of the accounts of government and its agencies in commercial banks therefore contravenes the CBN statute.

Unfortunately despite all the positive noises the government has been making for some time now that it would implement a Treasury Single Account (TSA), this is yet to come to fruition. My suspicion has always been that the pecuniary interests of government officers and agents have been central to preventing the adoption of TSA. Bluntly put, thanks to brokerage incentives, it is not uncommon for government agencies to have huge sums of money in their current accounts with commercial banks yielding little or no interests while at the same time borrowing huge sums of money at double digit interest rates from commercial banks.

Unfortunately, such practices have had unpalatable consequences for monetary policy formulation in Nigeria. Government through its imprudent fiscal practices inadvertently complicates monetary policy by creating an unhealthy base for real sector economic development to take place. Scarce government resources that could be profitably channeled to improving developmental infrastructure is wasted because of pecuniary gains of government

servants and agents. It is the inability of government to correct long drawn out base anomalies like the absence of the TSA that has no doubt helped in fuelling the widespread perception that corruption in Nigeria has been institutionalized. Thankfully, it is within the powers of monetary policy to correct this anomaly. Increasing CRR on government deposits to 100 percent simply removes the incentive for banks to cooperate with government agents and servants to sabotage the TSA policy.

For the avoidance of doubt, I do not share the view that our Central Bank, which has branches in all the states of the Federation may not be ready to undertake its statutory function of serving as banker to the Government. I am simply not convinced that the basic income and expenditure accounting structure of Nigerian government agencies is too complicated for our increasingly IT driven Central Bank especially in this era of cashless policy. This is in part because unlike most individuals, the expenses of governments (and companies) can mainly be done through cheques and bank transfers. My position that government should be forced to maintain a TSA is further reinforced by my personal belief that with the 75 percent CRR on public sector deposits, banks may have changed tactics by using such deposits to fuel and take advantage of our increasingly divergent official and parallel foreign exchange markets through arbitrage.

At another level, the move towards TSA will enable banks to focus on their core mandate of acting as intermediaries between excess and deficit units of the economy. In the long run, this has the potentials to force banks to lend to and grow the productive sectors of the Nigerian economy. This is by far the most plausible way to guarantee banking sector stability.

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 on private sector deposits at 15 percent; (3) to increase CRR on public sector deposits from 75 percent to 100 percent, and; (4) to retain Liquidity Ratio at 30 percent.

### **11.0 YAHAYA, SHEHU**

I vote to for a slight tightening of monetary policy through an increase on the CRR on private sector deposits, while maintaining the MPR at its current level of 12%, along with the symmetric corridor of +/-2%, the CRR on public sector deposits at the current level of 75%.

My decision is based on the following considerations:

## **International Economic Environment**

Economic recovery is underway in the US, despite the stutter in Q12014. Output continues to recover, unemployment is gradually falling and prices slowly rising. The asset purchase program by the Fed is scheduled to stop in October 2014. The main concern for developing and emerging economies is of course whether the ending of the asset purchase program will raise interest rates in the US and precipitate capital flight from the developing countries.

In the case of Europe, it is expected that the purchase of asset-backed securities to help stem deflationary trends will keep interest rates down and partially offset the effect of rising interest rates in the US. Stable demand growth in China continues to provide a source of demand for primary products and therefore growth for developing countries.

As far as prices are concerned, world prices continue to be fairly stable and are indeed declining in some OECD countries. For the most part therefore, there are no current concerns for significant imported inflation.

In the case of oil prices, there is already a downward trend, with the price of Bonny Light dipping below the US100/barrel mark for the first time in a while. OPEC has been concerned enough to try and

reduce supply. As the production of shale oil in the US continues (indeed it is at a historical peak now), and considering slow growth pick up in Europe, there is a risk that oil prices may fall further.

### **Domestic Economy**

Growth in the country in Q2 2014 is fairly robust at 6.54% and is expected to be around 6.75% for the year. The risks to sustained growth in the country emanate mainly from the effects of the insurgency in the North Eastern part of the country, possible decline in oil prices in the face of lower than planned output levels, as well as low domestic investment levels. On the other hand, there are prospects for investments in infrastructure and agriculture impacting positively on the real sector and on jobs.

Price levels have maintained an upward trend each month since March 2014 and are currently at 8.3 per cent. Headline inflation is projected to trend upwards up to the early part of 2015 on the back of persistent excess liquidity in the banking system, prospects of increased fiscal expenditure in the run-up to the election, as well as pressure on the forex market.

The exchange rate is currently under significant pressure. This is emerging from a number of directions, including a significant outflow of US\$4.1 billion in the first half of 2014 and the downward trend in

the price of Bonny light crude in the face of production challenges. These factors may put significant pressure on foreign reserves, which, although showing signs of recovery, are still vulnerable.

