Central Bank of Nigeria Communiqué No. 101 of the Monetary Policy Committee Meeting of Monday and Tuesday, May 18 and 19, 2015

The Monetary Policy Committee met on 18th and 19th May, 2015 against the backdrop of fragile but moderate growth and accentuating discrepancies in global output across regions and intensification of weaknesses in the domestic economy. In attendance were 11 out of the 12 members. The Committee reviewed the fragilities in the global economic and financial environment in the first four months of 2015, and reassessed the short to medium-term policy options for the domestic economy.

International Economic Developments

The Committee noted that global economic recovery continued at a modest but uneven pace partly because most countries were just shedding the deadweights of 2014. The IMF has projected a marginal increase in global output from 3.4 per cent in 2014 to 3.5 per cent in 2015, although with considerable variation across regions and major economies. The softening oil prices have continued to support an uptick in growth of oil importing countries but dampening growth prospects in major oil exporting economies. Overall, economic activities have gained some traction particularly in the US, underpinned by sustained monetary easing, ebbing fiscal consolidation, improvements in housing market conditions, lower financing cost, rising private consumption and increase in real household income. Elsewhere, low commodity prices continued to boost higher aggregate demand in addition to creating conditions for accommodative monetary policy especially in Japan and the euro area where recovery appears to suffer severe setbacks due to structural bottlenecks and the threat of deflation. For the Eurozone, however, the massive quantitative programme of the ECB opens a new growth vista, halting the slide in potential output and engendering a more solid recovery.

Global growth is expected to accelerate to 3.8 per cent in 2016 but with significant downside risks. Protracted stagnation in the Euro area could constrain global trade while the anticipated end of monetary easing in key industrial countries could limit investment growth. In addition, stronger currencies in both the US and UK may likely moderate net exports coupled with lower capital expenditure in the energy sector due to the softening oil prices. Furthermore, the huge asset purchase program by the UK Treasury and the Bank of Japan is an indication of divergent monetary policy stance among key advanced economies with the attendant widening of long-term interest rate differentials. We are of the view that with the UK inflation at -0.1 per cent in April, the size of its asset purchase programme of £385 billion may be revisited by the Treasury.

For many emerging markets, the outlook for growth is less optimistic, reflecting cyclical factors, domestic policy tightening, political tension, and structural factors. In China, growth is expected to decline below the long run target of 7.0 per cent in 2015 owing to financial market vulnerabilities, declining productivity, excess capacity, and weakening domestic demand. It is however, envisaged that recent policy stimuli by both government and the Peoples Bank of China would help unwind the excess capacity and strengthen the financial system with the ultimate goal of restoring growth to the historical path in the long run.

Developing economies as a group continue to show relative resilience with growth projected to accelerate from 4.4 per cent in 2014 to 4.8 per cent in 2015. Growth in the developing economies is also expected to remain uneven in the near term, reflecting the pattern in the advanced economies. Countries with high trade exposure to US and UK would likely gain substantial momentum while those depending on the Euro Area may experience continuing slow down in export demand in the near to medium-term.

Key risks to growth in the developing countries include the possible tightness in the global financial markets and the diverging stance of monetary policy in the advanced economies which portend grave consequences for capital flows, exchange rate stability, and inflation expectations. In addition, sudden deterioration in liquidity conditions, volatility in commodity and financial markets, narrowing fiscal space, and rising geopolitical tensions are headwinds that could constrain global output growth. Thus, monetary policy in a number of developing countries has to contend with the delicate choice among supporting growth, reining in inflation and stabilizing currencies and the financial systems.

Global inflation remains benign and is expected to be moderate in 2015-16 due to the tailwinds from the sharp drop in the prices of crude oil, excess capacity and appreciation of currencies in key advanced economies.

