



**CENTRAL BANK OF NIGERIA**

# **MONETARY POLICY REVIEW**

**AUGUST, 2014**



**Central Bank of Nigeria**

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## Central Bank of Nigeria

### Mandate

- Ensure monetary and price stability
- Issue legal tender currency in Nigeria
- Maintain external reserves to safeguard the international value of the legal tender currency
- Promote a sound financial system in Nigeria
- Act as banker and provide economic and financial advice to the Federal Government

### Vision

"By 2015: Be the model Central Bank delivering Price and Financial System Stability and promoting Sustainable Economic Development"

### Mission Statement

"To be proactive in providing a stable framework for the economic development of Nigeria through effective, efficient and transparent implementation of monetary and exchange rate policy and management of the financial sector"

### Core Values

- Meritocracy
- Leadership
- Learning
- Customer - Focus



## CONTENTS

	Page
<b>Table of Contents</b>	
Statement by the Governor .. .. .	ix
Chapter 1 Overview - - - - -	1
Chapter 2 Output in the Domestic Economy - - - - -	5
Chapter 3 Price Developments - - - - -	15
Chapter 4 Monetary Policy and Liquidity Management - ..	23
Chapter 5 Developments in the Financial Markets - - -	33
Chapter 6 Outlook - - - - -	53
<b>List of Tables</b>	
Table 3.1: Inflation Rates, June 2013 – June 2014 .. ..	15
Table 3.2: Selected CPI Components' Contribution to Headline.. Inflation (Y-on-Y) Jan-Jun 2014 .. .. .	16
Table 3.3: Selected CPI Components' Contribution to Headline Inflation .. .. . (M-on-M) Jan-Jun 2014	17
Table 3.4: Selected CPI Components' Contribution to Food Inflation (Y-on-Y), Jan-Jun 2014.. .. .	18
Table 3.5: Selected CPI Components' Contribution to Food Inflation .. .. . (M-on-M) Jan-Jun 2014	18
Table 3.6: Selected CPI Components' Contribution to Core Inflation (Y-on-Y) Jan-Jun 2014 .. .. .	19
Table 3.7: Selected CPI Components' Contribution to Core Inflation (M-on-M) Jan-Jun 2014 .. .. .	19
Table 3.8: Actual and Seasonally Adjusted Headline Inflation Jan-Jun 2014 .... .. .	21
Table 4.1 OMO Bills Auction (January 2009 – June 2014) (N'million)	26
Table 4.2 CBN Standing Lending Facility .. .. . (January 2009 – June 2014) (N'billion)	27
Table 4.3 CBN Standing Deposit Facility (January 2009 – June 2014) (N'billion) .. .. .	27
Table 4.4 Foreign Exchange Supply by the CBN (US\$ Million) ..	28
Table 4.12 Monetary Aggregates Outcomes (Growth in % except otherwise stated) .. .. .	31
Table 5.1 Weighted Average Money Market Interest Rates (Dec 2013 – June 2014) .. .. .	33
Table 5.2: Average Monthly Spot Exchange Rates (Jan 2013 – Jun 2014) (N/US\$) .. .. .	36
Table 5.3: End-Month Exchange Rates Movement (Jan 2013 – Jun 2014) (N/US\$) .. .. .	37
Table 5.4: Nominal and Real Effective Exchange Rates Indices (Jan 2013 – Jun 2014) .. .. .	37
Table 5.5: Foreign Exchange Demand and Supply (Jan 2013 – Jun 2014) (US\$'Million) .. .. .	38

	Page
Table 5.6: CBN Monthly Foreign Exchange Flows (Jan 2013 – Jun 2014) .. .. .	39
Table 5.7: Monthly Foreign Exchange Flows through the Economy (Jan 2013 – Jun 2014) (US\$ Million) .. .. .	40
Table 5.8: NSE All-Share Index (ASI) and Market Capitalization (MC) (June 2013 – June 2014) .. .. .	41
Table 5.9: Trends in Warren Buffett Valuation Metric in Nigeria (2013Q1-2014Q2) .. .. .	43
Table 5.10: Changes (MTM* % App/Dep) in Foreign Exchange Rates Across Selected African Countries .. .. .	46
Table 5.11: Changes (MTM* % App/Dep) in Foreign Exchange Rates in Nigeria and Selected North America .. .. .	46
Table 5.12: Changes (MTM* % App/Dep) in Foreign Exchange Rates in Nigeria and Selected South America .. .. .	47
Table 5.13: Changes (MTM* % App/Dep) in Foreign Exchange Rates in Nigeria and Selected European Countries .. .. .	47
Table 5.14: Changes (MTM* % App/Dep) in Foreign Exchange Rates Across Selected Asian Countries .. .. .	48
Table 6.1: Global Output and Inflation Outlook .. .. .	56

## List of Figures

Figure 2.1: Non-Oil Sector Performance, 2014Q1 and 2013Q4 ..	6
Figure 2.2: Agricultural Sector Contribution by Activity, 2013Q1 – 2014Q2 .. .. .	7
Figure 2.3: Industrial Sector Contribution by Activity, 2013Q1 – 2014Q2 .. .. .	8
Figure 2.4: Manufacturing Sub-Sector Contribution by Activity, 2013Q1 – 2014Q2 .. .. .	8
Figure 2.5: Services Sub-Sector Contribution, 2013Q1 – 2014Q2 ..	10
Figure 2.6: Crude Oil Production 2013Q1 – 2014Q2 .. .. .	11
Figure 2.7: Bonny Light Price Dec 2013 - June 2014 In US Dollars ..	11
Figure 3.1: Headline Inflation (June 2013-June 2014) .. .. .	15
Figure 3.2: Consumer Price Index, Headline, Core and Food (June 2013-June 2014).. .. .	16
Figure 3.3: Year-on-Year Headline, Core and Food (June 2013-June 2014).. .. .	16
Figure 3.4: Selected CPI Components' Contribution to Headline Inflation (Y-on-Y) Jan-Jun 2014 .. .. .	17
Figure 3.5: Selected CPI Components' Contribution to Headline Inflation (M-on-M) Jan-Jun 2014 .. .. .	17
Figure 3.6: Selected CPI Components' Contribution to Food Inflation (Y-on-Y) Jan-Jun 2014 .. .. .	18
Figure 3.7: Selected CPI Components' Contribution to Food Inflation (M-on-M) Jan-Jun 2014 .. .. .	18
Figure 3.8: Selected CPI Components' Contribution to Core Inflation (Y-on-Y) Jan-Jun 2014 .. .. .	19

	Page
Figure 3.9: Selected CPI Components' Contribution to Core Inflation (M-on-M) Jan-Jun 2014 .. .. .	19
Figure 3.10: 12 Months Moving Averages, Headline, Core and Food (June 2013-June 2014).. .. .	20
Figure 3.11: Actual Headline Inflation and Its 12 Month Moving Averages (MMA), June 2013 – June 2014 .. .. .	20
Figure 3.12: Actual Core Inflation and Its 12 Month Moving Averages (MMA), June 2013 – June 2014 .. .. .	20
Figure 3.13: Actual Food Inflation and Its 12 Month Moving Averages (MMA), June 2013 – June 2014 .. .. .	20
Figure 3.14: Actual and Seasonally Adjusted Headline Inflation Jan-Jun 2014 .. .. .	21
Figure 4.1: Monthly Reserve Money Benchmark and Actual (December 2013 – June 2014).. .. .	28
Figure 4.2: Reserve Money and its Components (Uses) .. .. .	28
Figure 4.4: Money Supply (M1) and (M2) (Dec 2013 – Jun 2014) .. .. .	29
Figure 4.5: Growth in Money Supply (M1) and (M2) (Dec 2013 – Jun 2014) .. .. .	29
Figure 4.6: Net Domestic Asset (NDA) (Dec 2013 – Jun 2014 .. .. .	30
Figure 4.7: NDA, NDC and Other Assets (net) (Dec 2013 – Jun 2014)	30
Figure 4.7: Net Domestic Credit (Dec 2013 – Jun 2014) .. .. .	30
Figure 4.10: Domestic Credit to Private Sector (Dec 2013 – Jun 2014)	31
Figure 5.1: Weighted Average Money Market Interest Rates (Dec 2013 – June 2014) .. .. .	34
Figure 5.2: Daily Interbank Call Rate (January – June 2014) .. .. .	34
Figure 5.3: Open Buy Back Rate (January – June 2014) .. .. .	35
Figure 5.4: Daily Exchange Rate (January – June 2014) .. .. .	35
Figure 5.5: End-Month Exchange Rates Movement (Jan 2013-June 2014) (N/US\$) .. .. .	36
Figure 5.6: Nominal and Real Effective Exchange Rate .. .. .	37
Figure 5.7: Demand and Supply of Foreign Exchange at r/wDAS	38
Figure 5.8: CBN Monthly Foreign Exchange Flows (Jan 2013 – Jun 2014) .. .. .	39
Figure 5.9: Monthly Foreign Exchange Flows through the Economy (Jan 2013 – Jun 2014) (US\$ Million) .. .. .	40
Figure 5.10a: NSE ASI and MC (Jan. 2014 – Jun. 2014) .. .. .	41
Figure 5.10b: NSE ASI and MC (June 2013 – June 2014) .. .. .	42
Figure 5.11: NSE Market Capitalisation by Sector as at End-June 2014	43
Figure 5.12: NSE Market Capitalisation by Sector as at End-December 2013 .. .. .	43
Figure 5.13: 10-Year U.S. Dollar-denominated Bond Yields for Nigeria (June 28, 2013 – June 30, 2014) .. .. .	44
Figure 5.14: FGN Bonds Yield Curves: End-June 2013 vs. End-December 2013 vs. End-June 2014 .. .. .	44
Figure 5.15: Structure of the Nigerian Capital Market (June, 2014)	45

	Page
Figure 5.16: Changes (MTM* % App/Dep) in Foreign Exchange Rates Across Selected African Countries .. ..	46
Figure 5.17: Changes (MTM* % App/Dep) in Foreign Exchange Rates in Nigeria and Selected North America ..	46
Figure 5.18: Changes (MTM* % App/Dep) in Foreign Exchange Rates in Nigeria and Selected South America ..	47
Figure 5.20: Changes (MTM* % App/Dep) in Foreign Exchange Rates in Nigeria and Selected Asian Countries ..	48
Figure 6.1: Fan Chart for Inflation from 2012:m3 - 2015:m12 ..	58

### List of Boxes

Box 2.1: GDP Rebasing and the Nigerian Economy .. ..	12
Box 2.2: Impact of Global Shale oil production on Nigeria ..	14
Box 5.1: Foreign Portfolio Investment (FPI) in the Nigerian Equities Market .. .. .	49
Box 5.2: Warren Buffett Valuation Metric .. .. .	51
Box 5.3 : QE3 Tapering .. .. .	52

## STATEMENT BY THE GOVERNOR

The monetary Policy environment in the review period was benign with continued moderation in consumer price inflation to single digit, indicating the effectiveness of the sustained tight monetary policy stance of the Bank. This was against the background of several key challenges including the announced QE3 tapering policy by the US Federal Reserve Bank; anticipated increase in government spending in preparation for the 2015 general elections; and the depletion of fiscal buffers required to sustain exchange rate stability on account of slow accretion to foreign reserves. Domestic output growth remained resilient in the face of a weakening global economy; although some of Nigeria's major trading partners including the US, Europe and China were gradually returning to a long-run growth path. Accordingly, the thrust of monetary policy in the second half of 2013 remained the sustenance of the relative price stability achieved in the first half of 2013.

The conclusion of the banking sector reforms afforded the MPC a clearer view of financial stability to detect a creeping perverse incentive problem reflected in the build-up in excess liquidity in the banking system, alongside sluggish growth in private sector credit and rising cost of liquidity management; all traced to DMB's appetite for government securities. Banks source huge amounts of public sector deposits and lend same to the Government (through securities) and the CBN (via OMO bills) at high rates of interest, thereby constricting the flow of funds to the real economy. In order to address this, the MPC announced a discriminatory CRR system for public and private sector deposits at the end of its regular meeting in July 2013. While the CRR on private sector deposits remained at 12.0 per cent, that on public sector deposits was raised to 50.0 per cent to address the effects of the buildup in excess liquidity on the banking system as well as stem the pressure on the exchange rate. Other policy measures were maintained. The decision of the Bank to retain, most of the policy measures that prevailed in the first half of 2013, was to allow the effects of previous policy actions to permeate through the economy, as well as promote better anchoring of inflation expectations by economic agents.

The outcome of policy measures was satisfactory and justified the investment in liquidity management. The performance of monetary aggregates was largely below indicative benchmarks for the period indicating the impact of tight monetary policy in controlling system liquidity. The naira exchange rate continued to enjoy relative stability as evidenced by the slight appreciations in the official and interbank rates, and modest depreciation at the BDC segment. However, the strategic intervention of the Bank in the foreign exchange market including the re-introduction of the retail Dutch Auction System (rDAS) helped in stabilizing the market. Market real interest rates remained positive, against the backdrop of moderating inflationary pressures which sustained the flow of investment into the

economy.

Emerging signals from both the international and domestic environments suggest a clouded fiscal and external sector outlook in the near to medium term but the monetary authority would continue to proactively respond to the various challenges with a view to fostering a stable and robust macroeconomic environment.

**Godwin I. Emefiele**  
**Governor,**  
**Central Bank of Nigeria.**

## CHAPTER ONE

### 1.0 OVERVIEW

Monetary policy in the first half of 2014 aimed at addressing price stability with specific focus on anchoring inflation within the single digit range. The policy stance was tight with a view to addressing the rising inflation trend. Headline Inflation was upward ticking, fluctuating between 8.0 and 8.2 per cent in January and June, respectively. Inflation was driven mostly by rising food prices due to insurgencies in some northern parts of the country. The exchange rate, which faced considerable pressure, was moderated by the tight policy stance throughout the period under review. While there were concerns about the possibility of a slowdown and perhaps capital reversal due to rising sovereign risk and QE3 tapering, external reserves in the first half of 2014 remained relatively stable. It however, recorded a slight dip at end-June 2014, compared with the end-December 2013 level. Overall, the financial markets remained generally stable, with spreads between lending and deposit rates remaining fairly constant. A mix of policy instruments were employed to address price and financial system stability, with a view to strengthening investor confidence and thus, undermining the impact of rising sovereign risk.

The primary policy instrument adopted to achieve these objectives was the Monetary Policy Rate (MPR), complemented with a mix of other intervention instruments. The intervention Instruments included; Open Market Operations (OMO), Discount Window Operations, Cash Reserve Ratio (CRR) and Foreign Exchange Net Open Position (NOP). During the period, MPR remained constant at 12.0 per cent with a symmetric corridor of +/- 200 basis points around the MPR. The CRR for both private and public sector deposits was increased from 12.0 and 50.0 per cent to 15.0 and 75.0 per cent, respectively, in order to address the liquidity surfeit in the banking system.

In the period under review, the National Bureau of Statistics (NBS) rebased and revised the Gross Domestic Product (GDP) from 1990 to 2010 basic prices. The rebasing identified a total of 46 economic activities from the previous 21, categorizing them under five broad sectors (Agriculture, Industry, Construction, Trade, and Services). Following the rebasing, real GDP for 2013 was N63.2 trillion (Nominal GDP of 80.2 trillion). Economic growth remained resilient in the first and second quarters of 2014, with real GDP growth rates of 6.21 and 6.54 per cent, respectively, (down from 6.77 per cent in quarter four of 2013). The non-oil sector remained the major driver of growth, rising by 8.21 and 6.71 per

cent, respectively, in the first and second quarters of 2014. Services, Agriculture and Trade were the major contributors to the non-oil sector GDP, as Industry and Construction contributed marginally. The overall increasing contribution of the Services sector to total real GDP signalled a diversification of the economy from the agricultural and oil sectors.

Liquidity management by the Central Bank was conducted mainly by using OMO to mop up liquidity from or inject liquidity into the system. In January 2014, there was a general decline in interest rates due to injections into the system arising from maturity of government securities. In the period under review, the economy continued to experience fluctuations in liquidity levels. The CRR was used to address these liquidity issues in order to smoothen the liquidity cycle. The trend in monetary aggregates, in general, reflected the effects of the continued tight monetary policy stance of the Bank during the review period. Reserve money and its components trended downwards relative to their volume in the second half of 2013. Both Broad and Narrow measures of money supply were slightly upward trending relative to the end-December 2013 values. The development reflected the liquidity surfeit attributable to cyclical Federal Account Allocation Committee (FAAC) allocations and increased spending as a build-up to the 2015 general elections.

The money market remained largely calm during the period. The Interbank Call and Open Buy Back (OBB) rates remained within the +/-200 basis points corridor, with rates oscillating around the lower band of the policy rate. Even though the OBB market was quite active during the period, OMO dominated activities in the money market as it was the most used instrument. Despite the occasional spikes experienced in the daily Nigerian Interbank Offered rates (NIBOR) that reflected periods of liquidity tightness, overall, the rate was mostly stable within the period. The Capital Market continued to demonstrate robustness in spite of anticipated portfolio capital reversal attributed to QE3 tapering as all market indices showed positive trends, compared with both the first and second halves of 2013. The All Share Index (ASI), the major indicator of equity market capitalization in Nigeria, grew by 2.8 and 17.5 per cent, when compared with the end-December 2013 and end-June 2013 levels, respectively. Transactions in the fixed income securities market was dominated by Federal Government of Nigeria (FGN) Bonds with fewer transactions observed in the State/Local Government and Corporate Bond segments of the market. On the global stage, financial markets remained relatively calm with concerns of capital reversal from the frontier and emerging markets to the developed markets, as QE3 tapering

gained ground. In the period under review, the exchange rates of major international currencies experienced mild fluctuations while regional currencies such as the Ghanaian cedi, Kenyan shilling, the South African rand and the Egyptian pound also experienced relative fluctuations.

The outlook for inflation is projected to remain stable and within single-digit in the near term, hinged on developments in the food component. Headline inflation is projected to oscillate around 8.4 and 8.1 per cent at the end of 2014 and 2015, respectively. This outlook is based on the assumption that the Bank will continue to pursue a tight monetary policy stance and the pump price of Premium Motor Spirit (PMS) remains stable.

Output growth in quarter four of 2013 was 6.77 per cent. This is projected to rise to 6.8 per cent in 2014 but slow to 6.7 per cent in 2015. The International Monetary Fund (IMF), however, has a more optimistic output forecast of 7.1 and 7.0 per cent in 2014 and 2015 respectively. This is against the backdrop of emerging global developments, security and infrastructural issues. The IMF's optimism is based on anticipated improvements in power supply and infrastructure following the on-going reforms.



## CHAPTER 2

### 2.0 OUTPUT IN THE DOMESTIC ECONOMY

The National Bureau of Statistics (NBS) released the 2010 GDP figures, rebased and revised from their 1990 basic prices. With 1990 as the base year, the relative price level had become progressively less representative of current economic conditions, necessitating the need to update the base year to a more recent period. The primary reasons for rebasing were the changing structure of the economy, consumption pattern and change in domestic prices between 1990 and 2014. The rebasing resulted in an increase of economic activities from 21 to 46 across five broad sectors, namely Agriculture, Industry, Construction, Trade, and Services).

Real GDP grew at 6.21 per cent in Q1 2014, up from 4.45 per cent recorded in the corresponding quarter of 2013, but lower than 6.77 per cent recorded in Q4 2013. The decrease in growth rate recorded in Q1 2014, compared with Q4 2013, was due to the decline in the relative contributions of industry, trade and services from 0.81, 1.28 and 3.44 per cent to 0.65, 1.09 and 2.73 per cent, respectively. However, the sectors that led growth in Q1 2014 were services, industry, agriculture and trade, with their total share of 36.28, 22.66, 19.65 and 17.35 per cent,

respectively, with construction contributing just 4.06 per cent.

In Q2 2014, real GDP growth rate was 6.54 per cent, higher than 5.40 per cent recorded in the corresponding quarter of 2013 and 6.21 per cent recorded in Q1 2014. In the second quarter, the services sector was the largest contributor to real GDP (53.15 per cent), followed by industry (25.96 per cent) and agriculture (20.89 per cent). The slowdown in the growth rate of real GDP relative to the Q4 2013 figure of 6.77 per cent was partly attributable to the decline in contribution of agriculture primarily due to threats of insurgency in the North-east of the country. On an annual basis, real GDP grew at 5.49 per cent in 2013, 4.21 per cent in 2012 and 5.31 per cent in 2011.

#### 2.1 Domestic Economic Activities

Domestic output growth remained resilient despite weak and sluggish recovery in the global economy.

The non-oil sector remained the major driver of growth. It grew by 8.21 per cent in Q1 2014, compared with 8.78 per cent in Q4 2013 and 7.44 per cent in Q1 2013. Growth in this sector however declined to 6.71 per cent in the second quarter of 2014, representing a 2.17 per cent decline compared with the corresponding quarter of 2013. Although the non-oil sector posted positive growth rates in

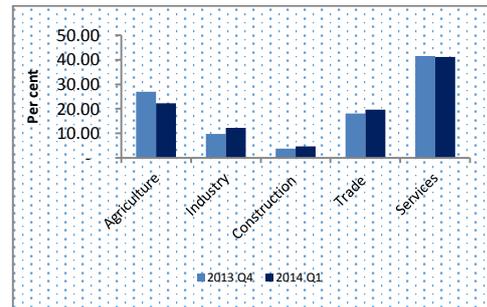
the first half of 2014, the growth rate of 6.71 per cent in Q2 2014 was less than the level of 8.21 per cent in Q1 2014.

Relative to the non-oil sector, oil refining declined in output by 15.23 and 6.75 per cent in Q1 and Q2 2014 respectively. This development can be attributed in part to oil pipeline vandalism and increased contribution of other sectors such as services to overall output.

In terms of contribution to the non-oil real GDP in the first quarter 2014, the services sector contributed 41.15 per cent, agriculture 22.29 per cent, trade 19.68 per cent, industry 12.28 per cent and construction 4.61 per cent. The increased contribution of the services sector to total real GDP in Q1 2014, demonstrated a diversification from the oil economy. The contribution of the services sector to the non-oil sector, however, declined from 41.51 per cent in Q4 of 2013 to 41.15 per cent in Q1 2014 (Figure 2.1).

In Q2 2014, crop production contributed 18.55 per cent to the total non-oil real GDP followed by trade, telecommunications and real estate with shares of 16.77, 9.25 and 7.87 per cent, respectively.

**Figure 2.1: Non-Oil Sector Performance, 2014Q1 and 2013Q4**



## 2.2 Sectoral Analysis

The following section analyses the performance of each sector, and highlights key institutional factors that influenced output in the period under review.

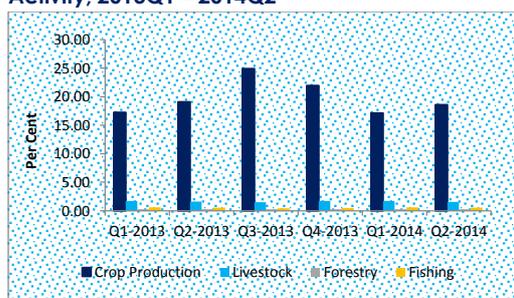
### 2.2.1 Agriculture

In the rebased GDP, agriculture was displaced to the third position by the services and industrial sectors. Nonetheless, the sector remained a major driver of economic activity in terms of provision of employment, staples and raw materials for the industrial sector. Its share of total GDP however declined from 24.39 per cent in Q4 2013 to 19.65 per cent in Q1 2014, rising to 20.89 per cent in Q2 2014. Compared with the 1990 base year, the agricultural sector's share of GDP declined from an average of 40.0 per cent to an average of 20.00 per cent in the 2010 base year.