The government on the other hand has demonstrated considerable fiscal prudence- both reducing borrowing and expenditure in the face of revenue slippages. This has helped give some headroom for monetary policy. The challenge is to maintain this fiscal stance in the run-up to the elections. The downside is that the burden of fiscal prudence has fallen disproportionately on capital expenditure. While credit to government has fallen, credit to the private sector has also been quite slow, despite the liquidity surfeit in the banking system.

In the money market, inter-bank rates fairly stable. Interest rates remain high and the spread between lending and deposit rates are still widening

## **Conclusion**

The main factors to be considered relate to the pressure on the exchange rate, the downside risk to oil prices, the risk of accelerated reversals of portfolio investment and the upward-creeping price levels. It is clear to me that something must be done to stem these pressures.

At this time, it may not be the best approach to raise MPR because of the probable effect on interest rates and the possible truncation of the positive trends in credit support for some real sectors. Nevertheless, excess liquidity has to be addressed in order to help avert its possible inflationary and exchange rate effects. I therefore vote for a small rise in CRR on private sector deposits so as to help stem the pressure on prices and the Naira exchange rate.

**12.0 EMEFIELE, I. GODWIN, GOVERNOR OF THE CENTRAL BANK OF NIGERIA AND CHAIRMAN, MONETARY POLICY COMMITTEE,**

Key macroeconomic indicators in the domestic economy revealed a mixed signal. Output expansion at 6.54 per cent during 2014Q2 could be adjudged fairly robust while external reserve level of about US40 billion in the face of rising demand pressure is still comparable with the level in most emerging economies. A reasonable degree of stability is also discernible in the financial markets particularly with the resurgence of transactions in the interbank market following a fairly prolonged lackluster performance of that segment of the money market. This is particularly welcomed in view of its salutary impact on the transmission mechanism of monetary policy.

A major concern however is the rising inflationary trend with headline inflation accelerating to 8.5 per cent in August. Against this background and coupled with the inherent risks in the near to

medium term outlook, therefore, policy choices at this meeting appear limited.

The risks in the near- to medium-term could be dimensioned into global and domestic. From the global side, the massive monetary stimulus of the Federal Reserve Bank is expected to cease with effect from October 2014 thereby reducing the supply of foreign capital, which enters the financial markets of emerging and frontier markets. To confront this risk, a number of central banks in emerging economies have held policy rates at elevated levels since the beginning of QE3 tapering in the latter part of 2013. Thus, it is advisable to keep the monetary policy rate (MPR) at the subsisting level of 12 per cent which is adjudged competitive with the risk adjusted level in comparable jurisdictions.

Another major issue in the external sector emanates from the commodity price developments, particularly the falling crude oil prices engendered by ample supply by rising shale oil production in the US. The worry is magnified by continuous softening in the price of crude oil despite the geo-political conflicts in oil-producing countries: Russia, Iraq, Syria, and Libya and also the war in Ukraine. This development portends considerable risk to Nigeria's fiscal revenue performance as well as accretion to external reserves.

In the domestic environment, factors such as election related expenses, likely increase in electricity tariffs, global rise in food prices, and supply shocks due to insurgency constitute upside risks to the medium term inflation outlook. Perhaps, more importantly, food inflation is projected to cross the single digit border over the next six months, heightening apprehension about the Bank's ability to maintain its short- to medium-term target on headline inflation. Also, money market rates have been virtually below the policy rate for a considerable part of fiscal 2014, suggesting persistence of liquidity surfeit with the attendant possibility of pressure in the foreign exchange market or the alternative burden of mopping up. The situation is expected to be complicated by the redemption of AMCON bonds to the tune of about N0.9 trillion by end-October. The foregoing scenario points to one policy direction: some form of tightening.

Before taking my decision, however, it is imperative to equally consider the evolving paradigm on monetary policy which is price stability with inclusive growth as articulated in my strategic vision document upon assumption of office. As a consequence, other key development indicators particularly the deteriorating trend in unemployment and poverty should be considered. My view is that further tightening either through raising the MPR or CRR would affect

the already elevated lending rates with implications on the quality of banking assets.

This demands that we begin to explore unconventional means to address the issues in the macroeconomy. Credit to the private sector grew by a mere 5.36 per cent at end-August 2014, translating to an annualized rate of 8.04 per cent compared with our annual target of 15.85 per cent. Aggregate money supply grew by 2.94 per cent during the same period, annualizing to 4.41 per cent against the annual target of 15.52 per cent. This analysis suggests that the liquidity surfeit only exists in the banking system while the economy as a whole is short of liquidity. The challenge for monetary policy, therefore, is to devise innovative means to channel the excess liquidity within the banking system to the economy rather than sucking them up. In the interim, however, I would advocate for moral suasion on the banks to deploy their excess liquidity into the real sector instead of gilt edged government securities and related investments.

In the light of the foregoing, I vote to keep steady all the subsisting measures of monetary policy. Specifically, MPR at 12 per cent with symmetric corridor of 200 basis points; Private sector CRR at 12 per cent; public sector CRR at 75 per cent; and Liquidity ratio at 30 per cent.