Domestic Economic and Financial Developments

Output

The deceleration in growth, which commenced in the third quarter of 2014, intensified in the first quarter of 2015 in the aftermath of declining crude oil prices. The National Bureau of Statistics (NBS) estimated Real GDP growth at 3.96 per cent in the first quarter of 2015, which is significantly lower than the 5.94 and 6.21 per cent in the preceding quarter and the corresponding period of 2014, respectively. Real GDP growth is projected to decline to 5.54 per cent in 2015 from 6.22 per cent in 2014. In line with trend, the non-oil sector remained the main driver of growth in the first quarter of 2015, recording 5.59 per cent. The key growth drivers in the non-oil sector during the period were services, trade, and agriculture which contributed 2.82, 1.27, and 1.05 percentage points, respectively. The modest improvements recorded in the oil sector in the fourth quarter of 2014 appear to have been reversed as oil GDP contracted by 8.15

per cent in the first quarter of 2015 compared with an increase of 1.2 per cent in the preceding quarter.

The Committee expressed concern about the weakening economic momentum but recognized the relative similarity in the condition to the evolving economic environment in virtually all oil exporting economies, suggesting the need for acceleration of various ongoing initiatives to diversify the economic base of the country.

With the successful completion of the 2015 general elections and the progress recorded so far in the fight against insurgency, the Committee was optimistic that the slow pace of economic momentum would reverse in the near term.

Prices

The Committee noted that the year-on-year headline inflation crept upwards for the fourth consecutive month in April 2015. The inflation rate rose from 8.2 per cent in January 2015 to 8.5 per cent in March and further to 8.7 per cent in April. The increase in headline inflation in April reflected increases in both the core and food components. Core inflation rose to 7.7 per cent in April from 7.5 per cent in March, while food inflation increased to 9.5 per cent from 9.4 per cent over the same period.

The Committee noted that the uptick in inflationary pressures, year-to-date, was largely traceable to transient factors such as high demand for transportation, food and energy, especially in the period around the general elections as well as the Easter festivities. It also noted the roles played by system liquidity and the pass-through effects of the recent depreciation of the naira exchange rate.

When the transient causes are isolated, the Committee observed the decline in month-on-month inflation across all the measures in April as headline inflation moderated to 0.8% from 0.9% in March; core inflation moderated to 0.6% from 0.8% and food inflation moderated to 0.9% from 1.0%.

The Committee reiterated its commitment to price stability noting that given the already tight stance of monetary policy and the transient nature of the incubators of the current inflationary trend, which are outside the direct control of monetary policy, the space for maneuver remains constrained, necessitating the intervention of fiscal and structural policies to stimulate output growth.

Monetary, Credit and Financial Markets Developments

Broad money supply (M2) increased by 1.80 per cent in April 2015, over the level at end-December 2014. When annualized, M2 increased by 5.39 per cent, which is lower than the growth benchmark of 15.24 per cent for 2015. The modest increase in money supply reflected the growth in the net domestic credit (NDC) of 9.66 per cent. Annualized, net domestic credit grew by 28.98 per cent over the end-December, 2014 level, which was within the provisional benchmark of 29.3 per cent for 2015. The significant growth in aggregate credit was traced mainly to Federal Government borrowing which increased by 177.26 per cent in April 2015 or 531.78 per cent on annualized basis.

In the period under review, money market interest rates were relatively volatile, reflecting the fluctuations in liquidity in the banking system. Average inter-bank call and OBB rates, which opened at 11.92 and 10.75 per cent on 2^{nd} March 2015, closed at 15.00 and 13.26 per cent, respectively, on April 17, 2015. Average inter-bank call and OBB rates for the period were 19.02 and 17.45 per cent, respectively.

The Committee noted a modest improvement in the equities segment of the capital market during the review period. The All-Share Index (ASI) rose by 9.3 per cent from 31,744.82 on March 31, 2015 to 34,708.11 on April 30. Similarly, Market Capitalization (MC) increased by 10.0 per cent from N10.72 trillion to N11.79 trillion in the same period. However, relative to end-December 2014, the indices increased marginally by 0.1 and 2.7 per cent, respectively. The recovery in share prices particularly in April 2015 was largely due to improvements in earnings and sentiments, amid successful conclusion of the 2015 general elections.