### 2.2.1.1 Agricultural Production and Food Prices

Agricultural output in the first half of 2014 was dominated by the production of crops such as maize and yam in the southern states and livestock farming and off season harvesting in the northern states. In Q1 2014, crop production contributed 17.12 per cent, livestock 1.72 per cent, forestry 0.24 per cent and fishing 0.58 per cent (Figure 2.2). In Q2 2014, the contribution of crop production and forestry rose to 18.55 per cent and 1.56 per cent, respectively, while livestock and fishing declined to 1.56 per cent and 0.53 per cent, respectively. Fishing, forestry and livestock with marginal contributions to real GDP, require intensified efforts including more incentive schemes and institutional support programmes to boost the performance of the sector. Livestock production in particular, was adversely affected by the insurgency in some parts of the Northern region that led to the displacement of some cattle rearers resulting in disruption of some cattle rearing activities.

**Figure 2.2: Agricultural Sector Contribution by Activity, 2013Q1 – 2014Q2**



### 2.2.1.2 Agricultural Policies and Institutional Support

The performance of the sector was enhanced by a number of policies, reforms and institutional support.

- The Agricultural Credit Guarantee Scheme (ACGS):** Between January and June 2014, the scheme guaranteed 35,413 loans valued at N5.928 billion.
- N200 Billion Commercial Agricultural Credit Scheme (CACs):** Between April and June 2014, a total of N6.192 billion was disbursed to six banks to fund eleven projects.
- N200 Billion SME Credit Guarantee Scheme (SMECGS):** Between April and June 2014, four projects valued at N155.234 million were supported under the scheme.

### 2.2.2 Industry

The industrial sector retained the second position in terms its contribution to GDP in the 2010 base year similar to the 1990 base year. The index of industrial production, which measures the output of businesses integrated within the industrial sector of the economy, namely crude petroleum and natural gas, solid minerals and manufacturing, grew by 1.12 per cent

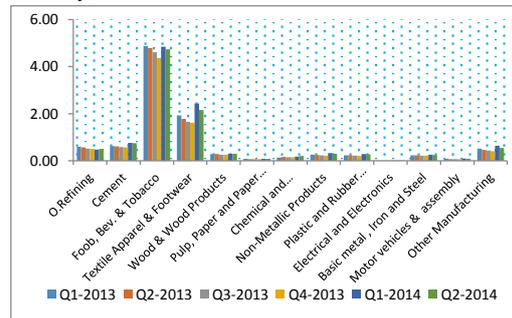
in the first quarter of 2014 compared with the corresponding quarter in 2013. The increase was attributed to relative increase in the supply of electricity during the review period.

**2.2.2.1 Industrial Production and Output**

Industry contributed a total of 22.66 per cent to total GDP in Q1 2014, declining to 21.07 per cent in Q2 2014. A Sub-Sectoral analysis of output in Q1 2014 showed that crude petroleum and natural gas, solid minerals and manufacturing contributed 11.83, 0.15 and 10.68 per cent, respectively. In Q2 2014, their contribution declined marginally; crude petroleum and natural gas 10.76 per cent, solid minerals 0.14 per cent, and manufacturing 10.16 per cent. Solid minerals performed the least in the sector (coal mining 0.01 per cent in both quarters; metal ores 0.01 per cent in both quarters; and other minerals 0.13 and 0.12 per cent in the first and second quarters, respectively).

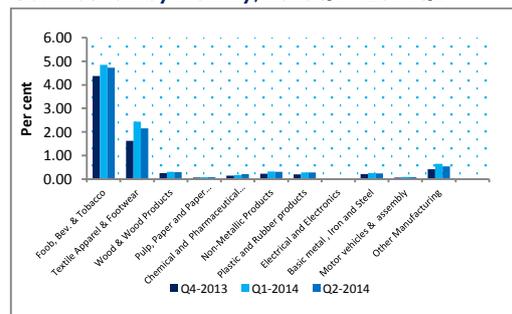
The development is indicative of the need for considerable investment and skills acquisition in the solid minerals sub-sector, in order to harness its potentials and improve its contribution to the overall economy.

**Figure 2.3: Industrial Sector Contribution by Activity, 2013Q1 – 2014Q2**



The manufacturing sub-sector contributed 10.68 per cent to total GDP. A total of thirteen activities contributed to the output of the sub-sector with Food, Beverages and Tobacco; and Textiles, Apparels and footwear dominating (figure 4).

**Figure 2.4: Manufacturing Sub-Sector Contribution by Activity, 2013Q1 – 2014Q2**



**2.2.2.2 Industrial Policy and Institutional Support**

The performance of the sector during the period benefited from the continuation of a number of reforms and incentives. These include:

- **N300 Billion Power and Airline Intervention Fund (PAIF):** The PAIF was instituted as a means of addressing the continued nationwide shortage of power supply and the weak infrastructural capacity of the airline industry. A total sum of N500 billion was approved by the Monetary Policy Committee in 2010 for investment in the securities of the Bank of Industry (BoI). 60.0 per cent of the fund was scheduled to finance infrastructure in the power and airline industry, while the balance was targeted at SME restructuring.
  - petrochemical 70.0 per cent each;
  - 25.0 per cent concession of the cost of providing basic infrastructure such as roads, water and electricity;
  - Dividends derived from manufacturing companies in petro-chemicals and liquefied natural gas sub-sector are tax-exempt;
  - Dividend from companies in the manufacturing sector with turnover of less than N100 million is tax-free for the first five years;
  - Right of access to the court for the determination of investor's interest and the amount of compensation to which the investor is entitled;
  - All areas of investment in the energy sector are considered to be of pioneer status and as a result there is tax holiday of 5 to 7 years ; and
  - Provision for 100.0 per cent foreign ownership of mining companies and concerns.
- **N200 Billion SME Restructuring/Refinancing Fund (RRF):** The Central Bank of Nigeria established the scheme in March 2010 to refinance and restructure banks' existing loan portfolio to manufacturers in line with FSS 2020 SME financing target of 20.0 per cent total credit to the economy.
- **Other incentives and reforms include:**
  - Foreign investors and industries are granted 30.0 per cent tax concession for five years for minimum local raw materials utilization as follows: agro 80.0 per cent, agro allied and

## 2.2.3 Construction and Trade

### 2.2.3.1 Construction

The sector's contribution to the broad performance of the overall economy was modest with 4.06 per cent in Q1 2014, rising to 4.32 per cent in Q2 2014. However, the sector grew by 17.88 per cent in Q1 2014 but slowed to 10.70 per cent in Q2 2014 compared with growth rates of 15.13 and 14.67 per cent in Q4 2013 and Q1 2013, respectively.

### 2.2.3.2. Trade

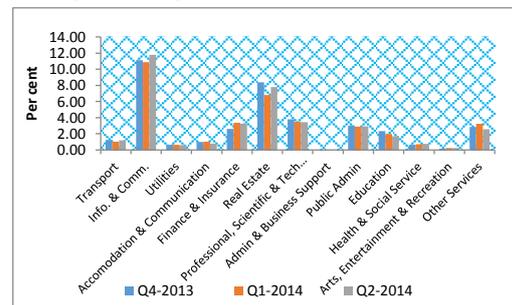
Trade continued to be a key sector in the economy, contributing 17.35 per cent to total real GDP in Q1 2014 and 16.77 per cent in Q2 2014 compared with 16.36 and 17.34 per cent in Q4 2013 and Q1 2013, respectively. The sector grew by 6.28 and 5.15 per cent in Q1 2014 and Q2 2014, respectively. The slight decline in the rate of growth in Q2 2014 was due to seasonal factors. Growth in the sector could be enhanced by improvements in the performance of other sectors.

## 2.2.4 Services Sector

The services sector became the largest sector in the rebased GDP displacing agriculture, which used to be the leading sector, to the third place. The development reflected the transformation that had taken place between 1990 and 2010. The sector's

share in the real GDP were 36.28 per cent in Q1 2014 and 36.95 per cent in Q2 2014. The services sector, which had 8 sub-sectors in the 1990 base year, now has 13 sub-sectors with 22 economic activities. The sector grew by 7.62 and 6.82 per cent in Q1 2014 and Q2 2014, respectively, compared with 17.98 per cent in Q4 2013. The performance of the key sub-sectors in the services sector are presented in figure 2.5.

**Figure 2.5: Services Sub-Sector Contribution, 2013Q1 – 2014Q2**

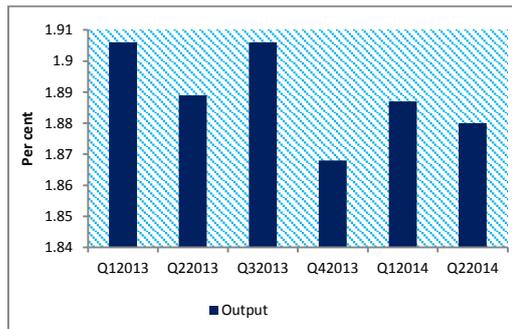


## 2.2.5 Oil Sector

The share of crude oil petroleum and natural gas declined from an average of about 20.0 per cent of the real GDP in the 1990 base year to an average of 11.0 per cent in the 2010 base year. On a quarterly basis, there was a marginal decrease in oil production from 1.887 million barrel per day (bpd) in Q1 2014 to 1.880 million bpd in Q2 2014. The sector, which contributed 11.83 and 10.76 per cent to the real GDP in Q1 and Q2 2014, respectively, declined by 6.6 per cent in Q1 2014 but grew by 5.14 per cent in Q2 2014. The

development was due to illegal bunkering, pipeline vandalism and oil theft, among others. The stepped-up efforts at curbing these anomalies by the authorities as well as on-going reforms, led to some recovery during the review period.

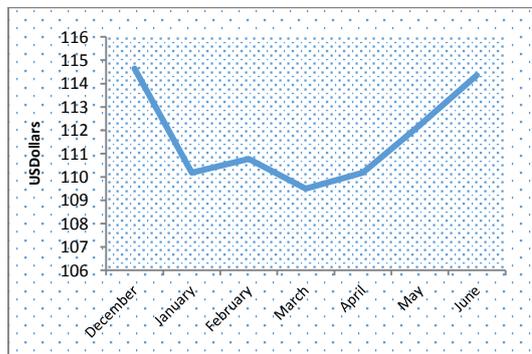
**Figure 2.6: Crude Oil Production 2013Q1 - 2014Q2**



Between January and June, 2014, the average price of bonny light at \$111.21 per barrel, was considerably higher than the \$103.10 per barrel, recorded in the corresponding period of 2013. The relatively high oil price boosted foreign exchange receipt and the overall federation revenue. Consequently, higher levels of public expenditure across the three tiers of government was facilitated, thereby accentuating the liquidity surfeit in the banking system.

Oil prices (bonny light) declined slightly between December 2013 and June 2014 from \$114.64 per barrel to \$114.36 per barrel, with major fluctuations over the review period (see Figure 2.7).

**Figure 2.7: Bonny Light Price Dec 2013 - June 2014 in US Dollars**



**BOX 2.1****GDP REBASING AND THE NIGERIAN ECONOMY**

The GDP is the monetary value of aggregate goods and services produced in a country over a period of time, usually one year. The measurement of economic activities by countries, captured by the Gross Domestic Product (GDP), is necessary for effective planning with a view to improving the standard of living of the citizens. The GDP is a measure of the current price and quantity of goods and services produced in an economy over a period, with a specified base year. Over time, the base year becomes outdated especially, when it is far removed from the current period owing to changes in prices and economic activities and structural transformation. As a result, the GDP may no longer be a true reflection of the size of the economy. To update the GDP requires a replacement of the old base year with a more recent one - a process known as rebasing.

In 2014, Nigeria's GDP was rebased from the 1990 to 2010 base year. The rebasing estimated a much higher real GDP for Nigeria, upscaling it to N63.2tn (forecast) in 2013, thereby making it the largest economy in Africa, while South Africa becomes the second. The rebasing also revealed important changes in the composition and structure of economic activities such as:

- Stronger diversification of the Nigerian economy: The structure of the Nigerian economy has changed significantly, leading to a decline in the share of agriculture and a rise in that of Services in nominal GDP, indicating stronger diversification of the Nigerian economy.
- Better coverage of the Services sector: Economic activities in the services sector, including human health & social services, information and communication as well as professional, scientific and technical services have been better captured.
- Inclusion of new economic activities: New activities such as entertainment, research, patents and copyrights, among others, have been included in the rebased GDP.

**Why Did Nigeria Rebase?**

The exercise is necessary for the following reasons;

- (i) To obtain more accurate and updated estimates of the size and structure of the economy;
- (ii) To provide policy makers and analysts with a better reflection of current realities in the economy for enhanced evidence-based decision-making;
- (iii) To provide better understanding of the structure of the economy and its sectoral drivers, with a view to identifying investment opportunities and resource allocation that facilitate growth and development;
- (iv) To correct distortions posed by the use of outdated base year and fixed base method of computing constant price GDP in Nigeria.

### **Implications of GDP Rebasing for the Nigerian Economy**

Rebasing Nigeria's GDP has policy implications for various sectors of the economy. Some of the implications are highlighted below:

#### **Fiscal Sector**

The rebased GDP has resulted in a lower ratio of tax revenue to GDP, and emphasized the need to improve and intensify revenue collection across all tiers of government, to meet up with increased government expenditure. In addition, the broader re-classification of economic activities in the rebasing presents opportunities for expanding the tax revenue base.

#### **Growth Opportunities**

The rebasing has highlighted sectors with huge growth potentials. The sectors include coal mining, arts, entertainment and recreation, motion picture, sound recording and music, telecommunications and information services, among others. Governments, investors and other economic agents are therefore provided with improved information regarding the investment opportunities that support economic growth, create jobs and improve livelihood.

#### **Financial Sector**

The rebased figures can be used to compute a number of financial intermediation metrics. For example, the ratio of SME Loans to GDP is now very low, and calls for improved access to credit to further enhance growth and job creation. In addition, the rebasing of GDP is expected to boost Nigeria's financial market as the increased size and transformation of the economy presents greater investment opportunities.

However, caution should be exercised in the interpretation and application of a number of ratios derived from the rebased GDP. In general, some ratios tend to diminish, for example M2/GDP, Credit to the Private Sector/GDP, Banking Sector Credit/GDP, SME/GDP and GDP per capita which is still very low indicating the need to intensify effort in these areas. On the contrary some ratios are exaggerated, suggesting that the indicators have improved. For instance, after the rebasing, the ratio of public debt to GDP was significantly reduced from 16.79 per cent to 8.87 per cent in 2013. This may suggest there is room for more Government borrowing, when in fact this may not be the case.

**BOX 2.2****Impact of Global Shale oil production on Nigeria**

Oil Shale is a naturally occurring organic-rich sedimentary rock from which liquid hydrocarbons called shale oil can be extracted. Shale oil is a substitute for conventional crude oil. It is, however, more expensive to produce and has a higher environmental impact than conventional crude oil. There is potential for shale oil (light oil) production to spread globally in the long term as large deposits have been discovered in several countries. Canada, Russia, China, Chile and some Middle Eastern countries etc. have indicated interest in exploiting their shale oil resources. Increasing oil supply from shale could likely reduce global demand for crude oil, resulting in a decline in oil price.

Net oil importers such as India, Japan, China, and the Eurozone would benefit from oil price reductions, while trade balances of oil exporters such as Nigeria, the Middle East and Russia, etc. could be adversely affected in the long run.

In Nigeria, oil export is the dominant source of public sector revenue and foreign exchange earnings. The emergence of shale oil and gas is therefore, a threat to Nigeria's economic fortunes in the areas of export earnings, accretion to reserves, public finance and macroeconomic stability. Currently, the increase in shale oil production has not translated into significant changes in the price of Bonny Light.

However, China's demand for Bonny Light and other African crudes has declined due to higher stocks from shale oil production in the US Gulf Coast, cheaper crude from Latin American producers (Venezuela, Brazil, Ecuador and Mexico, etc.) and higher freight rates of Bonny Light compared with Dubai crude, which reflects geopolitical risks.

The U.S. has long been one of the major importers of oil from Nigeria, accounting for 40 per cent of Nigeria's exports and 9 - 11 per cent of the US total crude oil import. However, this has changed as the Energy Intelligence Agency (EIA) of the United States has reported significant decline in oil imports from Nigeria. From May 2013 to May 2014, US crude oil imports from Nigeria fell by 70.2 per cent from 12.25 million to 3.65 million barrels per day.

Apart from its policy of reducing energy dependence, the projection for total U.S. oil production increased from an estimated 7.4 million b/d in 2013 to 8.5 million b/d in 2014 and 9.3 million b/d in 2015, reflecting production growth from shale oil development. The growth in U.S. domestic production has contributed to a significant decline in petroleum imports to 22 per cent of total U.S. liquid fuels consumption as at June 2014, from an average of 33 per cent in 2013 and 60 in 2005 (EIA).

## CHAPTER 3

### 3.0 PRICE DEVELOPMENTS

Underlying inflationary pressures, largely attributed to rising food prices, resulted in an upward trend in inflation rate in the first half of 2014. Following a decline from 8.0 per cent in January, 2014 to 7.7 per cent in February 2014, year-on-year headline inflation inched up steadily to 8.2 per cent in June 2014 (Figure 3.1). The exchange rate remained relatively stable over the period, with occasional fluctuations in the BDC segment of the foreign exchange market largely in response to policy impulses.

**Table 3.1: Inflation Rates, June 2013 – June 2014**

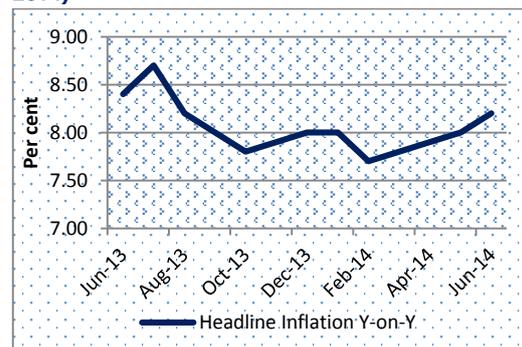
Year/ Month	Headline Inflation			Core Inflation			Food Inflation		
	CPI	Y-on-Y	12 MMA	CPI	Y-on-Y	12 MMA	CPI	Y-on-Y	12 MMA
Jun-13	146.60	8.40	10.40	145.50	5.50	10.70	147.50	9.60	10.40
Jul-13	147.40	8.70	10.00	147.20	6.60	10.00	148.40	10.00	10.20
Aug-13	147.80	8.20	9.80	149.10	7.20	9.40	149.20	9.70	10.20
Sep-13	148.90	8.00	9.50	150.00	7.40	8.90	150.40	9.40	10.10
Oct-13	150.00	7.80	9.20	150.90	7.60	8.60	151.60	9.20	10.00
Nov-13	151.10	7.90	8.80	151.80	7.80	8.10	152.90	9.30	9.80
Dec-13	152.30	8.00	8.50	153.00	7.90	7.70	154.30	9.30	9.70
Jan-14	153.30	8.00	8.40	153.30	6.60	7.30	155.50	9.30	9.60
Feb-14	154.00	7.70	8.30	154.10	7.20	7.00	156.50	9.20	9.50
Mar-14	155.20	7.80	8.20	154.70	6.80	7.00	158.00	9.30	9.50
Apr-14	156.20	7.90	8.10	155.30	7.50	7.00	159.30	9.40	9.40
May-14	157.40	8.00	8.00	156.30	7.70	7.20	160.60	9.70	9.40
Jun-14	158.60	8.20	8.00	157.40	8.10	7.40	161.90	9.80	9.50

The domestic interbank money market rates were well anchored within the policy rate band and oscillated around the lower limit of the corridor during the review period, reflecting liquidity surfeit in the banking system.

### 3.1 Trends in Inflation

The Bank maintained its tight monetary policy stance during the review period. This was with a view to containing the expected increase in spending as the 2015 elections approached and rising food prices due to insurgency in some parts of the Northern region of the country. The core and food measures of the Consumer Price Index (CPI) increased from 153.30 and 155.50 in January to 157.40 and 161.90 in June 2014, respectively. In effect, food inflation exerted greater pressure on headline inflation. Consequently, headline inflation (year-on-year) rose to 8.20 per cent in June from 8.00 per cent in January 2014 (Table 3.1 and Figures 3.1 - 3.3).

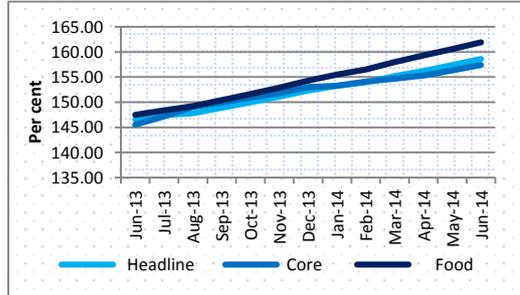
**Figure 3.1: Headline Inflation (June 2013-June 2014)**



Food inflation continued to be the major driver of headline inflation in the first half of 2014. Other factors included housing; water; electricity; and transport. Within the food measure of inflation, processed food (year-on-

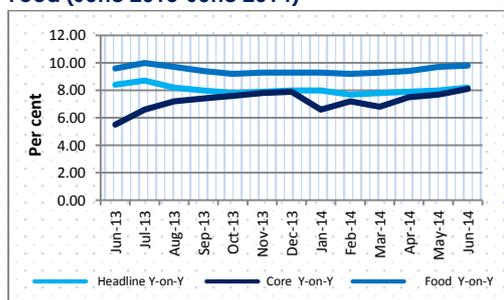
year) increased from 4.4 per cent in January to 9.2 per cent in June 2014.

**Figure 3.2: Consumer Price Index, Headline, Core and Food (June 2013-June 2014)**



Similarly, the contribution of meat to food inflation increased marginally from 0.86 per cent in January to 0.89 per cent in June 2014, while the contribution of yam, potatoes and other tubers decreased from 1.19 per cent in January to 1.13 per cent in June. The contribution of fish and sea food to food inflation increased from 0.88 per cent in January to 0.96 per cent in June.

**Figure 3.3: Year-on-Year Headline, Core and Food (June 2013-June 2014)**



Core inflation (year-on-year) accelerated to 8.10 per cent in June 2014 from 6.6 per cent in January 2014 (Figures 3.2. and 3.3). The continued

increase in core inflation in the first half of 2014 was attributable mainly to increases in energy costs.

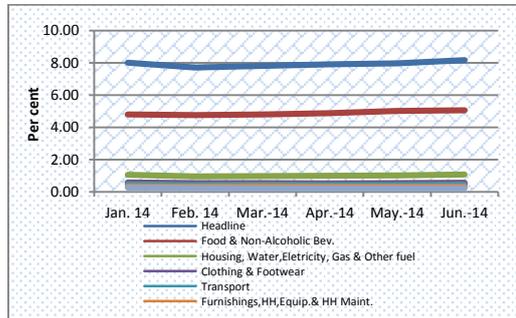
### 3.1.2 Headline Inflation

Analysis of the major components of headline inflation (year-on-year) reveal that food and non-alcoholic beverages component exerted the most pressure, as it rose from 4.79 per cent in January to 5.06 per cent in June 2014. This was followed by housing, water, electricity, gas and other fuel components, whose price rose from 0.95 to 1.07 per cent in the review period (Table 3.2 and Figure 3.4). Headline inflation was, however, moderated by the declines in the prices of clothing and footwear; transport; and education among others in response to the tight liquidity policy stance taken at the January and March 2014 MPC meetings. For instance, public sector CRR was raised from 50.0 to 75.0 per cent in January while private sector CRR was raised from 12.0 to 15.0 per cent in March 2014 to rein in excess liquidity in the system.

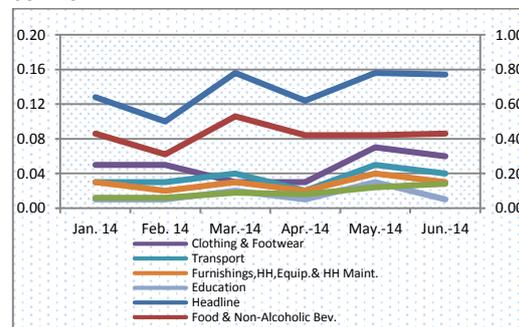
**Table 3.2: Selected CPI Components' Contribution to Headline Inflation(Y-on-Y) Jan-Jun 2014**

Date	Headline	Food & Non-Alcoholic Bev.	Housing, Water, Electricity, Gas & Other fuel	Clothing & Footwear	Transport	Furnishings, H.H. Equip. & HH Maint.	Education
Jan. 14	8.00	4.79	1.05	0.57	0.45	0.34	0.25
Feb. 14	7.70	4.75	0.95	0.54	0.42	0.32	0.23
Mar.-14	7.80	4.79	0.97	0.54	0.43	0.33	0.22
Apr.-14	7.90	4.88	1.00	0.52	0.42	0.32	0.22
May.-14	7.97	5.01	1.01	0.53	0.41	0.31	0.21
Jun.-14	8.17	5.06	1.07	0.56	0.44	0.32	0.22

**Figure 3.4: Selected CPI Components' Contribution to Headline Inflation(Y-on-Y) Jan-Jun 2014**



**Figure 3.5: Selected CPI Components' Contribution to Headline Inflation (M-on-M) Jan-Jun 2014**



**Table 3.3: Selected CPI Components' Contribution to Headline Inflation (M-on-M) Jan-Jun 2014**

Date	Headline	Food & Non-Alcoholic Bev.	Housing, Water, Electricity, Gas & Other fuel	Clothing & Footwear	Transport	Furnishings, HH, Equip. & HH Maint.	Education
Jan. 14	0.64	0.43	0.06	0.05	0.03	0.03	0.01
Feb. 14	0.50	0.31	0.06	0.05	0.03	0.02	0.01
Mar.-14	0.78	0.53	0.09	0.03	0.04	0.03	0.02
Apr.-14	0.62	0.42	0.08	0.03	0.02	0.02	0.01
May.-14	0.78	0.42	0.12	0.07	0.05	0.04	0.03
Jun.-14	0.77	0.43	0.14	0.06	0.04	0.03	0.01

Headline inflation (month-on-month) also maintained an upward trend from 0.64 per cent in January to 0.77 per cent in June 2014. The major components of headline inflation (month-on-month) continued to be food and non-alcoholic beverages; and housing, water, electricity, gas and other fuel, with price increases ranging from 0.31 and 0.60 per cent to 0.53 and 0.14 per cent, respectively (Table 3.3 and Figure 3.5).

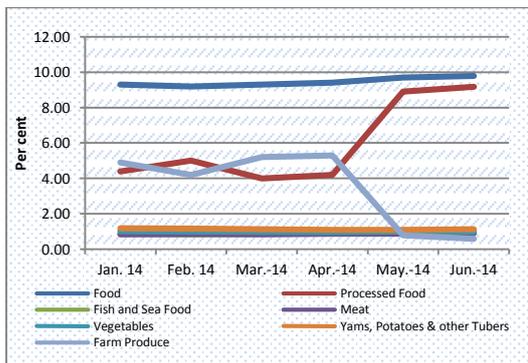
### 3.1.2 Food Inflation

During the review period, food inflation (year-on-year) consistently trended upward from 9.30 per cent in January to 9.78 per cent in June. Processed food was the main driver of food inflation, and fluctuated significantly, ranging from 4.40 per cent in January to 9.18 per cent in June. Fish and sea food was the next major contributor to food inflation, fluctuating between 0.88 per cent in January and 0.96 per cent in June. The prices of vegetables; yam, potatoes and other tubers; and farm produce, however maintained a downward pressure on food inflation as the raining season set in with price declines from 1.02, 4.10 and 1.19 per cent in January to 0.99, 0.59 and 1.13 per cent in June 2014, respectively (Table 3.4 and Figure 3.6).

**Table 3.4: Selected CPI Components' Contribution to Food Inflation (Y-on-Y), Jan-Jun 2014**

	Food	Processed Food	Fish and Sea Food	Meat	Vegetables	Yams, Potatoes & other Tubers	Farm Produce
Jan.-14	9.30	4.40	0.88	0.84	1.02	1.19	4.90
Feb.-14	9.20	5.00	0.84	0.86	1.00	1.16	4.20
Mar.-14	9.30	4.00	0.88	0.85	0.99	1.13	5.20
Apr.-14	9.40	4.20	0.92	0.87	0.97	1.10	5.30
May.-14	9.70	8.91	0.93	0.88	1.01	1.10	0.78
Jun.-14	9.78	9.18	0.96	0.89	0.99	1.13	0.59

**Figure 3.6: Selected CPI Components' Contribution to Food Inflation(Y-on-Y) Jan-Jun 2014**



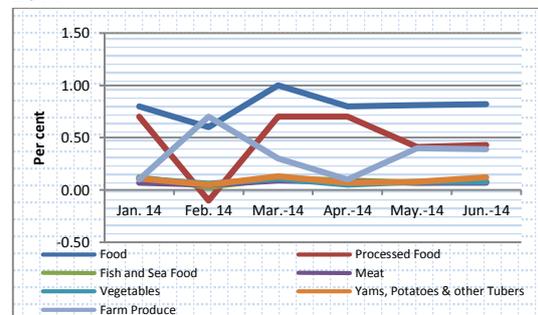
Food inflation (month-on-month) during the review period reflected a similar pattern to its year-on-year trend though to a lower degree. The major components responsible for the upward trend in food prices on month-on-month basis were farm produce; yams, potatoes and other tubers which rose from 0.10 and 0.11 per cent in January to 0.39 and 0.12 per cent in June 2014, respectively. The development was, however, moderated by the indices of processed food; fish and sea food; and vegetables that experienced price

declines from 0.70, 0.12 and 0.11 per cent in January to 0.43, 0.08 and 0.8 per cent in June 2014, respectively (Table 3.5 and Figure 3.7).

**Table 3.5: Selected CPI Components' Contribution to Food Inflation (M-on-M) Jan-Jun 2014**

Date	Food	Processed Food	Fish and Sea Food	Meat	Vegetables	Yams, Potatoes & other Tubers	Farm Produce
Jan.-14	0.80	0.70	0.12	0.07	0.11	0.11	0.10
Feb.-14	0.60	-0.10	0.03	0.05	0.06	0.05	0.70
Mar.-14	1.00	0.70	0.11	0.09	0.11	0.13	0.30
Apr.-14	0.80	0.70	0.09	0.08	0.05	0.07	0.10
May.-14	0.81	0.41	0.07	0.07	0.08	0.08	0.40
Jun.-14	0.82	0.43	0.08	0.07	0.08	0.12	0.39

**Figure 3.7: Selected CPI Components' Contribution to Food Inflation (M-on-M) Jan-Jun 2014**



### 3.1.3 Core Inflation

Core inflation (year-on-year) also exhibited an upward trend as it rose by 1.52 percentage points from 6.6 per cent in January to 8.12 per cent in June 2014. The price of all the major components of core inflation year-on-year (housing, water, electricity, gas and other fuel; transport; furnishing, household equipment and maintenance; clothing and footwear;

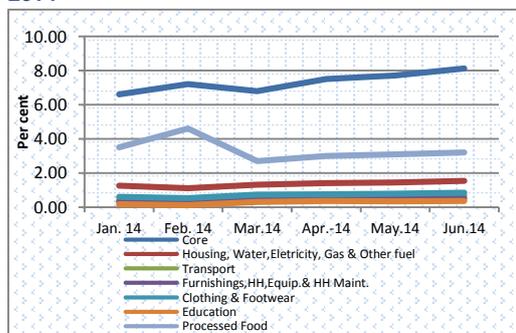
education; and processed food) contributed significantly to the steady increase recorded from January to June except in March, where there was a decrease of 0.4 percentage point (Table 3.6 and Figure 3.8).

Processed food recorded the highest price decrease of 1.90 percentage points from 4.6 per cent in February to 2.70 per cent in March, but thereafter trended upward and ended the half year on 3.21 per cent at end-June 2014. Housing, water, electricity, gas and other fuel component recorded price increase of 0.43 percentage point in the review period.

**Table 3.6: Selected CPI Components' Contribution to Core Inflation (Y-on-Y) Jan-Jun 2014**

Date	Core	Housing, Water, Electricity, Gas & Other fuel	Transport	Furnishings, HH, Equip. & HH Maint.	Clothing & Footwear	Education	Processed Food
Jan. 14	6.60	1.25	0.44	0.30	0.61	0.18	3.50
Feb. 14	7.20	1.10	0.37	0.23	0.53	0.12	4.60
Mar. 14	6.80	1.31	0.59	0.45	0.74	0.30	2.70
Apr. 14	7.50	1.41	0.62	0.49	0.76	0.35	3.00
May. 14	7.70	1.45	0.63	0.48	0.78	0.34	3.09
Jun. 14	8.12	1.53	0.67	0.51	0.84	0.36	3.21

**Figure 3.8: Selected CPI Components' Contribution to Core Inflation (Y-on-Y) Jan-Jun 2014**

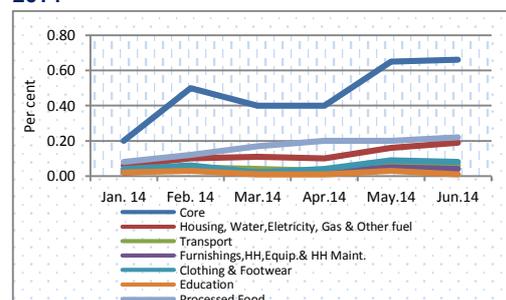


**Table 3.7: Selected CPI Components' Contribution to Core Inflation (M-on-M) Jan-Jun 2014**

	Core	Housing, Water, Electricity, Gas & Other fuel	Transport	Furnishings, HH, Equip. & HH Maint.	Clothing & Footwear	Education	Processed Food
Jan. 14	0.20	0.06	0.02	0.02	0.04	0.02	0.08
Feb. 14	0.50	0.10	0.05	0.04	0.06	0.03	0.12
Mar. 14	0.40	0.11	0.04	0.02	0.02	0.01	0.17
Apr. 14	0.40	0.10	0.03	0.02	0.04	0.01	0.20
May. 14	0.65	0.16	0.06	0.05	0.09	0.03	0.20
Jun. 14	0.66	0.19	0.06	0.04	0.08	0.01	0.22

On a month-on-month basis, core inflation shared a similar trend as its year-on-year counterpart. For instance, core inflation (month-on-month) rose persistently from 0.20 per cent in January to 0.66 per cent in June, 2014. Processed food continued to be the major driver of upward pressure in core inflation, followed by housing, water, electricity, gas and other fuel component (Table 3.7 and Figure 3.9).

**Figure 3.9: Selected CPI Components' Contribution to Core Inflation (M-on-M) Jan-Jun 2014**



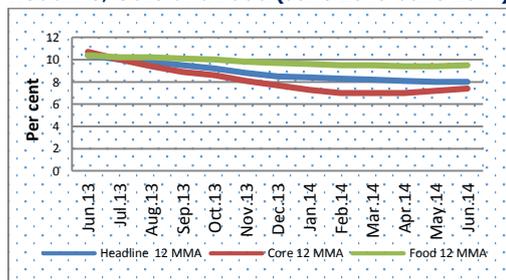
### 3.1.4 Moving Averages of Inflation

The headline, core and food inflation measures on twelve-month moving average (12MMA) basis, exhibited opposite trend when compared with

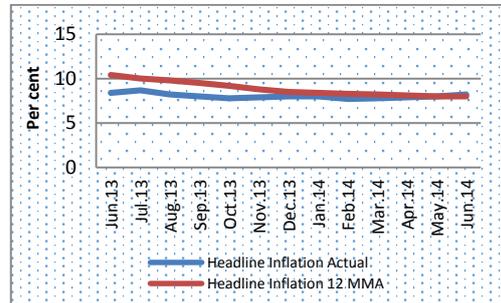
the year-on-year basis between January and June 2014 (Table 3.10 and Figure 3.10). The headline inflation on 12MMA basis consistently showed a downward trend from 8.4 per cent in January to 8.0 per cent in June 2014. Similarly, core inflation on 12MMA basis maintained a downward trend from 7.30 per cent in January to 7.0 per cent in February through April, before rising to 7.4 per cent in June 2014.

Food inflation on 12MMA basis remained fairly stable with a slight decline of 0.10 percentage point in the first half of 2014. It declined marginally from 9.60 per cent in January to 9.40 per cent in April and May before rising to 9.50 per cent in June 2014. Food inflation was the main driver of the headline inflation in both year-on-year and twelve-month moving average bases (Figures 3.11 - 3.13). The downward trend in all measures of inflation under the 12MMA basis was due to the waning effect or base effect as well as tight monetary policy measures in the review period.

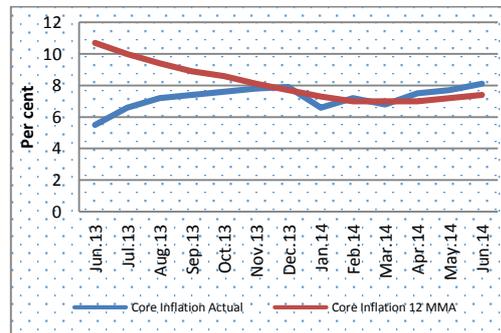
**Figure 3.10: 12 Months Moving Averages, Headline, Core and Food (June 2013-June 2014)**



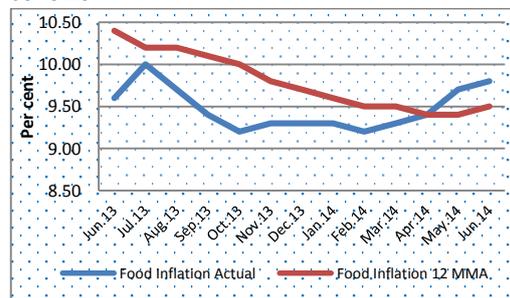
**Figure 3.11: Actual Headline Inflation and Its 12 Month Moving Averages (MMA), June 2013 – June 2014**



**Figure 3.12: Actual Core Inflation and Its 12 Month Moving Averages (MMA), June 2013 – June 2014**



**Figure 3.13: Actual Food Inflation and Its 12 Month Moving Averages (MMA), June 2013 – June 2014**



### 3.1.4 Seasonally-Adjusted Inflation

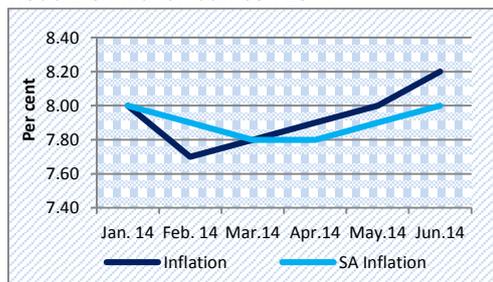
The actual headline inflation and seasonally-adjusted headline inflation

trended downwards, with the latter either the same or consistently lower than the former in most of the first half of 2014 (Table 3.8 and Figure 3.14). Earlier in the review period, both actual and seasonally-adjusted inflation showed downward trends between January and February 2014 (extending to March for seasonally-adjusted inflation), indicating the continued impact of tightness of the monetary policy stance. In April, May and June, actual inflation was consistently higher than seasonally-adjusted inflation, reflecting the increased consumption expenditures associated with the series of religious holidays (for Muslims and Christians) and World Economic Forum events.

**Table 3.8: Actual and Seasonally Adjusted Headline Inflation Jan-Jun 2014**

Date	Inflation	SA Inflation
Jan. 14	8.00	8.00
Feb. 14	7.70	7.90
Mar.14	7.80	7.80
Apr.14	7.90	7.80
May.14	8.00	7.90
Jun.14	8.20	8.00

**Figure 3.14: Actual and Seasonally Adjusted Headline Inflation Jan-Jun 2014**



### 3.3 Key Factors that Influenced the Domestic Price Level

The year-on-year headline and core measures of inflation were sustained at single digit level, though there was an upward trend in food inflation during the first half of 2014 compared with the preceding half year. The period also witnessed a gradual uptick in the rate of inflation from February to June 2014 which reinforced the need for a sustained tight monetary policy. These developments were attributed to both domestic and global economic and financial conditions, including excess liquidity, agricultural output and distribution bottlenecks in the North Eastern part of the country, among others.

#### 3.3.1 Demand-Pull Factors

The injection of funds subsequent to the approval of the 2014 budget, the increased pre-elections spending and additional spending due to security concerns exerted upward pressure on domestic prices.

In addition, the relatively high oil prices experienced during the review period boosted overall federation revenues and supported higher levels of public expenditure across the three tiers of government. These factors contributed to increased demand, which helped fuel inflation.

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### 3.3.2. Cost-Push Factors

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*I*n the first half of 2014, the contribution of agricultural output dropped relative to the previous period. In addition to the decline in agricultural output, the incessant security challenges hampered effective distribution of agricultural products, accentuating higher food prices.

The pricing in by economic agents of risk associated with the anticipated upward review of tariffs on imported cars that had been scheduled to take effect from July 1, 2014, further exerted upward pressure on domestic prices. Additional factors include high cost of imported factor inputs and the widening premium between the official, interbank and BDC exchange rates.

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### 3.3.3 Moderating Factors

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*T*he main moderating factor to domestic prices in the first half of 2014 was the continued tight monetary policy stance of the Bank. In addition, ongoing government reforms aimed at stimulating real sector activities and other incentives for micro small and medium scale enterprises (MSMEs) helped to lower industrial costs. The construction of new roads and improvement in the nationwide supply of fuel tempered energy costs, and had salutary effect on price development.

## Chapter Four

### 4.0 MONETARY POLICY AND LIQUIDITY MANAGEMENT

The conduct of monetary policy in the first half of 2014 was underpinned by concerns on issues such as uncertainties in the global economy, especially arising from the commencement of the QE3 tapering by the Fed; emerging challenges to monetary policy and slowing output growth in emerging markets that portend risks to both financial system and price stability in the domestic economy. On the domestic front, while stability in exchange rate was sustained and inflation largely remained in the single-digit target, concerns for monetary policy during the period included depletion of fiscal buffers following the continuing decline in oil revenue, rundown of reserves and depletion of excess crude oil savings. Portfolio and FDI inflows were on the downward trend with widening gap between the official and the BDC exchange rates.

These developments, coupled with the desire to consolidate on the achievements of price and exchange rate stability informed monetary policy decisions in the second half of 2014.

#### 4.1. Highlights of Monetary Policy Measures

The Bank largely maintained its tight monetary policy stance during the first half of 2014 as it retained the MPR at 12.0 per cent, with a corridor of +/-200 basis points around the MPR during the period. At its January 2014 meeting, the Monetary Policy Committee (MPC) raised public sector CRR from 50 to 75 per cent. The decision was predicated on the need to limit excessive reliance on external reserves to support the exchange rate by reining in on liquidity through further monetary tightening until fiscal buffers are rebuilt. In its meeting of March 2014, the MPC, opted for further tightening of monetary policy, considering the commencement of uptick in the inflation rate; the need to maintain exchange rate stability; the potential headwinds in 2014; the ultimate goal of transiting to a truly low – inflation environment; and the need to retain portfolio flows. The Committee consequently raised the CRR on private sector deposits by 300 basis points to 15 per cent.

#### 4.2. Decisions of the Monetary Policy Committee

##### 4.2.1 January 2014 MPC meeting

The Monetary Policy Committee (MPC) was delighted at the sustained stability of the exchange rate and single digit inflation in 2013. However,

the concerns for policy in the short to medium-term included the depletion of fiscal buffers following the continuing decline in oil revenue, rundown of reserves and depletion of excess crude oil savings; falling portfolio and foreign direct inflows; widening gap between the official and the BDC exchange rates; and creeping increase in core inflation.

The Committee re-affirmed its commitment to a stable exchange rate regime and urged the fiscal authority to provide support by reducing fiscal leakages, improving controls around oil revenues and reviewing terms around production sharing agreements with oil companies, while awaiting the passage of the Petroleum Industry Bill (PIB). The Committee also noted the necessity for a complementary monetary policy response to ensure sustained exchange rate stability and convergence of rates in all segments of the foreign exchange market.

The MPC consequently decided to retain the MPR at 12.0 per cent +/- 200 basis points and liquidity ratio (LR) at 30 per cent. Public sector CRR was increased from 50.0 per cent to 75.0 per cent; while private sector CRR was retained at 12.0 per cent. The Bank was mandated to take immediate step to redress the supply-demand imbalance in the BDC segment while maintaining its focus on anti-money laundering (AML) activities.

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#### 4.2.2 March 2014 MPC meeting

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The MPC meeting of March 2014 gave considerations to resurgence of core inflation in spite of the downward trend in headline inflation. Further, it opined that prudent monetary stance would facilitate better reserve and exchange rate management in an environment where QE3 tapering increases pressure on financial markets in emerging market economies. The Committee further noted that the sustenance of relative exchange rate stability and single digit inflation in 2014 given the risks in the horizon will require extra-ordinary measures. The foregoing informed the Committee's decision to continue on the path of tight monetary policy in order to consolidate on the gains in price, exchange rate and financial system stability in 2014. Other issues of policy concern related to frontier markets positioning themselves to attract higher capital inflows by raising their policy rates to contain inflation and also remain competitive. There were concerns over the sudden surge in domiciliary account balances which might offset the gains from imposing 75.0 per cent CRR on public sector funds.

While the Committee was unanimous on further tightening of monetary policy, opinions were divided on policy instruments to be adopted. Two policy options were considered; first, it considered an increase in the MPR to retain and attract more inflows, but

rejected the option because of the fears that such increase could impact negatively on access to credit and domestic output growth. The second option was to increase CRR as a tool of maintaining and consolidating on the positive achievements in price and exchange rate stability. Accordingly, the decisions were to hold the MPR and its corridor at current levels but raised the CRR on private sector deposits by 300 basis points to 15.0 per cent.

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#### 4.2.3 May 2014 MPC meeting

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The MPC met against the backdrop of mixed signals over the prospects for global growth in advanced, emerging markets and frontier economies. The overall domestic economic environment was characterized by macroeconomic stability with inflation contained within the target range, stability in the foreign exchange market, stable interbank rates and strong outlook for growth.