External Sector Developments

The average naira exchange rate was relatively stable at both the interbank and Bureau-de-Change segments of the foreign exchange market during the review period. The exchange rate at the interbank market opened at N197.80./US$ and closed at ₦197.00/US$, with a daily average of ₦197.04/US$. This represented an appreciation of ₦0.80k for the period. At the Bureau-de-Change segment, the exchange rate opened at ₦225.00/US$ and closed at ₦217.50/US$, with a daily average of ₦216.75/US$. This represented an appreciation of N7.50k for the period.

The stability and modest appreciation in the two segments of the market was largely due to the closure of the rDAS market and the modified two-way quote trading at the inter-bank segments of the market. Gross official reserves rose from US$29.34

billion at end-March 2015 to US$30.05 billion on May 15, 2015.

Committee's Consideration

The Committee noted the salutary effects of the successful conduct of the 2015 general elections on the macroeconomic environment. The Committee expressed optimism that the confidence and goodwill arising from the successful elections would stem the spate of capital reversal, reduce pressure in the foreign exchange market and stabilize the financial markets in the short to medium term. A combination of the renewed confidence and recent administrative measures around the foreign exchange market have eased pressure on the naira, resulting in relative stability in all segments of the foreign exchange market.

The Committee was concerned about the creeping headline inflation since January 2015 but noted that the causal factors were largely transient and outside the purview of monetary policy. Furthermore, the significant rising trend in credit to government was regarded as potential headwinds to growth with negative spillovers to the already elevated lending rates, credit to the private sector and aggregate domestic investment including inflationary pressures.
The Committee expressed deep concern over the lackluster performance of the external sector arising from a number of significant global shocks.

First, the prospects of monetary policy normalization in the US with attendant increase in global interest rates and accentuating capital flow reversal which could further exacerbate tightness in global financial conditions and create further pressure on the naira.

Second, the continued glut in crude oil supplies amidst softening prices, anchored by sluggish global output expansion could further threaten foreign exchange earnings and accretion to external reserves over a much longer period. A near- term rally in oil prices is further undermined by the diminishing market power of the Organization of the Petroleum Exporting Countries (OPEC).

Third, the anemic recovery in the Euro Area and Japan and tepid growth conditions in China constitute an additional drag on crude oil exports prospects. Consequently, the decline in trade balance, which commenced in the second half of 2014, could persist over a much longer period with further implications for public revenues and external reserves.

In the light of these developments, therefore, the Committee stressed the need for proactive measures to protect the reserve buffer to safeguard the value of the domestic currency and engender overall stability of the banking system. It was, however, noted that monetary policy is gradually approaching the limits of tightening and would, therefore, require complementary fiscal and structural policies.

Furthermore, the Committee considered that the current discriminatory CRR on public and private sector deposits has not only constrained the policy space but could inspire moral hazard by private market participants. Consequently, it was recognized that while additional tightening measures may not be appropriate now to avoid overheating the economy, a harmonization of the CRR was imperative in order to curb abuses and improve the efficacy of monetary policy.

The Committee's Decisions

In view of these developments, the Committee decided by a unanimous vote to retain the current tight stance of monetary policy. One member voted to increase CRR on private sector deposits from 20 to 25 per cent and retain CRR on public sector deposits at 75 per cent while another member voted to retain the CRR on private sector deposits at 20 per cent and increase CRR on public sector deposits from 75 to 100 per cent. Nine members, voted to harmonize the public and private sector CRR at 31 per cent. Two members voted to remunerate a portion of the CRR. All members voted to retain all other decisions taken at the last meeting of the MPC while improving the implementation of the CRR regime.

Consequently, the MPC voted to:

(i) Retain the MPR at 13 per cent with a corridor of +/- 200 basis points around the midpoint;

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

(iii) Harmonize the CRR on public and private sector deposits at 31.0 per cent.

Thank you.

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19th May 2015