Challenges to monetary policy from the external environment included the prospects for increasing yields and interest rates in the US; and the rather low level of economic activity in emerging market economies; both of which could have repercussions for foreign capital inflows (private and official) and stability of the naira exchange rate. While domestic concerns included the high systemic liquidity in the banking sector, elevated

security concerns and anticipated high election-related spending in the run-up to the 2015 general elections. High domestic liquidity could exert sustained pressure on both the exchange rate and consumer prices, as well as accentuate the already high demand for foreign exchange, further depleting the country's external reserves. In addition, core inflation continued to send conflicting signals since January 2014. The Committee felt that if the upward trend continues as observed in April 2014, it could be a major factor in the upward trend in price levels. The Committee was also worried by the continued erosion of fiscal buffers, which was capable of exposing the economy to vulnerabilities arising from both domestic and external shocks.

Consequently, the Committee decided to retain its tight monetary policy stance and left all its policy instruments unchanged.

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#### 4.3 Instruments of Liquidity Management

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Sustenance of the price stability objective of the Bank provided a guide for the management of liquidity position in the economy during the review period.

Consequently, the MPC deployed the MPR in conjunction with other traditional instruments that include the CRR, Open Market Operations (OMO)

and Discount Window Operations in the review period.

#### 4.3.1. Monetary Policy Rate (MPR)

The MPR, the Bank's benchmark policy rate, remained the major signaling instrument for monetary policy complemented by the interest rate corridor (standing lending/deposit facility rates). However, given the sustained stability of the exchange rate and prices during the review period, the MPC kept the MPR unchanged at 12.0 per cent with a symmetric band of +/- 200 basis points during the period under review.

#### 4.3.2. Open Market Operations (OMO)

Open Market Operations (OMO) remained the major tool of liquidity management in the review period. Actual sales during the period under review amounted to N4,484.94 billion, compared with N3,348.39 billion in the second half of 2013 and N7,099.54 billion in the corresponding period of 2013. This represented a decline of 36.83 per cent over the corresponding period of 2013, and an increase of 33.94 per cent over the second half of 2013 (Table 4.1).

**Table 4.1 OMO Bills Auction (January 2009 – June 2014) (N'million)**

Date	2013	2014	% Change over the Previous Period
Jan	1,756.66	1,091.49	
Feb	1,351.59	307.4	
Mar	1,265.25	714.57	
Apr	1,516.69	285.94	
May	1,27.40	905.99	
Jun	81.95	1,179.54	
<b>1st Half</b>	<b>7,099.54</b>	<b>4,484.94</b>	<b>-36.83</b>
Jul	508.14		
Aug	91.72		
Sep	150.51		
Oct	1,206.86		
Nov	791.09		
Dec	599.47		
<b>2nd Half</b>	<b>3,348.39</b>		<b>33.94</b>
<b>Cumulative Figure</b>	<b>10,447.93</b>		

#### 4.3.3 Reserve Requirements

The use of reserve requirements, Cash Reserve and Liquidity Ratios, complement OMO and other instruments of liquidity management. As earlier mentioned, the MPC increased the CRR on public and private sector deposits and retained the Liquidity Ratio at 30.0 per cent in the first half of 2014. These decisions were taken against the background of the relative liquidity surfeit in the banking system.

#### 4.3.4 Standing Facilities

The DMBs and Discount Houses (DH) continued to access the standing facilities (lending/ deposit) to meet their daily liquidity requirements in the first half of 2014. The volume of transactions at the CBN Standing Lending Facility (SLF) in the first half of

2014 stood at N2,021.19 billion compared with N6,923.86 billion recorded in the second half of 2013 and N5,248.70 billion in the corresponding period of 2013. The volume of SLF at end-June 2014 represented a decrease of 61.49 per cent compared with the corresponding period of 2013. The significant decrease in the volume of SLF transactions in the first half of 2014, reflected the liquidity surfeit that persisted in the banking system arising from FGN Bonds and NTBs that matured in the review period.

A significant increase in the cumulative volume of transactions at the CBN Standing Deposit Facility (SDF) window was however recorded during the period under review. The cumulative volume of SDF stood at N46,496.63 billion in the first half of 2014, compared with N26,862.21 billion in the second half of 2013 and N17,484.78 billion in the corresponding period of 2013. The level of SDF as at end-June 2014 represented 165.93 and 73.09 per cent increases over the levels in the corresponding period of 2013 and the second half of 2013, respectively (Table 4.2).

The observed increase in the use of the SDF window reflected an increased system wide liquidity in the review period.

**Table 4.2 CBN Standing Lending Facility (January 2009 – June 2014) (N'billion)**

Date	2013	2014	% Change Over the Preceding/Corresponding Period
Jan	669.75	615.59	
Feb	1,115.64	653.74	
Mar	993.47	560.27	
Apr	778.7	50.29	
May	796.89	44.88	
Jun	894.25	96.42	
1st Half	<b>5,248.70</b>	<b>2,021.19</b>	<b>-61.49</b>
Jul	793.07		
Aug	2,465.79		
Sep	2,407.54		
Oct	263.36		
Nov	314.22		
Dec	679.88		
2nd Half	<b>6,923.86</b>		<b>-70.81</b>
Total	<b>12,172.56</b>		21.58

**Table 4.3 CBN Standing Deposit Facility (January 2009 – June 2014) (N'billion)**

Date	2013	2014	% Change Over the Preceding/Corresponding Period
Jan	2,132.70	13543.87	
Feb	3,047.91	4953.72	
Mar	6,101.42	5844.76	
Apr	2,817.00	8190.69	
May	1,718.53	8061.09	
Jun	1,667.22	5902.5	
1st Half	<b>17,484.78</b>	<b>46,496.63</b>	<b>165.93</b>
Jul	6,341.59		
Aug	5,282.96		
Sep	2,905.72		
Oct	8,328.91		
Nov	5,321.54		
Dec	4,003.03		
2nd Half	<b>26,862.21</b>		<b>73.09</b>
Total	<b>44,346.99</b>		

### 4.3.5 Foreign Exchange Intervention

Intervention in the foreign exchange market continued to be a major policy tool employed by the Bank in sustaining the stability of the Naira. In the first half of 2014, the total supply of

foreign exchange by the Bank was US\$20,752 million compared with US\$17,728.04 million and US\$13,861.67 million in the second half and the corresponding period of 2013, respectively (Table 4.4).

There was an increase in total supply compared with the level in the preceding half-year, as well as the corresponding period of 2013 to douse the demand pressure during the review period.

**Table 4.4 Foreign Exchange Supply by the CBN (US\$ Million)**

YEAR	2013			2014		
	Sales to wDAS	Sales to BDC	Total Supply (wDAS + BDAC)	Sales to wDAS	Sales to BDC	Total Supply (wDAS + BDAC)
Jan	1,640.65	365.73	2,006.38	2,989.43	556.3	3,545.73
Feb	1,942.18	720.59	2,662.77	3,101.87	567.05	3,668.92
Mar	1,452.75	698.16	2,150.91	3,151.59	560.95	3,712.54
Apr	891.52	492.76	1,384.28	2,663.92	712.8	3,376.72
May	1,487.00	625.52	2,112.52	2,928.49	619.84	3,548.32
Jun	3,000.00	544.81	3,544.81	2,398.55	501.22	2,899.77
1st Half	10,414.10	3,447.57	13,861.67	17,233.85	3,518.16	20,752.00
Jul	3298.09	575.3	3,873.39			
Aug	2,166.99	466.52	2,633.51			
Sep	2,625.22	480.45	3,105.67			
Oct	2,387.28	598.35	2,985.63			
Nov	2,404.32	522.7	2,927.02			
Dec	1,998.02	404.8	2,402.82			
2nd Half	14,679.92	3,048.12	17,728.04			
Total	25,591.05	6,495.69	32,086.74			

#### 4.4 Developments in Monetary Aggregates

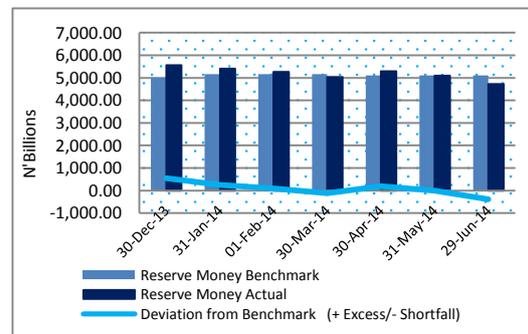
The sluggish performance of the monetary aggregates continued in the first half of 2014. This is indicative of the tight monetary policy stance and reluctance of deposit money banks to extend credit to the private sector. Consequently, most of the monetary aggregates declined while there were

modest increases in some components, leading to a marginal increase in the money stock.

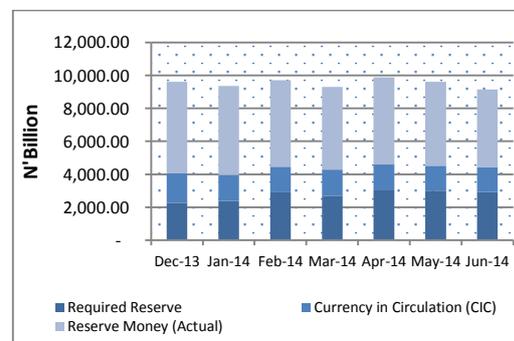
#### 4.4.1 Reserve Money

Reserve Money (RM), declined by 15.0 per cent to N4,723.07 billion by end-June 2014, down from N5,558.92 billion as at end-December 2013. The end-June 2014 value of RM also fell by 22.27 per cent (N1352.94 billion) below the benchmark value of N6,076.01 billion for the period.

**Figure 4.1: Monthly Reserve Money Benchmark and Actual (December 2013 – June 2014)**



**Figure 4.2: Reserve Money and its Components (Uses)**



#### 4.4.2 Broad Money (M2)

Broad money at N15,928.38 billion at end-June 2014 rose by 1.66 per cent over the end-December 2013 level of N15,668.95. This translated to an annualized growth rate of 3.32 per cent, compared with 1.42 per cent in the corresponding period of 2013 and the benchmark of 14.5 per cent for end-December 2014. On a year-on-year basis, Broad Money increased by N335.21 billion or 2.14 per cent, when compared with the end-June 2013 value of N15,593.17 billion ( Figures 4.4 and 4.5).

Figure 4.4: Money Supply (M1) and (M2) (Dec 2013 – Jun 2014)

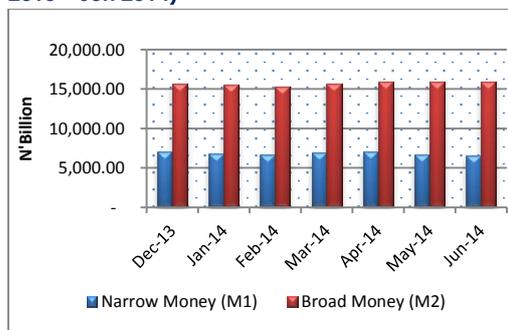
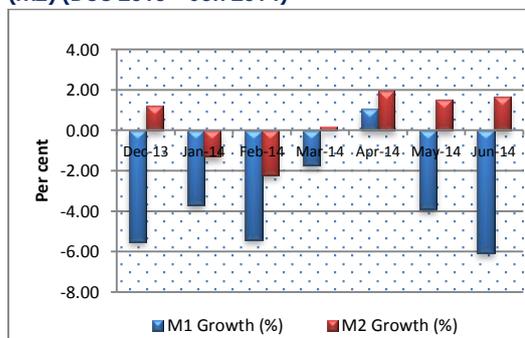


Figure 4.5: Growth in Money Supply (M1) and (M2) (Dec 2013 – Jun 2014)



#### 4.4.3 Narrow Money (M1)

Narrow Money (M1) decelerated by 6.07 per cent to N6,587.28 billion at end- June 2014 down from N7,012.83 billion as at end-December 2013. On annualized basis, M1 declined by 12.14 per cent compared with a decline of 12.98 in the corresponding period of 2013 and in contrast to the benchmark growth rate of 17.44 per cent for end-December 2014.

On a year-on-year basis, Narrow Money increased by N425.55 billion or 5.08 per cent when compared with the end-June 2013 value of N6,939.55 billion ( Figures 4.4 and 4.5).

#### 4.5 Drivers of Major Monetary Aggregates

##### 4.5.1 Net Foreign Assets (NFA)

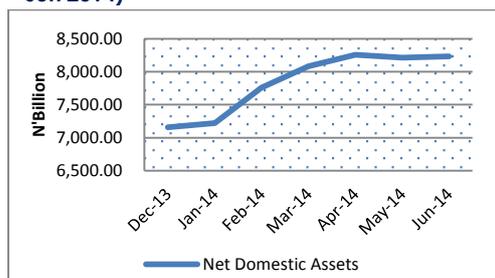
At N7,693.27 billion at end-June 2014, Net Foreign Assets (NFA) declined by 9.63 per cent below the level of N8,513.27 billion at end-December 2013. On annualized basis, NFA declined by 19.26 per cent compared with 0.6 per cent in the corresponding period of 2013. This development was in contrast to the benchmark growth rate of 9.3 per cent for end December 2014. (Figure 4.7).

##### 4.5.2 Net Domestic Assets (NDA)

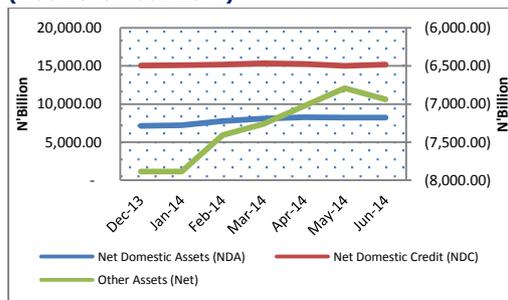
Net Domestic Asset (NDA) as at end-June 2014 stood at N8, 235.10 billion,

representing an increase of 15.0 per cent over the level of N7,155.68 recorded end-December 2013. On a year-on-year basis, NDA increased significantly by 1,806.36 billion or 28.10 per cent when compared with the end-June 2013 value of N6,428.74 billion. (Figure 4.8).

**Figure 4.6: Net Domestic Asset (NDA) (Dec 2013 – Jun 2014)**



**Figure 4.7: NDA, NDC and Other Assets (net) (Dec 2013 – Jun 2014)**

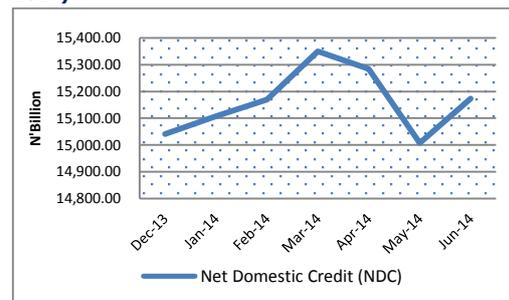


#### 4.5.3 Net Domestic Credit

Aggregate net Domestic Credit (NDC) as at end-June 2014 stood at N15,173.56 billion indicating a marginal increase of 0.88 per cent over the level of N15,040.70 billion at end-June 2014. When annualized, NDC grew by 1.76 per cent at end-June 2014, compared with 9.4 per cent growth rate in the

corresponding period of 2013 and the indicative benchmark of 28.4 per cent for end-December 2014. On a year-on-year basis NDC increased by N2,024.18 billion or 13.46 per cent when compared with end-June 2013 value of N13,149.38 billion (see Figure 4.7).

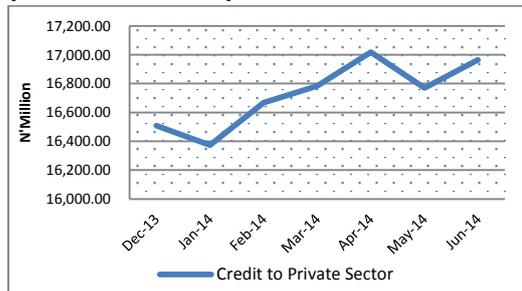
**Figure 4.7: Net Domestic Credit (Dec 2013 – Jun 2014)**



#### 4.5.4 Credit to the Government (C<sub>g</sub>)

Net claims of the banking system on Government remained negative all through the review period. It declined by 21.89 per cent to stand at N1,790.22 billion at end-June 2014 from N1,468.78 billion at end-December 2013. When annualized, credit to government declined by 43.78 per cent compared with the decline of 4.56 per cent in the corresponding period of 2013. The development was in contrast to the indicative benchmark of 31.5 per cent growth rate for fiscal year 2014. This indicated that the public sector continued to be a net creditor to the banking system during the review period. (Figure 4.10).

**Figure 4.10: Domestic Credit to Private Sector (Dec 2013 – Jun 2014)**



#### 4.5.5 Credit to the Private Sector(C<sub>p</sub>)

Credit to the private sector (C<sub>p</sub>) grew by 2.75 per cent to N16, 963.78 billion at end-June 2014 from N16,509.47 at end-December 2013. On annualized basis, C<sub>p</sub> grew by 5.5 per cent at end-June 2014, compared with the corresponding period of 2013 and the benchmark of 23.07 per cent for end-December, 2014. (Figure 4.10).

A summary of the major monetary aggregates and the provisional outcome as at end-June 2014, is shown in Table 4.12 below.

**Table 4.12: Monetary Aggregates Outcomes (Growth in % except otherwise stated)**

Key Policy Variables	2011	2012	2013	Provisional Outcome for June, 2014
Broad Money Growth (M2)	15.43	16.39	1.20	1.66**
Narrow Money Growth (M1)	21.54	9.59	(5.50)	-6.07**
Base (Reserve) Money (Naira Billion)	2,784.07	3,704.48	5,558.92	4,723.07
Aggregate Credit to the Domestic Economy (Net)	54.76	(3.46)	18.45	-0.88**
Credit to Government (net)	22.62	138.04	40.14	-21.89**
Credit to the Private Sector	44.28	6.83	8.96	2.75**
Inflation rate	10.30	12.00	8.00	8.20
Real GDP growth	5.31	4.21	5.49	6.58***



## Chapter Five

### 5.0 DEVELOPMENTS IN THE FINANCIAL MARKETS

The Nigerian financial market was significantly influenced by global and financial developments, especially, the U.S expansionary monetary policy in the first half of 2014. Following the announcement on December 18, 2013 of the intention to taper, the tapering of the U.S. quantitative easing had tremendous effect on many emerging and frontier market economies, including Nigeria. Nigeria had hitherto enjoyed substantial capital inflows enhanced by the quantitative easing and attractive yields prior to the implementation of the tapering. Tapering led to a re-orientation of global capital flows owing largely to the prospect of favorable interest rate environment in the U.S.

#### 5.1 Money Market

The money market remained active in the first half of 2014 with CBN bills and government securities actively traded in the market. Liquidity conditions continued to influence market activities as well as the increase in public and private sector CRR during the review period. The interbank call and Open Buy Back (OBB) rates remained locked-in within the policy rate corridor of MPR +/-200 basis points.

Collateralized lending, Open Market Operations (OMO) and standing facilities dominated activities in the money market. The OBB segment of the money market was very active, as it accounted for nearly 100 percent of interbank fund placements. Uncollateralized interbank and Repo transactions were moribund as the patronage for call money and Repo remained low throughout the period.

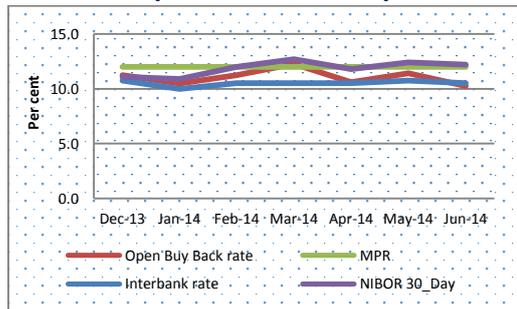
#### 5.1.1 Short-term Interest Rate Developments

Money market interest rates exhibited less volatility, and were mostly around the lower band of the corridor. The Bank conducted strategic OMO auctions to contain the cyclical effects of liquidity upsurge associated with FAAC allocations, and maturities of treasury bills, FGN bonds and AMCON bonds. The average interbank call rate ranged between 10.00 and 10.67 per cent, while the open-buy-back (OBB) rate was between 10.50 and 12.94 per cent during the review period.

**Table 5.1 Weighted Average Money Market Interest Rates (Dec 2013 – June 2014)**

Month	Interbank rate	Open Buy Back rate	NIBOR 30-Day	MPR
Dec-13	10.80	11.20	11.10	12.00
Jan-14	10.00	10.47	10.70	12.00
Feb-14	10.50	11.30	12.40	12.00
Mar-14	10.50	11.90	13.00	12.00
Apr-14	10.50	10.60	12.20	12.00
May-14	10.70	10.50	12.40	12.00
Jun-14	10.50	10.50	12.20	12.00

**Figure 5.1 Weighted Average Money Market Interest Rates ( Dec 2013 – June 2014)**



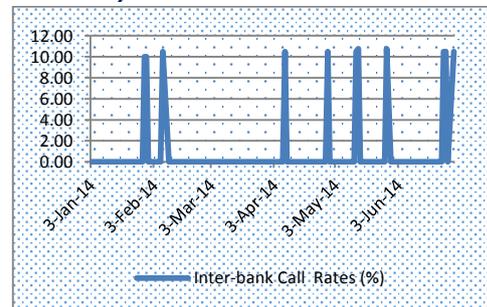
**(i) Interbank Call Rate**

The weighted average interbank call rate increased by 67 basis points from 10.0 per cent in January 2014 to 10.67 per cent in May, before declining to 10.50 in June 2014. The lull in the interbank call activity evidenced by only few days of transactions in the market in the review period, resulted in the call rate being almost flat at 10.50 per cent through the months of February to June 2014, except for the marginal rise to 10.67 per cent in May. Interbank call rate dropped approximately by 30 basis points in June 2014 relative to December 2013.

The decline in activities at the interbank segment was attributed to; (i) DMBs effort to avoid default risks following the revocation of license of two discount houses and; (ii) the launching of Real Time Gross Settlement System (RTGS) and the Scripless Security Settlement System (S4) that transparently simplifies settlement of secured transactions, hence encouraging more transaction

at the Open Buy Back window (Figure 5.2).

**Figure 5.2: Daily Interbank Call Rate (January – June 2014)**



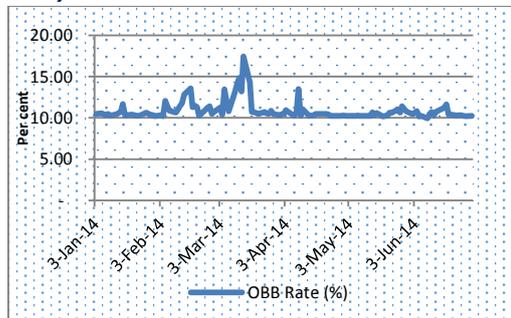
**(ii) Open Buy Back Rate**

The average (weighted) open buy-back rate fell by 72 basis points to 10.52 per cent in June 2014 from 11.24 per cent in December 2013. The rate, however, rose to 11.94 in March 2014 following the 300 basis point increase in private sector CRR, but was down to 10.52 per cent at the end the first half of the year. (Figure 5.3). Transactions in the OBB segment remained active and relatively stable in the review period.

The relative stability was attributed to the liquidity surfeit in the banking system occasioned by the release of statutory revenue to the state and local governments as well as matured FGN bonds and CBN bills. Activities at this collateralized segment of the market reflected the real dynamics of the interbank market when compared with the uncollateralized window which was largely inactive in the first half of 2014. On a year-on-year basis,

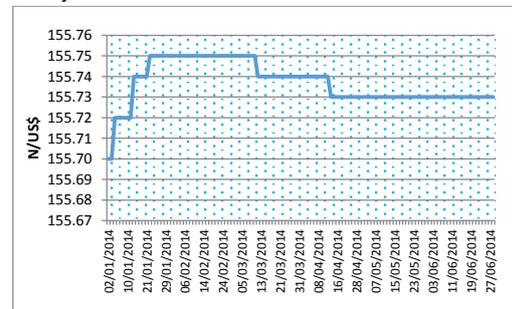
the average OBB rate rose by 20 basis points, when compared with the level in June, 2013.

**Figure 5.3: Open Buy Back Rate (January – June 2014)**



rate around the mid-point of US\$/₦155 +/-3.0 was sustained through foreign exchange market interventions.

**Figure 5.4: Daily Exchange Rate (January – June 2014)**



**(iii) Nigeria Interbank Offered Rate (NIBOR)**

Nigeria's reference rate for tenured transactions, the Nigeria Interbank Offered Rate (NIBOR) was relatively stable in the review period across tenors with occasional spikes. The average weighted 30-day NIBOR, which was 11.1 per cent in December 2013 rose to 12.7 per cent in March owing to the upward review in both public and private sector CRR in the first quarter before moderating to 12.2 per cent by June 2014. (Table 5.1)

**5.2 Foreign Exchange Market**

Amidst pronounced external shock largely induced by investors' response to the Fed tapering, the achievement of exchange rate stability remained cardinal to the Central Bank of Nigeria in the first half of 2014. The Bank's policy thrust of stabilizing the exchange

**5.2.1 Average Exchange Rate**

The w/rDAS spot rate appreciated slightly to an average of ₦157.30/US\$ in the first half of 2014 from ₦157.32/US\$ in the second half of 2013 indicating an appreciation of 0.01 per cent. Conversely, at the interbank foreign exchange market (IFEM), the average exchange rate depreciated to ₦162.56/US\$ in the first half of 2014 from an average of ₦160.32/US\$ in the second half of 2013, representing a depreciation of 1.38 per cent. Similarly, relative to an average of ₦158.18/US\$ and ₦160.32/US\$ in the first and second half of 2013, the exchange rate at the interbank market depreciated by 2.69 per cent to settle at ₦162.56/US\$. The rate at the BDC segment averaged ₦169.49/US\$ in the first half of 2014 compared with the average rate of ₦165.23/US\$ in the second half of 2013. This represented a depreciation of 2.51 per cent. Also,

when compared with the average of N159.66/US\$ in the first half of 2013, the rate depreciated by 5.80 per cent. The mild appreciation in the w/rDAS segment of the exchange rate market reflected efforts by CBN to douse exchange rate pressure, which was amplified by the depreciation witnessed at the interbank and BDC segments of the foreign exchange market in the first half of 2014 (Table 5.2).

**Table 5.2: Average Monthly Spot Exchange Rates (Jan 2013 – Jun 2014) (N/US\$)**

Date	CBN	IFEM	BDC
Jan-13	157.30	156.96	159.12
Feb-13	157.30	157.52	158.70
Mar-13	157.31	158.38	159.80
Apr-13	157.31	158.20	159.81
May-13	157.30	158.02	159.57
Jun-13	157.31	160.02	160.98
Average	157.31	158.18	159.66
Jul-13	157.32	161.12	162.43
Aug-13	157.31	161.15	162.28
Sep-13	157.32	161.96	163.14
Oct-13	157.42	159.83	165.00
Nov-13	157.27	158.79	167.14
Dec-13	157.27	159.05	171.40
Average	157.32	160.32	165.23
Jan-14	157.29	160.23	171.71
Feb-14	157.31	163.62	169.45
Mar-14	157.30	164.61	171.50
Apr-14	157.29	162.19	170.25
May-14	157.29	161.86	166.85
Jun-14	157.29	162.82	167.17
Average	157.30	162.56	169.49

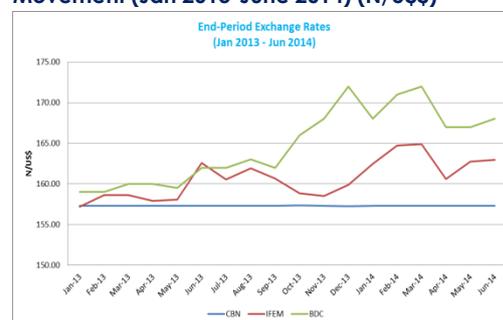
### 5.2.2 End-Period (Month) Exchange Rate

The naira depreciated in the w/rDAS and interbank segments of the foreign exchange market at end-June 2014, but appreciated at the BDC segment, when compared with end-December

2013. At the w/rDAS, the naira depreciated by 0.02 per cent to ₦157.29/US\$ at end-June 2014 from ₦157.26/US\$ at end-December 2013. When compared with end-June 2013, the naira appreciated mildly by 0.01 per cent at end-June 2014.

At the interbank market, the naira depreciated by 1.87 per cent from ₦159.90/US\$ at end-December 2013 to ₦162.95/US\$ at end-June 2014. Over the corresponding period of 2013, it depreciated by 0.21 from ₦162.60/US\$ at end-June 2013 to N162.95/US\$ at end-June 2014. At the BDC segment, the naira, however, appreciated by 2.38 per cent from N172.00/US\$ at end-December 2013 to N168.00/US\$ at end-June 2014. However, when compared with the same period a year earlier, the naira depreciated by 3.57 per cent from N162.00/US\$ at end-June 2013 to N168.00/US\$ at end-June 2014 (Figure 5.5 and Table 5.3).

**Figure 5.5: End-Month Exchange Rates Movement (Jan 2013-June 2014) (N/US\$)**



Strategic interventions by the CBN through spot and forwards foreign exchange transactions at both w/rDAS

and interbank markets contributed significantly in dousing exchange rate pressures experienced from the second half of 2013.

**Table 5.3: End-Month Exchange Rates Movement (Jan 2013 – Jun 2014) (N/US\$)**

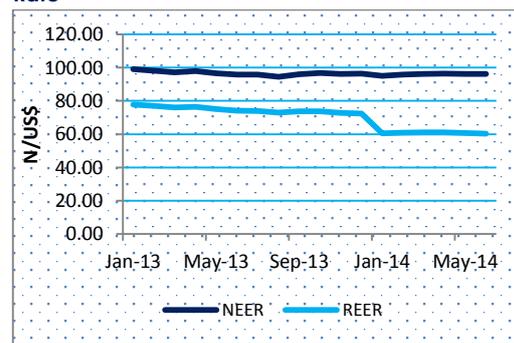
	CBN	IFEM	BDC
Jan-13	157.30	157.20	159.00
Feb-13	157.31	158.60	159.00
Mar-13	157.31	158.63	160.00
Apr-13	157.31	157.90	160.00
May-13	157.30	158.10	159.50
Jun-13	157.31	162.60	162.00
Jul-13	157.32	160.55	162.00
Aug-13	157.32	161.90	163.00
Sep-13	157.31	160.65	162.00
Oct-13	157.36	158.85	166.00
Nov-13	157.28	158.52	168.00
Dec-13	157.26	159.90	172.00
Jan-14	157.31	162.50	168.00
Feb-14	157.31	164.70	171.00
Mar-14	157.30	164.90	172.00
Apr-14	157.29	160.63	167.00
May-14	157.29	162.73	167.00
Jun-14	157.29	162.95	168.00

### 5.2.3 Nominal and Real Effective Exchange Rate

The Nominal Effective Exchange Rate (NEER) depreciated on average by 0.05 per cent to 96.01 in the first half of 2014 from 95.96 in the second half of 2013. However, when compared with the corresponding period in 2013, average NEER appreciated by 1.48 per cent from 97.43 in the first half of 2013. On the other hand, the Real Effective Exchange Rate (REER) appreciated significantly by 20.63 per cent from 73.26 in the second half 2013 to 60.73 in the first half of 2014. Similarly, when compared with the corresponding

period in 2013, the average Real Effective Exchange Rate appreciated by 22.1 per cent (Figure 5.6 and Table 5.4). In general, the trend indicated that the naira appreciated markedly, especially in real terms relative to the currencies of Nigeria's major trading partners.

**Figure 5.6: Nominal and Real Effective Exchange Rate**



**Table 5.4: Nominal and Real Effective Exchange Rates Indices (Jan 2013 – Jun 2014)**

Date	NEER	REER
13-Jan	99.05	77.84
13-Feb	98.12	77.08
13-Mar	97.16	76.1
13-Apr	97.88	76.34
13-May	96.56	75.02
13-Jun	95.78	74.15
2013: H1 Average	97.43	76.09
13-Jul	95.83	74
13-Aug	94.5	72.96
13-Sep	96.08	73.71
13-Oct	96.85	73.79
13-Nov	96.14	72.74
13-Dec	96.34	72.34
2013: H2 Average	95.96	73.26
2013 Average	96.69	74.67
14-Jan	94.96	60.43
14-Feb	95.87	60.96
14-Mar	96.24	61.05
14-Apr	96.42	61.05
14-May	96.29	60.67
14-Jun	96.27	60.22
2014: H1 Average	96.01	60.73

### 5.2.4 Demand and Supply of Foreign Exchange

Total demand for foreign exchange at the w/rDAS in the first half 2014 rose by 27.65 per cent to US\$23,905.81 million at end-June 2014 from US\$18,727.85 million at end-December 2013. Similarly, demand for foreign exchange in the w/rDAS window rose by 122.41 per cent when compared to US\$10,748.71 million in the corresponding period of 2013. The development was attributable to the effects of the slowdown in portfolio inflows and the effects of the U.S. tapering, which encouraged capital reversal during the period. In addition, uncertainties associated with the change in the leadership of the Bank, and the possibility of a change in policy stance fuelled temporary speculative demand for foreign exchange in the first half of 2014. The total supply of foreign exchange at the w/rDAS increased by 16.34 per cent from US\$14,813.51 million in the second half of 2013 to US\$17,233.85 million in the first half of 2014. When compared with US\$10,711.03 million in the first half of 2013, supply in the first half of 2014 increase by 60.90 per cent (Figure 5.7 and Table 5.5).

The Bank continued to implement measures to moderate the demand pressure in the foreign exchange market. These measures included continued implementation of rDAS, cap on purchases by BDCs, prohibition

of importation of foreign currency bills by authorized dealers without prior CBN approval and stringent returns requirement on forex utilization. In addition, the Bank introduced new measures, which included the ample supply of foreign exchange to the market, the revival of the interbank foreign exchange forwards market, and foreign exchange swaps among authorized dealers.

Figure 5.7: Demand and Supply of Foreign Exchange at r/wDAS

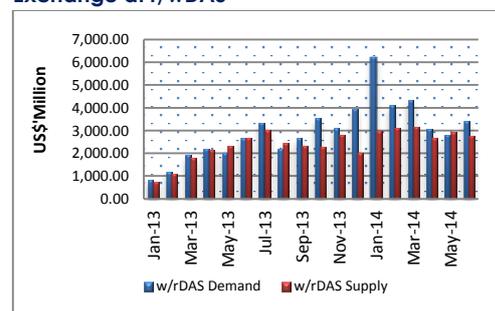


Table 5.5: Foreign Exchange Demand and Supply (Jan 2013 – Jun 2014) (US\$ Million)

Date	w/rDAS Demand	w/rDAS Supply
Jan-13	836.39	713.5
Feb-13	1,164.28	1,072.82
Mar-13	1,911.29	1,801.54
Apr-13	2,156.22	2,154.47
May-13	2,019.20	2,318.70
Jun-13	2,661.33	2,650.00
<b>2013: H1 Tot:</b>	<b>10,748.70</b>	<b>10,711.04</b>
Jul-13	3,325.56	3,000.00
Aug-13	2,179.38	2,437.08
Sep-13	2,660.13	2,297.82
Oct-13	3,541.93	2,274.38
Nov-13	3,095.32	2,796.47
Dec-13	3,925.53	2,007.76
<b>2013: H2 Tot:</b>	<b>18,727.85</b>	<b>14,813.51</b>
Jan-14	6,236.67	2,989.43
Feb-14	4,096.46	3,101.87
Mar-14	4,320.04	3,151.59
Apr-14	3,045.49	2,663.92
May-14	2,805.74	2,928.49
Jun-14	3,401.41	2,398.55
<b>2014: H1 Tot:</b>	<b>23,905.82</b>	<b>17,233.85</b>

### 5.2.5 Foreign Exchange Flows through the CBN

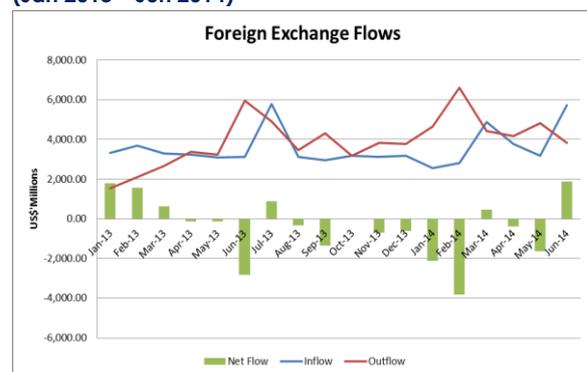
Gross foreign exchange inflows through the CBN rose to US\$22,888.75 million in the first half of 2014 from US\$21,322.85 million in the second half of 2013 and US\$19,747.47 million in the corresponding period of 2013, indicating increases of 7.34 and 15.91 per cent, respectively. Gross foreign exchange outflows rose to US\$28,501.98 million in the first half of 2014 from US\$23,456.99 million in the second half of 2013 and US\$18,856.14 in the corresponding period of 2013, reflecting increases of 21.51 per cent and 51.15 per cent, respectively.

In the review period, foreign exchange flows through the CBN resulted in a net outflow of US\$5,613.24 million in the first half of 2014, compared with a net outflow of US\$2,134.04 million in the second half of 2013 but in contrast to a net inflow of US\$891.32 million in the first half of 2013 (see Table 5.6 and Figure 5.8).

Table 5.6: CBN Monthly Foreign Exchange Flows (Jan 2013 – Jun 2014)

Date	Inflow	Outflow	Net Flow
13-Jan	3,320.80	1,538.10	1,782.70
13-Feb	3,681.10	2,103.40	1,577.70
13-Mar	3,302.64	2,671.54	631.10
13-Apr	3,238.83	3,369.37	(130.55)
13-May	3,095.50	3,233.68	(138.18)
13-Jun	3,108.60	5,940.05	(2,831.45)
<b>2013: H1 Total</b>	<b>19,747.47</b>	<b>18,856.14</b>	<b>891.32</b>
13-Jul	5,778.32	4,891.29	887.02
13-Aug	3,132.99	3,467.97	(334.97)
13-Sep	2,946.00	4,308.10	(1,362.00)
13-Oct	3,175.31	3,177.75	(2.44)
13-Nov	3,125.46	3,837.85	(712.39)
13-Dec	3,164.77	3,774.03	(609.26)
<b>2013: H2 Total</b>	<b>21,322.85</b>	<b>23,456.99</b>	<b>(2,134.04)</b>
<b>2013 Total</b>	<b>41,070.32</b>	<b>42,313.13</b>	<b>(1,242.72)</b>
14-Jan	2,543.55	4,652.19	(2,108.65)
14-Feb	2,797.57	6,612.99	(3,815.41)
14-Mar	4,880.32	4,430.48	449.83
14-Apr	3,779.45	4,155.76	(376.31)
14-May	3,171.28	4,819.22	(1,647.94)
14-Jun	5,716.58	3,831.34	1,885.24
<b>2014: H1 Total</b>	<b>22,888.75</b>	<b>28,501.98</b>	<b>(5,613.24)</b>

Figure 5.8: CBN Monthly Foreign Exchange Flows (Jan 2013 – Jun 2014)



### 5.2.6 Foreign Exchange Flow through the Economy

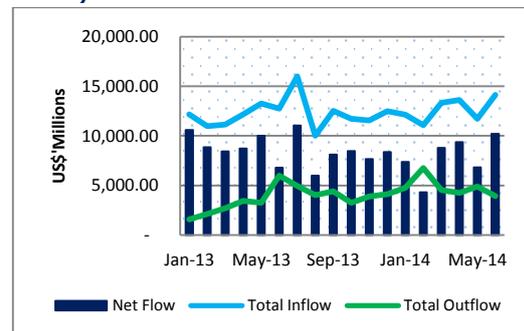
Gross foreign exchange inflow to the economy rose by 2.33 and 4.87 per cent to US\$75,966.99 million in the first half of 2014 from US\$74,234.57 million in the second half of 2013 and US\$72,436.22 million in the first half of 2013. Similarly, gross foreign exchange outflow rose to US\$29,092.92 million in the first half of 2014 from US\$24,579.59 million in the second half of 2013 and US\$19,058.02 million in the first half of 2013, indicating increases of 18.32 and 52.65 per cent, respectively.

In the first half of 2014, foreign exchange flows through the economy resulted in a net inflow of US\$46,874.06 million compared with US\$49,654.99 million in the second half of 2013 and US\$53,378.30 million in the first of 2013, representing a decline of 5.60 and 12.19 per cent, respectively. The decline in the net inflow for the period reflected the effect of U.S. tapering, which induced capital reversal (Table 5.7 and Figure 5.9).

**Table 5.7: Monthly Foreign Exchange Flows through the Economy (Jan 2013 – Jun 2014) (US\$ Million)**

Date	Total Inflow	Inflow (CBN)	Inflow (Autonomous)	Total Outflow	Outflow (CBN)	Outflow (Autonomous)	Net Flow	Net Flow (CBN)	Net Flow (Autonomous)
13-Jan	12,154.30	3,320.80	8,833.60	1,561.20	1,538.10	23.10	10,593.10	1,782.70	8,810.40
13-Feb	10,972.70	3,681.10	7,291.70	2,130.10	2,103.40	26.70	8,842.70	1,577.70	7,265.00
13-Mar	11,141.76	3,302.64	7,839.12	2,712.82	2,671.54	41.28	8,428.94	631.10	7,797.85
13-Apr	12,149.85	3,238.83	8,911.02	3,430.09	3,369.37	60.72	8,719.76	(130.55)	8,850.30
13-May	13,264.84	3,095.50	10,169.35	3,252.14	3,233.68	18.46	10,012.70	(138.18)	10,150.89
13-Jun	12,752.77	3,108.60	9,644.17	5,971.67	5,940.05	31.62	6,781.10	(2,831.45)	9,612.55
2013:H1 Total	72,436.22	19,747.47	52,688.96	19,058.02	18,856.14	201.88	53,378.30	891.32	52,486.99
13-Jul	15,980.58	5,778.32	10,202.27	4,941.04	4,891.29	49.75	11,039.54	887.02	10,152.52
13-Aug	10,007.30	3,132.99	6,874.31	4,020.74	3,467.97	552.77	5,986.57	(334.97)	6,321.54
13-Sep	12,506.90	2,946.00	9,560.80	4,397.00	4,308.10	88.90	8,109.90	(1,362.00)	9,471.90
13-Oct	11,704.37	3,175.31	8,529.07	3,236.63	3,177.75	58.89	8,467.74	(2.44)	8,470.18
13-Nov	11,549.56	3,125.46	8,424.10	3,880.79	3,837.85	42.94	7,688.77	(712.39)	8,381.16
13-Dec	12,485.86	3,164.77	9,321.09	4,103.39	3,774.03	329.36	8,382.47	(609.26)	8,991.73
2013:H2 Total	74,234.57	21,322.85	52,911.64	24,579.59	23,456.99	1,122.61	49,654.99	(2,134.04)	51,789.03
2013 Total	146,670.79	41,070.32	105,600.60	43,637.61	42,313.13	1,324.49	103,033.29	(1,242.72)	104,276.02
14-Jan	12,126.18	2,543.55	9,582.63	4,756.04	4,652.19	103.85	7,370.13	(2,108.65)	9,478.78
14-Feb	11,057.50	2,797.57	8,259.93	6,745.36	6,612.99	132.38	4,312.14	(3,815.41)	8,127.55
14-Mar	13,327.08	4,880.32	8,446.76	4,526.49	4,430.48	96.01	8,800.58	449.83	8,350.75
14-Apr	13,610.72	3,779.45	9,831.27	4,245.80	4,155.76	90.04	9,364.93	(376.31)	9,741.23
14-May	11,711.73	3,171.28	8,540.45	4,895.44	4,819.22	76.22	6,816.29	(1,647.94)	8,464.23
14-Jun	14,133.78	5,716.58	8,417.20	3,923.79	3,831.34	92.45	10,209.99	1,885.24	8,324.75
2014:H1 Total	75,966.99	22,888.75	53,078.24	29,092.92	28,501.98	590.95	46,874.06	(5,613.24)	52,487.29

**Figure 5.9: Monthly Foreign Exchange Flows through the Economy (Jan 2013 – Jun 2014) (US\$ Million)**



### 5.3 Capital Market

The capital market witnessed improved performance in the first half of 2014, compared with the second half of 2013 and the corresponding period of 2013. This development was due largely to improved earnings, favourable market sentiments and confidence in macroeconomic management. Despite the improved performance, the stock market was weighed down in the early part of the year by the effects of QE3 tapering, as declines were observed in market performance in January and April 2014, compared with December 2013.

#### 5.3.1 Equities Market

The All-Share Index (ASI) increased by 2.8 per cent to 42,482.48 at end-June 2014, from its end-December 2013 figure of 41,329.19, and by 17.5 per cent, when compared with 36,164.31 recorded at end-June 2013. Market Capitalization (MC) for equities also increased by 6.1 per cent to N14.03 trillion at end-June 2014 from N13.23 trillion at end-December 2013, and by 22.8 per cent when compared with the N11.43 trillion recorded at end-June 2013 (Table 5.8 and Figures 5.10a and 5.10b).

The 2.8 per cent year-to-date increase in ASI was driven mainly by strong performance in the oil and gas, and banking indices. The NSE Oil and Gas and Banking Indices rose by 172.96

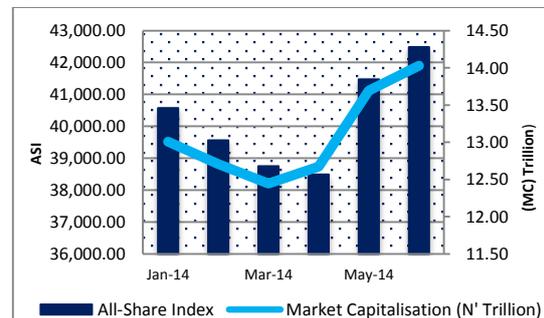
and 7.59 per cent, respectively, over their levels at end-June 2013. The performance of two other sectoral indices, the NSE Insurance and Consumer Goods Indices, also increased by 6.00 and 3.90 per cent, respectively.

**Table 5.8: NSE All-Share Index (ASI) and Market Capitalization (MC) (June 2013 – June 2014)**

Date	ASI	MC (Equities) (N' Trillion)
Jun-13	36,164.31	11.43
Jul-13	37,914.32	12.01
Aug-13	36,248.53	11.50
Sep-13	36,585.08	11.65
Oct-13	37,622.74	12.02
Nov-13	38,920.85	12.45
Dec-13	41,329.19	13.23
Jan-14	40,571.62	13.01
Feb-14	39,558.89	12.71
Mar-14	38,748.01	12.45
Apr-14	38,485.48	12.67
May-14	41,474.40	13.69
Jun-14	42,482.48	14.03

Source: NSE

**Figure 5.10a: NSE ASI and MC (Jan. 2014 – Jun. 2014)**



**Figure 5.10b: NSE ASI and MC (June 2013 – June 2014)**



### 5.3.2 Market Turnover

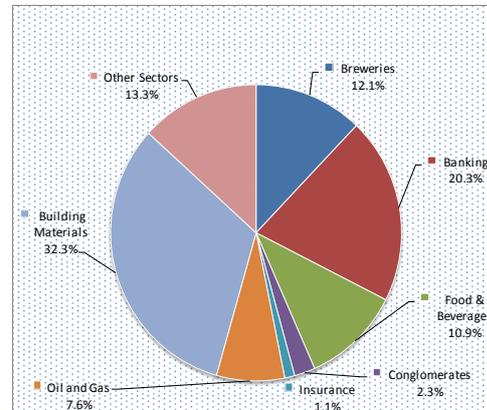
Aggregate stock market turnover in the first half of 2014 decreased by 59.34 per cent to 43.32 billion shares, valued at N466.93 billion, in 505,324 deals, compared with 106.54 billion shares valued at N1,043.31 billion, in 1,380,789 deals in the second half of 2013. Relative to the first half of 2013, market turnover decreased by 25.75 per cent from 58.34 billion shares valued at N591.56 billion, in 763,974 deals.

### 5.3.3 Sectoral Contribution to Equities Market

The building materials sub-sector was the most capitalized sector in the period under review. Its share in overall market capitalization rose to 32.3 per cent at end-June 2014, from 31.6 per cent at end-December 2013. Other leading sub-sectors were banking, breweries and food & beverages, with market shares of 20.3, 12.1 and 10.9 per

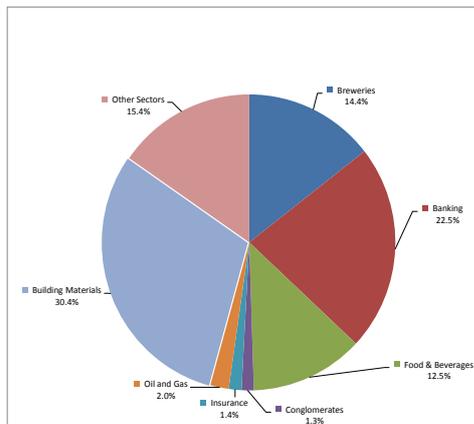
cent respectively, at end-June 2014 (Figures 5.11 and 5.12).

**Figure 5.11: NSE Market Capitalisation by Sector as at End-June 2014**



Source: NSE

**Figure 5.12: NSE Market Capitalisation by Sector as at End-December 2013**



Source: NSE

### 5.3.4 Warren Buffett Valuation Metric and Equities Market

The Warren Buffett valuation metric is applied to evaluate the performance of the Nigerian stock market. The index applies the ratio of market capitalisation to GDP to determine the

level of performance of the stock market vis-a-vis its equilibrium value (see Box 4.2 for further details). Table 5.9 below presents the trend of Warren Buffett Valuation Metric in Nigeria, from the first quarter of 2013 to the second quarter of 2014. The trend reveals that the Nigerian stock market is undervalued, with the exception of the first and second quarters of 2013, where the market was fairly valued. The average valuation metric for the entire period was 63.72, which showed that the market was generally undervalued.

**Table 5.9: Trends in Warren Buffett Valuation Metric in Nigeria (2013Q1-2014Q2)**

Period	Market Capitalization	Gross Domestic Product (Rebased GDP)	Warren Buffet Indicator
2013Q1	14,535,420,950,000	16,410,495,123,940	1.13
2013Q2	15,096,763,550,000	17,434,643,062,653	1.15
2013Q3	16,454,372,460,000	17,803,108,823,996	1.08
2013Q4	17,132,164,770,000	19,164,918,186,463	1.12
2014Q1	15,438,679,500,000	12,445,691,016,787	0.81
2014Q2	16,084,622,310,000	14,027,606,317,874	0.87

Source: NSE and NBS.

The trend explains the increase in capital inflows into the Nigerian equity market, especially foreign portfolio investment. This has projected the growing prominence of the equity segment of Nigeria's capital market as a source of funds for portfolio investment, in addition to individual and institutional investors' appetite for better yields. The cumulative effect of QE tapering and the favourable rate of returns (from the observed increase in the Buffet metric in the first and second

quarters of 2013) suggests fair market valuation. However, given the perceived sovereign risk surrounding the 2015 general elections and increased insurgencies in some parts of the country, foreign portfolio investors are likely to factor in sovereign risk above net yields between the Nigerian market and other frontier markets.

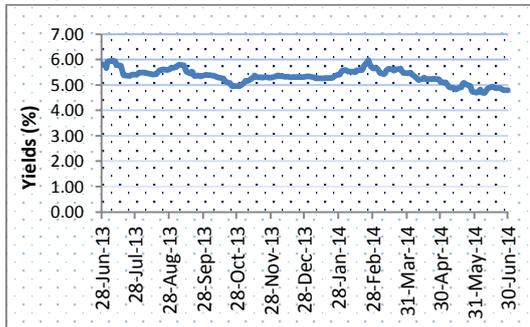
### 5.3.5 Bonds Market

The fixed income securities market in Nigeria continued to be dominated by the Federal Government of Nigeria (FGN) bonds. Sub-national government and corporate bonds witnessed some activities, with the corporate bonds segment having the least share by market volume. In the review period three new issues were made (10-year FGN bond valued at N331.35 billion, 7-year State government bond valued at N4.79 billion and 5-year corporate bond valued at N4.5 billion) totaling N340.64 billion.

#### 5.3.5.1 FGN Eurobond

Yields on the dollar-denominated assets decreased to 4.80 per cent at end-June 2014, from 5.33 and 5.83 per cent at end-December 2013 and end-June 2013, respectively (Figure 5.13). This development indicated investor confidence in Nigeria's sovereign instrument during the review period

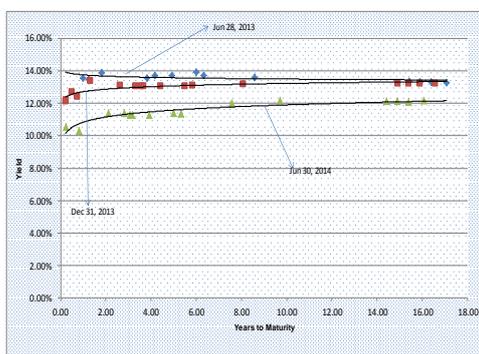
**Figure 5.13: 10-Year U.S. Dollar-denominated Bond Yields for Nigeria (June 28, 2013 – June 30, 2014)**



Source: Bloomberg

Consequently, the FGN bonds yield curve at end-June 2014 trended downwards by 104 basis points, compared with the position at end-December 2013, and 204 basis points compared with the position at end-June 2013 (Figure 5.14). Furthermore, FGN bonds yields were positive and well above the June 2013 – June 2014 rates of inflation.

**Figure 5.14: FGN Bonds Yield Curves: End-June 2013 vs. End-December 2013 vs. End-June 2014**



### 5.3.5.2 State/Local Government Bonds

Activity in the sub-national bonds market segment was at low ebbs

during the review period. The total value of outstanding state/local government bonds at end-June 2014 was N528.87 billion compared with N558.5 billion in the second half of 2013. In the period under review, only one N5 billion, 7-year tenor bond was issued by the Nasarawa State Government on January 6, 2014, compared with two bond issues by the Niger State Government (N12 billion 5-year bonds) and Lagos State government (N87.5 billion, 7-year bonds) in the second half of 2013.

### 5.3.5.3 Corporate Bonds

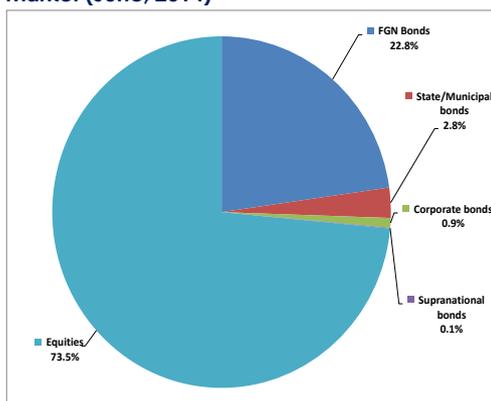
In the first half of 2014, the value of outstanding corporate bonds was N163.45 billion, compared with N571.24 billion recorded in the second half of 2013. There was only one new 5-year bond valued at N4.5 billion issued by DANA on April 1, 2014. The general slowdown of activities in the corporate bond market may be explained by the preference for equities given the perceived undervaluation of the equities market.

### 5.3.5.4 Overall Analysis of Fixed Income Securities

The value of FGN bonds increased by 9.5 per cent to N4.346 trillion at end-June 2014 from N3.970 trillion at end-December 2013 and by 3.8 per cent at end-June 2013. FGN bonds accounted for 22.8 per cent of the aggregate market capitalization at end-June

2014. Also, the value of the state/municipal bonds and corporate bonds closed at N528.87 billion and N169.90 billion, accounting for 2.8 per cent and 0.9 per cent of the aggregate market capitalization, respectively. The value of supranational bonds remained constant at N12.00 billion, accounting for 0.1 per cent of the aggregate market capitalization. The equity market capitalization accounted for 73.5 per cent of the aggregate market capitalization as at June 2014, while the combined share of FGN bonds, state/municipal bonds, corporate bonds and supranational bonds accounted for the remaining 26.5 per cent of the aggregate market capitalization. (Figure 5.15).

**Figure 5.15: Structure of the Nigerian Capital Market (June, 2014)**



## 5.4 Global Financial Market Development

Recent developments in the global financial markets increased doubt as to the resilience of the economic

recovery following the global financial crisis. Monetary policy continued to face the twin challenges of maintaining a stable exchange rate and low inflation in developing and emerging market economies.

### 5.4.1 African Region

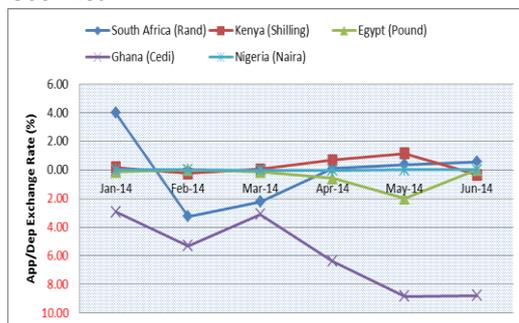
The volatility of exchange rate across five African countries presented in Table 5.10 and Figure 5.11 indicated that the naira appreciated slightly on two occasions by 0.01 per cent between December, 2013 and February, 2014. However, between March and June, 2014, it depreciated twice and remained flat in other months.

Similarly, the South African rand appreciated between December, 2013 and January 2014; and from April to June, 2014, but depreciated significantly between January and March, 2014. The Kenyan Shilling also showed a similar trend, appreciating against the U.S Dollar in most of the months. Conversely, the Ghanaian cedi depreciated throughout the review period and the Egyptian pound depreciated against the U.S. Dollar in four out of six months during the review period (Table 5.10 and Figure 5.16).

**Table 5:10: Changes (MTM\* % App/Dep) in Foreign Exchange Rates Across Selected African Countries**

	Dec 2013/Jan 2014	Jan 2014/Feb 2014	Feb 2014/Mar 2014	Mar 2014/Apr 2014	Apr 2014/May 2014	May 2014/June 2014
	MTM%	MTM%	MTM%	MTM%	MTM%	MTM%
	App/Dep	App/Dep	App/Dep	App/Dep	App/Dep	App/Dep
South Africa (Rand)	4.01	3.24	2.23	0.10	0.38	0.57
Kenya (Shilling)	0.17	0.23	0.06	0.70	1.15	0.34
Egypt (Pound)	0.14	0.00	0.14	0.57	2.00	0.00
Ghana (Cedi)	2.94	5.31	3.10	6.39	8.83	8.77
Nigeria (Naira)	0.01	0.01	0.01	0.01	0.00	0.00

**Figure 5:16: Changes (MTM\* % App/Dep) in Foreign Exchange Rates Across Selected African Countries**



### 5.4.2 North American Region

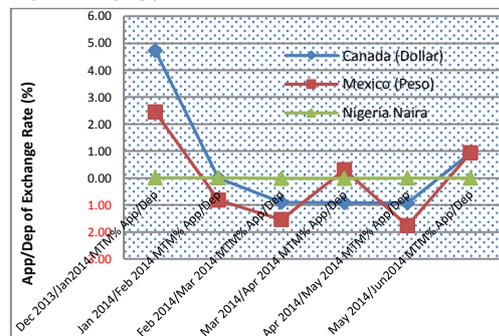
In the North American region, exchange rates experienced significant fluctuations in Canada, but moderated in Mexico in the review period. The Canadian dollar rate varied widely from an appreciation of 4.72 per cent to a depreciation of 0.92 per cent in January and May, respectively. On the other hand, the Mexican Peso, which experienced mild volatility, appreciated in January, April and June 2014, but depreciated in

February, March and May, 2014 (see Table 5:11 and Figure 5:17).

**Table 5.11: Changes (MTM\* % App/Dep) in Foreign Exchange Rates in Nigeria and Selected North America**

	Dec 2013/Jan 2014	Jan 2014/Feb 2014	Feb 2014/Mar 2014	Mar 2014/Apr 2014	Apr 2014/May 2014	May 2014/June 2014
	MTM%	MTM%	MTM%	MTM%	MTM%	MTM%
	App/Dep	App/Dep	App/Dep	App/Dep	App/Dep	App/Dep
Canada (Dollar)	4.72	0.00	0.90	0.91	0.92	0.93
Mexico (Peso)	2.45	0.82	1.54	0.31	1.76	0.93
Nigeria (Naira)	0.01	0.01	0.01	0.01	0.00	0.00

**Figure 5.17: Changes (MTM\* % App/Dep) in Foreign Exchange Rates in Nigeria and Selected North America**



### 5.4.3 South American Region

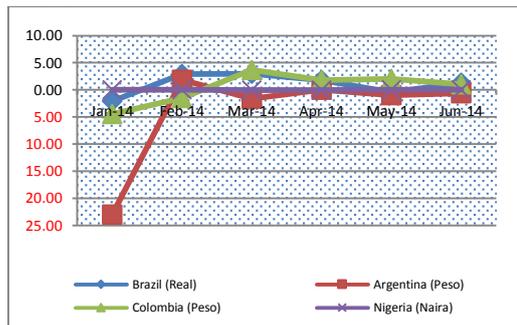
In the South American region, there was exchange rate volatility against the U.S dollar in the review period. The computed monthly changes in exchange rate indicate that the Brazilian real depreciated against the U.S dollar between January and May 2014, but appreciated in the remaining four months. Likewise, while the Argentine peso depreciated against the US dollar by 23.01 per cent

between December 2013 and January 2014, it moderated in the later part of the review period and appreciated in February 2014. In general, the Nigerian naira appeared to have performed better than the Brazil and Argentina currencies, given the relative stability of the Naira against the U.S dollar owing to the effectiveness of monetary policies applied in the review period (Table 5.12).

**Table 5.12: Changes (MTM\* % App/Dep) in Foreign Exchange Rates in Nigeria and Selected South America**

	Jan-14	Feb-14	Mar-14	Apr-14	May-14	Jun-14
Brazil (Real)	2.12	2.90	2.99	1.76	0.45	1.34
Argentina (Peso)	23.01	1.87	1.65	0.00	1.00	0.62
Colombia (Peso)	4.48	1.51	3.67	1.77	2.03	1.04
Nigeria (Naira)	0.01	0.01	0.01	0.01	0.00	0.00

**Figure 5.18: Changes (MTM\* % App/Dep) in Foreign Exchange Rates in Nigeria and Selected South America**



#### 5.4.4 The European Region

During the period under review, the British pound fluctuated mildly, depreciating in January, February, April and June 2014, but appreciated

in May and remained unchanged in March 2014. The Euro also fluctuated as the British Pound, depreciating in February and April 2014, appreciated in January, March and May, but remained unchanged in June 2014. The changes in exchange rates in the UK and Euro Area currencies mirrored each other during the period under review. In Russia, the rubble appreciated against the US dollar in January, February and April, but depreciated in March, May and June 2014. Again, comparatively, the Naira exchange rate appeared to be more stable than the European currencies throughout the period (see Table 5.13 and Figure 5.13).

**Table 5.13: Changes (MTM\* % App/Dep) in Foreign Exchange Rates in Nigeria and Selected European Countries**

	Dec 2013/Jan 2014 MTM% App/Dep	Jan 2014/Feb 2014 MTM% App/Dep	Feb 2014/Mar 2014 MTM% App/Dep	Mar 2014/Apr 2014 MTM% App/Dep	Apr 2014/May 2014 MTM% App/Dep
British Pound	1.67	1.64	0.00	1.67	1.69
The EURO	1.37	2.70	1.37	1.37	1.39
Russia Rubble	6.94	2.02	1.92	1.39	2.13
Nigeria Naira	0.01	0.01	0.01	0.01	0.00

#### 5.4.5 The Asian Region

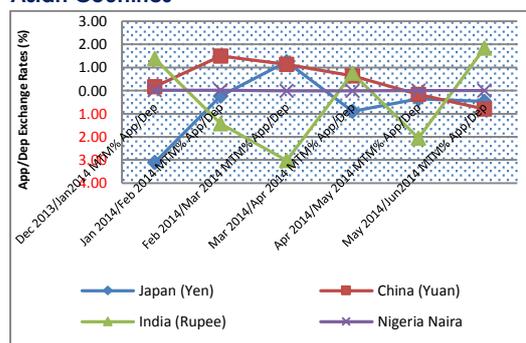
In the period under review, the Japanese yen depreciated in most of the months, except in March by 1.25 per cent. The Chinese yuan appreciated by 0.17, 1.49, 1.14 per cent and 0.64 per cent at the end of January, February, March and April respectively. However, the rate

depreciated by 0.16 and 0.80 per cent in May and June, respectively. In India, the rupee experienced fluctuations, appreciating at the end of January, April and June, but depreciated in the remaining months of the review period. The naira's relative stability compared favourably with selected currencies of the Asian Region (see Table 5.14 and Figure 5.20).

**Table 5.14: Changes (MTM\* % App/Dep) in Foreign Exchange Rates Across Selected Asian Countries**

Date	Dec/Jan 2014	Jan/Feb 2014	Feb/Mar 2014	Mar/Apr 2014	Apr/May 2014	May/June 2014
	MTM* % App/Dep					
Japan (Yen)	-3.11	-0.24	1.25	-0.90	-0.36	-0.47
China (Yuan)	0.17	1.49	1.14	0.64	-0.16	-0.80
India (Rupee)	1.39	-1.44	-3.03	0.75	-2.06	1.84
Nigeria (Naira)	0.01	0.01	-0.01	-0.01	0.00	0.00

**Figure 5.20: Changes (MTM\* % App/Dep) in Foreign Exchange Rates in Nigeria and Selected Asian Countries**



### **Box 5.1**

#### **Foreign Portfolio Investment (FPI) in the Nigerian Equities Market**

The management of foreign portfolio flows is central to international business transactions in an economy. Globalization and greater integration provided the impetus for several developing and emerging market economies to relax restrictions, among other measures, to attract international capital. These economies require foreign capital in order to ensure economic development. Developing countries are characterized by low level of domestic savings, and in order to attain the desirable level of investments, foreign capital is required to bridge the saving-investment gap. These countries therefore stand to benefit from increased foreign capital. Capital inflows are expected to foster economic activities in less developed countries in particular, and promote economic growth and development in general. While portfolio investment has been a notable feature of developed economies, in recent times, it has become a very important component of the balance of payments of many emerging and frontier economies such as China, Hong Kong, India, Singapore, Taiwan, Brazil, South Africa, etc. Recently, portfolio investment has gained prominence in Nigeria.

Despite the importance of FPI, surges in inflow are associated with macroeconomic imbalances such as high inflation, exchange rate fluctuations and high domestic interest rates. The adverse impact of reliance on FPI becomes more pronounced during economic crisis or recession, such as the Asian financial crisis of 1997 and the global financial and economic crisis of 2007. During the 2007 crisis, Nigeria and many other countries experienced reduction in FPI, as investors fled to safety to mitigate the impact of the crisis on their portfolios. In addition, inward remittances declined as the impact of the recession hit Western economies, driving up unemployment. The need for increased foreign portfolio divestment and repatriation of dividends by foreign investors worsened pressure on the exchange rate, leading to a significant drawdown on the nation's external reserves. As a result, the naira depreciated at the wDAS/rDAS window from about N117.97/US\$ at end-December 2007 to N132.56/US\$ at end-December 2008. The depreciation of the naira was further accentuated by adverse terms of trade, occasioned by oil price fluctuations, which again impacted negatively on the country's external reserves.

A review of capital controls in Nigeria reveals a systematic reduction of restrictions on capital flows of the economy. For instance, the 1-year minimum tenor on purchases of FGN Bonds and Nigerian Treasury Bills by foreign investors was removed. Foreign investors were also allowed to invest directly in private equity as well as in the capital market. In addition, investors were guaranteed unrestricted repatriation of their capital. Moreover, foreign investors have unfettered access to non-government instruments such as Bankers Acceptances, etc. Furthermore, foreign investors were allowed to extend loans to private Nigerian entities, without restrictions. Such loans could either be in the form of capital importation, evidenced by the issuance of a Certificate of Capital Importation (CCI), or supplier's credit, in order to facilitate repayment of principal/interest. However, the loans were without government guarantees. It is important to state that in the case of investment in government securities, foreign investors can divest the investment before maturity by transferring the underlying CCI to a new investor.

Aggregate inflow to Nigeria has expanded remarkably in the last ten years. Some prominent pull-factors for this expansion included an improved macroeconomic environment, increased

confidence in macroeconomic management, investor-friendly investment policies, and comparatively robust returns on investment. In the last 5 years, the Nigerian economy has recorded stable and relatively better outcomes, underpinned by sound economic and financial reforms. The financial system has remained resilient and stable. Overall growth has averaged over 6.0 per cent, with inflation stabilizing in the single digit range since 2013. The exchange rate has also maintained relative stability, accompanied by a fairly robust external reserve level.

Foreign portfolio investment (FPI) in bonds and equities constituted the bulk of foreign inflows to Nigeria. However, it is important to note that the structure of capital importation is skewed towards investment in equities, leading to the growing prominence of the equity market in Nigeria. Between January and December, 2013, FPI in equities accounted for 71.75 per cent of total inflows, against 5.13 per cent in the bonds market. As at June 2014, FPI in equities accounted for 63.20 per cent as against 12.51 per cent in the bonds market.

At end-June 2014, total equity transactions at the Nigerian Stock Exchange stood at N225.51 billion (about \$1.45 billion), representing an increase of 58.54 per cent compared with end-December, 2013. Total foreign transactions increased by 69.61 per cent from N69.57 billion at end-December 2013 to N118.00 billion at end-June 2014. As at end-June 2014, FPI accounted for 30.50 per cent of total transactions, while the outflows accounted for 21.83 per cent. In comparison to the same period in 2013, total FPI inflows decreased by 23.70 per cent, while total FPI outflows decreased by 18.09 per cent. Overall, there was a 21.46 per cent decrease in total foreign transactions in comparison to the position at end-June 2013.

In terms of market share, foreign transactions in the Nigerian equities market as a percentage of total transactions stood at 52.32 per cent, while domestic transactions accounted for the balance of 47.68 per cent as at end-June 2014, demonstrating a minimal dominance of foreign portfolio investment over its domestic counterpart. The near-equivalent share of domestic players in the capital market in relation to their foreign counterparts increases the risk of major shocks in the event of a sudden drawdown by foreign investors.

**Box 5.2**  
**Warren Buffett Valuation Metric**

Ratio of Market Capitalisation to GDP	Valuation	Expected Investment Behaviour
Ratio<50%	Significantly Undervalued	Rush to buy if the fundamentals are right
50%<Ratio<75%	Modestly Undervalued	Buy more
75%<Ratio<90%	Fairly Valued	Trade at current level
90%,Ratio<115%	Modestly Overvalued	Sell of
Ratio>115%	Significantly Overvalued	Massive sell of

appreciation based on market participants' correct interpretation of equity prices. However, if the ratio is over 115 per cent, the stock market is considered overvalued. In such a situation, the market may soon become bearish as market participants take profits, leading to market correction. This has consequences for savings and investment behaviour in the economy.

The Warren Buffett Valuation Metric (BVM) is an indicator employed in determining the state of a stock market to establish whether it is trading above or below its equilibrium value relative to the GDP of the economy. The BVM which is computed as the ratio of market capitalization to GDP, is one of the best measures of stock market valuation. It provides a perspective on the position of the stock market in the economic cycle, and is also thought of as an economy wide price to sales ratio. Indeed, one of the major challenges confronting policymakers in recent times is determining if stock markets are appropriately priced in order to provide relevant policy response to emerging issues.

The Table above shows the Warren Buffett Valuation Metric. From the Table, if the percentage relationship between market capitalization and GDP is less than 75 per cent, this is an indication that traded securities are undervalued, giving room for

### Box 5.3 QE3 Tapering

One of the major developments in the global economy in the past few years was the implementation of quantitative easing (QE) as a result of the failure of conventional monetary policy instruments to address anomalies in macroeconomic indicators. This measure involves the purchase of both public and private sector assets by central banks, and extension of credit to commercial banks among others. By this action, funds are injected into the economy to stimulate nominal spending necessary for economic recovery.

On May 22, 2013, 'Tapering' was introduced into the financial lexicon. The then Fed Chairman, Ben Bernanke, while testifying at the Congress, stated that the Fed may taper – i.e. reduce - the size of the asset acquisition programme referred to as QE. The programme, designed to stimulate the economy, had served the secondary purpose of supporting financial market recovery. The tapering tantrum led to substantial turmoil in the financial markets of emerging and developing economies. However, the commencement of the implementation was delayed until December 18, 2013, when the programme reduced asset holdings from its original level of US\$85.0 billion to US\$75.0 billion. The justification for this action was that the economy had become strong enough for the Fed to feel confident in reducing the level of stimulus. Further tapering continued on January 29, 2014, when the Fed announced that continued improvement in economic conditions had resulted in the need to further reduce QE. As at end-June 2014, the monthly asset purchase had been reduced from US\$85.0 billion to US\$35.0 billion with a promise to continue the downward trend till the programme is brought to a close as the economy improve.

Tapering received significant attention from investors and policy makers, particularly in emerging markets due to the role it played in the revival of global capital markets. The continued decision of the Fed to reduce asset purchases threw up sovereign risks in emerging markets, as margins improved in the US, thus heightening the risk of capital reversal. Emerging market currencies such as the South African rand and the Turkish lira depreciated sharply in response to this new trend.

In anticipation of capital reversals, central banks in emerging and developing market economies responded swiftly by raising policy rates to curtail possible outflows. In Nigeria, the Monetary Policy Committee (MPC) reacted by maintaining its tight monetary policy stance, keeping its policy rate (MPR) at 12.0 per cent and increasing its cash reserve ratio (CRR) for both public and private sector funds from 50.0 and 12.0 per cent to 75.0 and 15.0 per cent, respectively, in the first half of 2014.

The tapering exercise and its impact on the Nigerian financial sector help to highlight the need to improve the macroeconomic fundamentals. With right fundamentals, the economy would attract foreign capital more in the form of Foreign Direct Investment (FDI) that has the advantage of irreversibility at short notice.

## CHAPTER 6 ECONOMIC OUTLOOK

### 6.1 OVERVIEW

The growth in the global economy moderated to 2.75 per cent in the first quarter of 2014, making it imperative for the IMF to mark down world output forecast for 2014 by 0.35 percentage point to 3.4 per cent from 3.75 per cent in the second half of 2013 (*World Economic Outlook* (WEO) update in July 2014).

The upside economic surprises in selected advanced countries notwithstanding, lackluster outcomes in the United States, Russia and China, inventory correction in some countries and less optimistic outlook in many emerging economies weighed heavily on global economic activity. With somewhat stronger growth expected in some advanced economies, the global growth projection for 2015 remains at 4 per cent (Table 6.1).

In the United States, the strong correction after 2013 inventory overhang, dampened demand due to a harsh winter, sharp decline in exports, and contraction in output in the first quarter of 2014 were moderating factors. In China, the moderation in domestic demand was accounted for by the authorities' effort to rein in credit growth, coupled with a correction in the real estate sector. In Russia, geopolitical tensions accentuated

already weakened demand, leading to sharp deceleration in activity.

Global growth is, however, expected to rebound from the second quarter of 2014, as some drivers of first quarter weakness began to wane and others offset by policy reforms. The anticipated recovery would be driven largely by highly accommodative monetary policy and moderating fiscal consolidation in most advanced countries. Structural reforms should help to close infrastructure gaps, strengthen productivity, and lift potential growth in many advanced and emerging market economies. In general, some aspects of the demand weakness in the first quarter, such as the inventory correction in the United States, appear to be more perennial, and are expected to result in lower global growth in 2014.

In the advanced economies, growth is projected to increase to about 2.25 per cent in 2014–15, an improvement of about 1.0 percentage point compared with 2013. Highly accommodative monetary policies and a reduction in fiscal tightening (except in Japan) are expected to drive growth in those economies.

In the euro area, an uneven recovery across countries is expected to continue in 2014, with growth expectation of 1.2 per cent. There are pockets of stronger growths in the region, with growth projection of about

1.5 per cent in the medium term. The key drivers of recovery are stronger external demand, a smaller fiscal drag, and expectations of improving credit conditions in many countries.

Growth is projected to pick up gradually from 4.7 per cent in 2013 to about 5 per cent in 2014 and 5.25 per cent in 2015 in emerging market and developing economies. Stronger exports to advanced economies are expected to drive growth, although tighter financial conditions will continue to moderate domestic demand on the other hand.

In Sub-Saharan Africa, the IMF has projected acceleration of economic activities to remain same at 5.4 per cent in 2014, but to increase to 5.8 per cent in 2015 due to positive domestic supply-side developments and the strengthening global recovery.

In Nigeria, growth continues to be strong owing to relatively high oil prices, despite security challenges in the North-Eastern part of the country. Nigeria's GDP is projected to grow by 7.0 per cent, as production in the non-oil sectors continues to expand and oil production improves.

## 6.2 Outlook of Global Output

Overall, global economic growth was projected to rise to 3.4 per cent in 2014 and 4.0 per cent in 2015 from an annual rate of 3.2 per cent in 2013.

Data from the IMF WEO (July 2014 Update) indicates that the projected annual output growth for 2014 and 2015 in advanced economies would be 1.8 and 2.4 per cent; emerging markets and developing economies (EMDEs), 4.6 and 5.2 per cent; Sub-Saharan Africa, 5.4 and 5.8 per cent, respectively (see Table 6.1 below). The bulk of the acceleration is expected to come from high income countries (notably the US and the Euro Area), as the drag on growth from fiscal consolidation, weak labour market conditions and pent-up demand improve remarkably in those countries during the first quarter of 2014.

In the US, growth is projected at 1.7 per cent in 2014, rising to 3.0 per cent in 2015. In the Euro Area, the projection for 2014 is 1.1 per cent and 1.5 per cent in 2015. Overall growth is expected to remain uneven across the region, stronger in the core countries but weaker in those with high debt profile (both public and private), and financial fragmentation, all of which will weigh on domestic demand, resulting in high levels of unemployment. In the United Kingdom, growth is forecast at 3.2 and 2.7 per cent in 2014 and 2015, respectively.

Growth in Japan is forecast at 1.6 and 1.1 per cent in 2014 and 2015, respectively. The pessimistic expectation in 2015 is mainly attributed to the planned unwinding of fiscal stimulus. In China, growth is forecast at

7.4 and 7.1 per cent in 2014 and 2015, respectively. The IMF has advised China to refrain from further stimulating measures aimed at driving the economy beyond the growth target of 6.5 – 7.0 per cent in 2015. India's growth is forecast at 5.4 and 6.4 per cent for 2014 and 2015, respectively.

Brazil's growth forecast is revised downwards to 1.3 per cent in 2014 and 2.0 per cent in 2015, owing to tighter financial conditions and continued weakness in business and consumer confidence. Growth in South Africa is put at 1.7 and 2.7 per cent in 2014 and 2015, respectively. The modest improvement expected in South Africa would come mainly from stronger external demand as the domestic economic condition is plagued by electricity constraints and labour conflicts.

In the Sub-Saharan Africa, the projected 5.4 and 5.8 per cent growth rates in 2014 and 2015 respectively, are expected to be driven by the commodities market, as domestic currencies have depreciated substantially in recent times. In the Middle East and North Africa (MENA), regional growth is projected at 3.1 per cent in 2014 and 4.8 per cent in 2015. The projected growth is expected to be led by the oil-exporting economies in the region, where high public spending will buoy non-oil activities and oil supply difficulties are expected to be partly alleviated in others.

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### 6.3 Downside Risks to Global Outlook

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Many downside risks still attend the modest improvement in economic projections for 2014. Primarily, the geopolitical risks have intensified in many fronts. Recent developments in the Middle East and Ukraine pose serious risks of oil price distortions. The global financial markets on the other hand face potential risk of a renewed rise in longer-term interest rates due to the long-awaited normalization of the US monetary policy.

In the Euro area, the persistently low inflation will feature in the radar of policy makers and analysts. Although growth potentials are very high in emerging market economies, they are perennially plagued by issues arising from domestic weaknesses and external vulnerabilities, which could cause a sudden worsening of their financial conditions and capital reversals.

In the Sub-Saharan Africa, many oil-importing economies continue to struggle with difficult sociopolitical and security conditions, which weigh on confidence and economic activity.

To overcome the downside risks, advanced economies may have to retain their accommodative monetary policies. In addition, there should be a renewed focus on financial system stability, using macroprudential

guidelines and the implementation of financial regulatory reforms. Emerging market and developing economies may have to allow exchange rates to respond to changing market fundamentals. Furthermore, they need to address inflationary pressures and policy credibility. In general, all economies should focus on closing infrastructural gaps, strengthening productivity and raising growth potential.

**Table 6.1: Global Output and Inflation Outlook**

	2012	2013	2014	2015
<b>A. World Output</b>				
World Output	3.5	3.2	3.4	4
<b>Advanced Economies</b>	1.4	1.3	1.8	2.4
USA	2.8	1.9	1.7	3
Euro Area	-0.7	-0.4	1.1	1.5
Japan	1.4	1.5	1.6	1.1
UK	0.3	1.7	3.2	2.7
Canada	1.7	2	2.2	2.4
Other Advanced Economies	2	2.3	3	3.2
<b>Emerging &amp; Developing Economies</b>	5.1	4.7	4.6	5.2
Commonwealth of Independent States	3.4	2.2	0.9	2.1
Latin America and the Caribbean	2.9	2.6	2	2.6
Middle East and North Africa	4.9	2.5	3.1	4.8
Sub-Saharan Africa	5.1	5.4	5.4	5.8
<b>B. Commodity Prices (US Dollars)</b>				
Oil	1	-0.9	0.1	-4.3
Non-fuel	-10	-1.2	-1.7	-3.6
<b>C. Consumer Prices</b>				
Advanced Economies	2	1.4	1.6	1.7
Emerging & Developing Economies	6.1	5.9	5.4	5.3

Source: IMF WEO Update, July 2014

### 6.4 Outlook for Domestic Output Growth

The GDP growth rate for 2014 is projected at 6.21 per cent by the National Bureau of Statistics, down

from 6.77 per cent recorded in 2013. This compares favourably with the International Monetary Fund's (IMF) projection of a higher growth rate in output of 7.1 per cent for the rest of 2014. This positive outlook for the coming months is due to a number of reasons. They include a sustained implementation of the on-going economic reforms, a successful implementation of the Growth Enhancement Scheme (GES), designed to guarantee timely supply of inputs to farmers, leading to increased agricultural activities. Others are continued power sector reforms and renewed efforts to curb crude oil theft. The projected growth in output is expected to be driven principally by developments in the non-oil sector, especially the agricultural, trade, services, telecommunication and industrial sectors.

The upside risks to these projections include the weak infrastructural facilities and security challenges in the north east of the country.

### 6.5 Global Inflation Outlook

World inflation pressure is expected to remain subdued in 2014 through 2015, given the persistent negative output gaps in advanced economies, weaker domestic demand in several emerging market economies, and falling commodity prices. In particular, recent decline in headline inflation across the globe has been due to decreases in

the prices of commodities, especially fuels and food.

In advanced economies, inflation is projected at 1.5 per cent in 2014 and 1.6 per cent in 2015. The US inflation forecast for 2014 and 2015 is projected to be 1.4 and 1.6 per cent, respectively. In the Euro Area, it is expected to rise to 1.2 per cent in 2015 from 0.9 per cent in 2014. The forecast for Japan is 2.8 and 1.7 per cent in 2014 and 2015, respectively. The relatively subdued projections in the advanced economies are mainly due to their persistent output gaps, which should encourage expansion in their economic activities.

Inflation in Emerging Market and Developing Economies is forecast at 5.5 and 5.2 per cent in 2014 and 2015, respectively. China's forecast is 3.0 per cent in 2014 and 2015, while the forecast for India is 8.0 per cent in 2014 and 7.5 per cent in 2015. As in previous review period, slower demand growth and consistent fall in commodity prices continue to moderate inflation in those economies.

Sub-Saharan Africa (SSA) price level is forecast at 6.1 and 5.0 per cent in 2014 and 2015, respectively. The forecast for South Africa is 6.0 and 5.6 per cent in 2014 and 2015, respectively, while that of Ghana is put at 13.0 and 11.1 per cent over the same period. Recent regional insurgencies and the Ebola Virus Disease (EVD) epidemic and their

impact on food production notwithstanding, the use of appropriate monetary policy measures, along with the continuous moderation in commodity prices, should help to calm inflation surprises in the region.

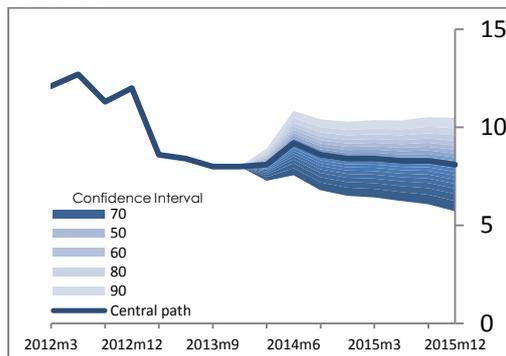
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## 6.6 Outlook for Domestic Inflation

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*I*nflation continues to moderate, though there was an uptick to 8.2 in June 2014 from 8.0 in December 2013. The NBS projected that headline inflation lies between 8.39 and 8.82 between July and December 2014. Staff estimates, however, suggest headline inflation at the end of 2014 and 2015 to be 8.40 and 8.10 per cent, respectively (Figure 6.1). Given existing economic fundamentals, along with the potential external and domestic shocks to the economy, the headline inflation forecasts are in the range of 5.5 and 10.1 per cent between July 2014 and December 2015. This implies that headline inflation may be breaking through to a double digit range, as against the CBN set target of 6-9 per cent, and calls for monetary policy action to curtail inflation surprises.

**Figure 6.1: Fan Chart for Inflation from 2012:m3 - 2015:m12**



curtail expected inflationary pressure that may arise as the 2015 general elections approach and the end-of-the-year spending activities by both the private and public sectors.

### 6.7 Outlook for Monetary Policy In 2014

Nigeria's monetary policy environment in the first half of 2014 was characterised by liquidity surfeit; output was robust and inflation increased moderately despite upward pressure exerted by food inflation in the second quarter of 2014. Fuel supply remained stable but agricultural production declined slightly, in response to the security threat in some parts of the Northern region.

The sustained tight monetary policy stance of the CBN contributed to macroeconomic stability. The relatively high rate of return in the economy contributed to the inflow and sustenance of portfolio investments, which buoyed the reserve level and assisted in ensuring exchange rate stability, robust asset prices as well as increased external reserves. It is anticipated that the monetary policy stance in the second half of 2014 will continue to be tight. This will help to

## Appendices

### Central Bank of Nigeria Communiqué No. 93 of the Monetary Policy Committee Meeting of Monday 20 and Tuesday 21 January, 2014

The Monetary Policy Committee (MPC) met on January 20 and 21, 2014 against the backdrop of uncertainties in the global economy, especially arising from the commencement of the QE3 tapering by the Fed. In attendance were eight (8) out of the ten (10) members following the retirement of Mr. Tunde Lemo, Deputy Governor, on January 11, 2014 and Mr. John Oshilaja, an external member of the MPC, who completed his term on December 31, 2013. The Committee reviewed key global and domestic economic developments in 2013 and re-assessed the short- to medium-term risks to inflation, domestic output and financial stability and the outlook for 2014.

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#### International Economic Developments

The global economy is expected to continue recovering from the global financial crisis, as growth is projected to accelerate in 2014. The International Monetary Fund (IMF) projected global growth at 3.4 and 3.5 per cent in 2014 and 2015, respectively, up from 2.4 per cent in 2013. Some other sources, however, have produced less optimistic projections of global growth for 2014; for example, the United Nations Department for Economic and

Social Affairs' (UNDESA) has projected 3 per cent growth. The decision by the US Federal Reserve to reduce its monthly asset purchases from USD85 billion to USD75 billion left most markets stable having already priced-in the development. The quantitative easing measures by the US Federal Reserve had helped to restore momentum to the US economy and also contributed to the improvement of the Eurozone economy in 2013. Europe is forecast to return to growth in 2014 after two years of contraction. Greece, which has been at the centre of the Bloc's banking and debt crisis, is expected to record its first economic expansion in six years. Emerging markets that were major beneficiaries of cheap money from the Fed stimulus could experience financial market instability as tapering begins, although the US authorities have made it clear that they remain sensitive to the impact of their domestic policies on global markets and will therefore aim to minimize disruptions.

Global inflation is projected to rise to 2.71 per cent in 2014, up from about 2.30 per cent in 2013. Favorable developments in food and fuel supply would moderate upward pressure on prices of major commodities, despite the expected acceleration in global activity. The US recorded inflation of 1.5 per cent in December, up from 1.2 per cent in November, 2013. Most central banks maintained a cautious posture in 2013, retaining or varying policy rates

only slightly. The financial markets expect monetary authorities to continue with policies aimed at supporting growth in 2014. In effect, monetary conditions are likely to remain easy in key advanced economies over the short- to medium-term on the back of the forward guidance that monetary authorities in these economies have given, with regard to the conditions that must be met before any change in policy stance comes into effect.

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### Domestic Economic and Financial Developments Output

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The National Bureau of Statistics (NBS) estimated real Gross Domestic Product (GDP) growth rate of 7.67 per cent for the fourth quarter of 2013, which was higher than the revised figure of 6.81 and 6.99 per cent recorded in the third quarter, and the corresponding period of 2012, respectively. Overall, growth rate for fiscal 2013 was estimated at 6.87 per cent up from 6.58 per cent in 2012. The non-oil sector remained the major driver of growth, recording 8.73 per cent in the fourth quarter of 2013. The growth drivers in the non-oil sector remained agriculture; wholesale and retail trade; and services which contributed 1.64, 2.34, and 2.66 per cent, respectively. The relatively robust growth performance despite sluggish global recovery reflected the continuing favourable climatic conditions for increased agricultural production, sustained outcome of

banking sector reforms and macroeconomic stability.

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### Prices

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The moderation in inflationary pressure, which began in the fourth quarter of 2012, continued in 2013. The year-on-year headline inflation fell consistently from 9.0 per cent in January to 8.6 and 8.4 per cent in March and June, respectively, before ending the year at 8.0 per cent. Also, food inflation, which constitutes 51.8 per cent of the CPI basket, declined from 10.1 per cent in January to 9.5, 9.6, 9.4 and 9.3 per cent in March, June, September, and December 2013, respectively.

However, core inflation initially declined to 7.2 and 5.5 per cent in March and June from 11.3 per cent in January, but rose during the second half of the year to 7.4 and 7.9 per cent in September and December, 2013, respectively. The moderation in domestic price level was largely due to the tight monetary policy stance coupled with the relatively stable exchange rate regime during the period, which resulted in single digit inflation in the three measures for the whole year. This is the first time the country has achieved this since 2007. The Committee noted with satisfaction that the year-on-year headline inflation remained within the indicative target range of 6-9% in the second half of 2013. However, the Committee noted the underlining pressure on core inflation, which may not be

unconnected with the widening spread between official and BDC exchange rates. In order to head off the spectre of rising inflation in 2014, concrete actions will be needed to stabilize the currency and minimize the divergence between the two segments of the foreign exchange market.

### Monetary, Credit and Financial Market Developments

Broad money supply (M2) contracted by 4.82 per cent in December 2013 over the level at end-December 2012, in contrast to the growth of 16.39 per cent in the corresponding period of 2012. M2 was also below the growth benchmark of 15.20 per cent for 2013. Aggregate domestic credit (net) grew by 11.11 per cent in December 2013, over the end-December 2012 level. The aggregate domestic credit (net) at end-December 2013 was, however, below the provisional benchmark of 22.98 per cent for 2013. The decline in M2 was due mainly to the decrease in Net Foreign Assets by 5.86 per cent. Interest rates in all segments of the money market reflected the liquidity conditions in the banking system. At the MPC meeting of November 18- 19, 2013, the Monetary Policy Rate (MPR) was retained at 12.00 per cent with a symmetric corridor of +/- 200 basis points, thus effectively maintaining the SLF and SDF rates at 14.00 and 10.00 per cent, respectively. Alongside the existing Cash Reserve requirement (CRR) of 12.0 per cent, the 50.0 per

cent CRR on public sector deposits was retained to address excess liquidity in the banking system. Consequently, both the weighted average inter-bank call and OBB rates opened at 11.73 per cent in December 2012 but closed at 10.86 and 10.46 per cent in December 2013, respectively. The capital market continued its rally with the equities market providing the lead. The All-Share Index (ASI) increased by 47.2 per cent from 28,078.81 on December 31, 2012 to 41,329.19 on December 31, 2013. Market Capitalization (MC) increased by 47.4 per cent from N8.97 trillion to N13.23 trillion during the same period. Improved earnings and investor confidence in macroeconomic management contributed to the rise in stock prices.

### External Sector Developments

The end-period exchange rate remained stable at the w/rDAS and interbank segments but depreciated significantly at the BDC segment. The exchange rate at the w/rDAS-SPT in 2013 opened at N157.33/US\$ (including 1% commission) and closed at N157.26/US\$, representing an appreciation of N0.07k or 0.04 per cent. The inter-bank selling rate opened at N156.25/US\$ and closed at N159.90/US\$, representing a depreciation of N3.65k or 2.34 per cent for the period. However, at the BDC segment of the foreign exchange market, the selling rate opened at N159.50/US\$ and closed at

N172.00/US\$, representing a depreciation of N12.50k or 7.84 per cent. Gross external reserves as at December 31, 2013 stood at US\$42.85 billion, representing a decrease of US\$ 0.98 billion or 2.23 per cent compared with US\$ 43.83 billion at end-December 2012. The Committee noted that the decrease in the reserves level resulted largely from a slowdown in portfolio and FDI flows in Q4 2013 resulting in increased funding of the foreign exchange market by the CBN to stabilize the currency. The Committee again expressed concern over the continued depletion of the Excess Crude Account (ECA) which balance stood at less than US\$2.5 billion on January 17, 2014 compared with about US\$11.5 billion in December 2012. This absence of fiscal buffers increased our reliance on portfolio flows thus, constituting the principal risk to exchange rate stability, especially with uncertainties around capital flows and oil price.

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### The Committee's Considerations

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The MPC welcomed the sustained stability of the exchange rate and single digit inflation in 2013. It, however, identified four (4) key concerns for policy in the short- to medium-term:

1. Depletion of fiscal buffers following the continuing decline in oil revenue, rundown of reserves and depletion of excess crude oil savings;
2. Falling portfolio and FDI inflows;
3. Widening gap between the official and the BDC exchange rates; and
4. Creeping increase in core inflation.

On the depletion of fiscal buffers, the Committee decried the continuous fall in revenue from oil despite stable price of oil and production in 2013. Although the Committee acknowledged output losses due to theft and vandalism, this could not wholly explain the magnitude of the shortfall in revenue. As a consequence, accretion to external reserves remained low while much of the previous savings have been depleted, thereby undermining the ability of the Central Bank to sustain exchange rate stability. The Committee therefore, urged the fiscal authorities to block revenue leakages and rebuild fiscal savings needed to sustain confidence and preserve the value of the naira. The MPC also noted the reduction in portfolio inflows driven by the commencement of the QE3 tapering by the Fed, transition concerns at the CBN and continued depletion of the ECA, thus dampening investor confidence. The reduction of the US stimulus especially, could in addition, trigger capital flow reversals and put greater pressure on the naira exchange rate. The Committee also expressed concern about the widening gap between the official and the BDC exchange rates, noting

that this could precipitate speculation and round-tripping. Though, the BDCs represent a small component of the foreign exchange market, the widening spread appeared to have fed into creeping increases in core inflation. The Committee re-affirmed its commitment to a stable exchange rate regime while urging the fiscal authority to provide support by reducing fiscal leakages, improving controls around oil revenues and reviewing terms around production sharing agreements with oil companies, while awaiting the passage of the Petroleum Industry Bill (PIB). The Committee also noted the necessity for a complementary monetary policy response to ensure sustained exchange rate stability and convergence of rates in various segments. In the light of this, two options were considered: a) Allowing a depreciation of the currency to avoid further tightening and depletion of reserves; and b) Maintaining our commitment to currency stability while stressing that monetary policy is almost at its limits and needs support from the fiscal side in the form of excess crude savings if currency stability is to be maintained in the future. The Committee decided that the costs of a weaker naira far outweigh the benefits to the Nigerian economy and the core mandate of the CBN. It therefore opted to maintain its commitment to currency stability. Furthermore, having looked at all the options, the Committee decided against excessive

reliance on external reserves to support the exchange rate and opted for monetary tightening until fiscal buffers are rebuilt.

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### Decision

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Having considered all the issues above the Committee decided as follows:

- All members voted for an increase in CRR on public sector deposits from 50 per cent to 75 per cent with effect from February 4, 2014
- Five (5) members voted for a retention of CRR on private sector deposit at 12 per cent while three (3) voted for an increase in this component to 15 per cent
- One (1) member voted for allowing the currency to depreciate by either shifting the mid-point or widening the band.

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### The decision is therefore as follows:

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1. MPR remains at 12 per cent +/- 200 basis points and liquidity ratio (LR) at 30 per cent
2. Public sector CRR increased from 50 per cent to 75 per cent
3. Private sector CRR retained at 12 per cent
4. The CBN to take immediate step to redress the supply-demand imbalance in the BDC segment while maintaining its focus on

anti-money laundering (AML) activities.

**Sanusi Lamido Sanusi, CON**

Governor  
Central Bank of Nigeria  
**21st January, 2014**

**PERSONAL STATEMENTS BY THE  
MONETARY POLICY COMMITTEE  
MEMBERS:**

**1.0 ALADE, SARAH**

*This first MPC of the year is coming at a time of some uncertainties in the world economy. The world's four largest economies are currently undergoing transitions with the United State of America struggling to boost growth in a fractured political environment. China is moving from a growth model based on investment and exports to one led by internal demand. Europe is struggling to preserve the integrity of its common currency while resolving a multitude of complex institutional and debt issues, and Japan is trying to fight two decades of deflation with aggressive and unconventional monetary policies. All these have implications for the Nigerian economy, with deep dependency on export earnings and external demand. These development coupled with internal domestic dynamics during an election year, which are discussed below will require careful maneuvering and appropriate policies to safeguard the stability of the economy. Against this background, I support a no change in Monetary Policy Rate (MPC), a 75 per cent increase in public sector deposits Cash Reserve Requirement (CRR) and a review of the exchange rate midpoint to safeguard the economy.*

**Headline inflation increased slightly to 8.0 per cent in December compared to**

### **7.9 per cent recorded in November 2013.**

Notwithstanding the slight increase in inflation in December 2013, the goal of single digit inflation was achieved in 2013 with average headline inflation for the year at 8.52 per cent. In the same period, core inflation rose slightly to 7.9 per cent in December from 7.8 per cent recorded in November 2013, while food inflation remained unchanged at 9.3 per cent from the previous month. Despite this downward trend in inflation, there are still pockets of risks in the short term. These include the upcoming planting season and the fiscal risk through increased election spending. Additional risks include reduction to the fiscal buffers and its impact on the investors/consumer confidence and exchange rate stability. Based on this, monetary policy should remain restrictive to forestall the anticipated impact of fiscal risks and food seasonality.

***Although there is likelihood of heightened fiscal spending as the electioneering season commence, the late passage of the bill give room to maneuver in the first quarter.***

The 2014 national budget submitted to the National Assembly has a deficit of 1.9 per cent, which is lower than 2.17 per cent recorded in 2013 and even lower than the 3 per cent stipulated in the Fiscal Responsibility Act. The late passage of the bill will mean that expenditure would be delayed

suggesting dampened risk for front-loading of expenditure in the first quarter. Monetary policy will have to expect an increased spending later in the year due to electioneering activities.

***There has been intense pressure on exchange rate as the spread between the official and Bureau de change (BDC) rates has widened.***

As at December, 2013, foreign exchange reserves stood at \$42.85 billion, mainly on the back of foreign inflows and reduced government revenue. Government oil revenue declined throughout 2013 on the back of oil theft and pipeline vandalism, resulting in the depletion of Excess crude Account (ECA) and pressure on the exchange rate. In the face of planned sustained tapering from the United States, it is important that an appropriate exchange rate policy is adopted to balance the objective of stable currency without unduly depleting the accumulated reserves. Effort should be intensified at rebuilding the fiscal buffers in anticipation of exit as cheap money dries up. Otherwise, the exit could pose downside risk to the domestic economy through exchange rate pressure and reserve depletion if not managed properly. Already, available data suggest that Gross Foreign Direct Investment (FDI) and portfolio inflows decreased significantly in the last quarter of 2013. Given that monetary policy is approaching its

limit, there is need to allow for more flexibility in the exchange rate.

**Gross Domestic Product (GDP) although robust is trending below forecast.**

The 2013 third quarter GDP grew by 6.81 and the projection for the fourth quarter is expected to be higher due to reforms in the agricultural sector which drove the growth in non-oil sector to 7.95 per cent in the third quarter. The oil sector's contribution to GDP declined by -0.58 per cent in the third quarter attributable to oil theft and pipeline vandalism in the Niger Delta that have resulted in the shutdown of some oil wells and reduced oil production. Although National Bureau of Statistics (NBS) projections suggest a GDP growth of 7.27 per cent for 2014, its achievement will require careful planning and maintenance of stable macroeconomic environment. Precaution should be taken to safeguard the Naira, suggesting that monetary easing at this time is premature, however to guarantee growth, increasing rate could dampen the projections. It is therefore important to manage the inflation-growth nexus in the face of high level of poverty in the country. Base on this, focus must be on striking the right balance between interest rate and flexible exchange rate in the management of inflation.

**The banking system continues to show high level of liquidity, suggesting that monetary easing at this time may be counterproductive.**

Banking system deposits at the CBN deposit facility has consistently been high. Even with OMO operations, Interbank and OBB rate still traded below the standing deposit facility rate at 10.54 per cent and 10.23 per cent respectively as at January 10, 2014. However, lending rates remained high at over 23 per cent, suggesting that care must be taken to manage the structural liquidity and the structural impediments to credit growth. In addition, pressure on the exchange rate window is impacting the foreign exchange reserves negatively. Therefore, a balance between defending the naira and saving the reserve must be struck for economic stability.

**Global economic growth projection is showing some improvements boosted by recovery in major economies especially in the United States.**

The IMF upgraded the global economic outlook to 3.6 per cent from 2.9 per cent projected in the April World Economic Outlook (WEO) citing stronger US economy and return to positive but subdued growth in the euro zone. The Federal Reserve Quantitative Easing (QE) have helped channel cheap funds to emerging markets such as Nigeria helping to drive equity market growth and

reserve build up. However, the Federal Reserve policymakers decided last month to cut the monthly bond purchases to \$75 billion from \$85 billion and suggested it would further trim its buying in future meetings if conditions continue to improve. Most analysts are of the opinion that economic conditions are positive enough to suggest that the Fed will continue reducing its bond purchases in 2014. This has implications for foreign inflows, reserve build up and exchange rate stability in emerging countries. There is also a possibility that as the cheap money from quantitative easing dries up, foreign investors could exit the country with consequences for the domestic economy. Therefore to remain competitive and attract foreign investors, tight monetary policy stance should be maintained. **Based on the above**, with benign inflationary outlook, high structural liquidity and sustained pressure on the foreign exchange, I will support a no increase in Monetary Policy Rate, a 75 per cent increase in public sector deposits Cash Reserve Requirement (CRR) and a review of the midpoint in exchange rate band.

## 2.0 BARAU, SULEIMAN

### i. REVIEW OF SIGNIFICANT DEVELOPMENTS

□ **The estimated GDP growth rate of 6.87 for 2013 is impressive** and is an indication of a rebound in growth statistics as it is higher than 6.58%

recorded in 2012. The 7.67% recorded in Q4 2013 did not only show a very strong rebound over growth performance in earlier quarters of 2013 but it is also higher than 6.99% recorded in corresponding period (Q4) of 2012.

□ **The robust growth recorded in 2013 is inspite of the tight monetary measures** implemented by the CBN. A point may be made that this is below Nigeria's potential but we must also state that this development shows that what is required to spur radical growth in the real sector is the implementation of significant reforms that would make credit to gravitate towards that sector. The second point to make is that Nigeria's GDP growth is taking place at a time that other emerging economies such as India have not reversed recent trends in GDP decline effectively since the beginning of the global financial crises. Finally, Nigeria's **GDP growth is substantially and consistently higher than Sub-Saharan African estimate of 5% in 2013.**

□ **The global economy is showing strong signs of recovery.** The IMF expects global growth to accelerate from 2.9% in 2013 to 3.6% in 2014. While the US economy has shown signs of strong growth going into 2014, China and other emerging market economies are projected to continue to grow at levels that are higher than those of the advanced economies. Europe is also forecast to return to

strong growth in 2014 after over two years of crisis. Overall the rebound in global growth would on balance be positive to developing economies including Nigeria.

□ **Financial markets around the world were not significantly jolted by the “tapering”** announcement of December 18, 2013 by the US Federal Reserve System reducing monthly Asset Purchase program from \$85 billion to \$75 billion monthly. This is because markets had anticipated and largely factored in the expected “tapering”. Latest job figures released in the US shows that targets have been missed and informed opinion suggest that “tapering” would continue to be gradual perhaps in magnitude of \$10 billion reduction until end2014. What is very clear is that the Quantitative Easing measures of the Federal Reserve have helped the strong rebound of the US, reversal of slide in Europe and have supported recent modest growth in developing and emerging economies.

□ **Domestic inflation remains largely subdued.** All measures of inflation remained at single digit. Headline Inflation (YoY) inched up marginally to 8.0% from 7.8% in December and November respectively. The Core measure continued its marginal upswing from 7.75% to 7.87% in November and December respectively. However Food Inflation moderated to 9.25% in December

compared to 9.31% in November. It is important to highlight that month on month measures for the three broad measures of inflation have shown increasing tendencies.

□ **Money markets rates were relatively stable during review period.**

With average interbank call rate at 12.24% and OBB at 11.98%, rates were largely within the corridor throughout 2013. However, the sustained high spread between deposit and lending rates remain a source of concern for policy.

□ **Exchange rates remained largely stable** particularly in the Wholesale/Retail (w/r) DAS and Interbank segments.

The rate at w/r DAS witnessed appreciation of 0.04 in 2013 while interbank and BDC rates depreciated by 2.34% and 7.84%. Of concern is the premium between rDAS and BDC rates which has widened to 9.38% due largely to measures taken to check the uncontrolled outflow of funds at the BDC window.

□ **The level of external reserves declined to \$42.85 billion but they remain largely at decent levels,** capable of supporting over 10 months of import. There has been substantial downward pressure on the reserves due to a combination of declining revenues from sale of crude oil due to leakages and increased demand that is driven by the liquidity in the system.

## ii. CHALLENGES/RISKS

The following (not in any particular order of importance) are the key pressure points facing the MPC;

□ **Keeping inflation at single digit** in view of the forecasts for 2014 and the upward trend of the Core Inflation measure.

□ **Reversing the declining levels of foreign reserves** particularly in view of the observed reduction in and likely reversal of foreign portfolio inflows following reversal of QE by the Fed of the USA.

□ **Containing demand and supply issues at the Foreign Exchange market.** The supply issues are largely as a result of reduced revenues due to oil theft and other possible sources of leakages. Demand pressure is driven largely by the evidence of sustained liquidity, fiscal spending and market sentiment.

□ **Checking the premium between rDAS and BDC rates.** The immediate cause for the sharp rise in premium is traceable to the recent measures taken by CBN to curb money laundering. This was aggravated by activities of clients who may have been forced to recourse to the use of foreign currencies to avoid charges associated with Naira cash withdrawals.

□ **Preparing for the effect of capital outflows/"tapering"** The newly

appointed US Fed Chief Yellen's statement that QE will continue through 2014 is a good development. The pattern of tapering is still a source for concern. A sudden and drastic reversal will lead to massive reversal of portfolio flows. It is gratifying that a survey of financial experts in the US suggests that "tapering" may be in monthly equal amounts of N10b.

□ **Narrowing the spread between Deposit and Lending rates.** While market rates have remained stable, the spread between deposit and lending rates have remained disturbingly high. The shared services initiative of the banking industry when fully implemented would help to narrow spreads. Nigerian banks also have one of the highest costs of doing business but the weak state of the fixed income segments of the capital market, have also reduced options available to borrowers and this has led to the distortion in pricing the cost of capital by banks who now literally play in quasioligopolistic market scenario.

□ **Pre—election year/fiscal spending** – liquidity injection is expected to be stepped up. This is perhaps responsible for the recent substantial reduction in the Excess Crude Account (ECA) balances. Further depletion of the ECA will increase the liquidity risk to the system and impact price stability negatively.

□ **Oil price/international oil demand/global growth in oil production**; staff reports indicating that growth in production will marginally outstrip demand growth in spite of the shale oil developments make the oil price outlook, at least in the short run, to be positive. The crises in South Sudan and Syria though unfortunate, appear helpful. Strong oil price forecast should help or at least reduce the effect of oil revenue leakages and will impact portfolio flow risk but oil price collapse is still a risk we must keep in view given the volatile current state of the global economy.

### iii. FOREIGN EXCHANGE, MARKET STABILITY AND FISCAL ISSUES

□ Out of the above challenges, the issue of currency stability (exchange rate and smooth functioning of the foreign exchange market) should now take the centre stage in view of recent commentary advocating some form of depreciation or devaluation to address the strong demand and exchange rate premium between rDAS and BDC rates. I have the following comments on this matter;

- I am aware of the recurring debate as to whether the Naira is overvalued or not at the moment. The jury is still out there on this matter.
- The increased foreign exchange demand we have witnessed recently is driven by established

high level of liquidity in the system which itself is caused by past accelerated fiscal spending.

- Depreciation of the Naira will have significant pass through effect on domestic prices and obviously wipe out the gains we have made in taming inflation. Besides, being an import dependent economy, depreciation will not benefit the economy unless we see structural reforms that will help diversify the economy, make our products/exports internationally competitive and stimulate exports.
- The aggravated demand for foreign exchange (for transfers/Letters of Credit, valid) that we have seen in 2013 is largely in the area of invisibles which has increased by 23.8% from 2012 to 2013 or 24% (\$13.3b) and 48.2% (\$26.1b) of total outflows.
- Total Demand for Foreign Exchange in 2013 was \$35 billion while total accretion to reserves from purchase of foreign exchange from Government excluding autonomous sources was \$45billion. At current estimated level of supply and demand, it is difficult to justify a depreciation. In this regard, it is difficult to rationalize market

sentiment beyond saying that we should depreciate simply because other emerging economies, with less strong market fundamentals, have also depreciated.

- In assessing the Naira/ dollar exchange rate, there are two levels of analysis that is required. Whether the demand/supply interplay is driven by fundamental or technical factors. In my view demand is not driven by fundamental but by technical factors and market sentiments which we could address. The second level is whether our response should be strategic or tactical. In terms of strategy, I recommend that currency stability is important given the consequence of depreciation on the economy unless it is absolutely necessary. We have a large number of tactical measures that we could take to contain some of the demand/supply pressures and by extension, the exchange rate. These have started and should be sustained. In addition to these, we need to take out further liquidity from the system so as to reduce the demand pressure. We should consider depreciation after these measures have failed.

#### iv. RECOMMENDATIONS

It is in view of the foregoing issues, challenges and pressure points that I voted as follows;

- That we maintain the current tight policy regime
- That we increase Cash Reserve Rate (CRR) to 15% and Public Sector CRR to 75%
- That we keep Monetary Policy Rate (MPR) at 12%
- That we maintain the corridor around MPR at plus and minus 2% on the Standing Lending and Standing Deposit Facilities.
- That we keep minimum Liquidity Ratio at 30%
- That we keep the Net Open Position limit at 1% of Shareholders Funds

### 3.0 GARBA, ABDUL-GANIYU

#### MY VOTE

- I vote for (i) an increase in the CRR on public sector deposit from 50% to 75% and (ii) holding CRR on private sector deposit at 12%; MPR at 12% and the asymmetric corridor of  $\pm 2\%$ .

#### JUSTIFICATION

- Given the structure of the Nigerian economy and, the inflation process in particular, a stable exchange rate is critical to the primary

goal of price stability. Available evidence links the downward trend of the headline inflation from 12% in December 2012 to 8% in December 2013 to a stable exchange rate regime.

iii. Yet, a stable exchange rate regime has been achieved by sacrificing monetary policy independence a point that is theoretically obvious from the *impossible trinity* thesis. Ideally, the maintenance of stable exchange rate regime ought to make fiscal policy a more potent instrument for achieving growth and employment goals. However, the fiscal policy regime is yet to take advantage of the stable exchange rate and price stability to develop national economic competitiveness. Also, a non-forward looking and non-strategic management of oil and gas resources is failing to sustain inflows of forex revenue to support monetary policy in stabilizing the exchange rate with minimal tightening. iv. It is clear to me that (i) a *forward looking* fiscal policy regime is critical to the attainment of macroeconomic goals in Nigeria; (ii) a *forward looking* fiscal policy depends on a commitment to the fiscal rules in the Fiscal Responsibility Act of 2007 and (iii) a strategic and forward looking management of oil and gas resources is critical to building the forex reserves required to support a stable currency. v. The macroeconomic management in Nigeria as I indicated

in my last personal statement faces two key *structural challenges* that need urgent attention. The first is the global challenge that is rooted in the *low interest rate and quantitative easing trap* that the major western economies have dug themselves into. The trap has (i) weakened the transmission mechanisms of policies (monetary and fiscal) and (ii) distorted financial-real economy relationships while causing financial markets to malfunction in the allocation and pricing of financial assets. As a consequence, global financial flows are threatening the financial and economic stability of emerging markets. The danger is acute for economies committed to exchange rate stability and free capital flows. This is because the monetary policy of such an emerging market could easily be trapped in a high interest rate regime because easing in such a regime will exert downward pressures on the exchange rate. A stable exchange rate and price regime could very easily unravel. vi. To the extent that exchange rate stability is necessary for the attainment of the primary goal of price stability, and given the pressures that rising yield in developed economies are exerting on an expanding set of emerging countries, monetary policy has to be forward looking. Therefore, a monetary response to emerging dangers is necessary. vii. I have always argued consistently for a *creative mix of policies and institutional changes*

because institutions and the incentives they embed are critical to the strategies and outcomes of the games that economic agents play in Nigeria. For instance, while simplistic analysis will narrow policy options to that defined by the impossible trinity, creative analysis expands the choice set and enables a not only an informed choice but, a wise one. We now know from past experiences and evidence that a creative mix of policies works. We also know from studies and past experience that a regime of (i) lowering supply to BDC and (ii) rDAS creates arbitrage opportunities that rational players exploit and widens regardless of the fundamentals. Whereas, a positive current account balances and a positive balance on the financial flow account should lead to upward pressures on the exchange rate appreciation, arbitrage opportunities works contrariwise. In 2011, we confronted a similar situation that was effectively checkmated by appropriate reaction functions – policy/institutional. viii. Of the options evaluated, the CRR on public sector deposits has proven to be very effective as an instrument of monetary policy. As we have argued since the July MPC, the increase in the CRR on public deposit is a game changer for monetary policy, for fiscal policy, for Nigerian financial markets and, for Nigerian banks. Personal Statements have been providing forward guidance about the policy direction on public deposit. Forward looking

fiscal policy operators ought to be working speedily towards a Treasury Single Account (TSA) while forward looking deposit money banks ought to be changing (i) their business model hence, (ii) the composition of their liabilities and assets. ix. The increase in public sector CRR to 50% in July 2013 was complemented by financial system stability supportive measures. We now know as anticipated that the rise in OBB and interbank rate was short-lived. Also, that the short term interest rates (maximum and prime lending rates) were flat while the treasury bills rate has trended downwards. In addition, the composition of the deposits of the DMBs has been shifting significantly in favour of public sector deposits which rose by 148% to N5.9 Trillion by ending of December 2013. x. In voting to increase the CRR on public sector deposit to 75%, I expect the fiscal authorities to speed up the process towards the Treasury Single Account (TSA) which I have consistently argued is “indispensable (i) to avoiding a high interest rate trap and (ii) to preparing the economy to soften the likely adverse effects of the low interest rate trap imploding.” xi. I have also anchored my vote on the premise that with “a more efficient and effective cash management that a Treasury Single Account will facilitate; the federal government would be a net lender to the economy. This will have several positive effects: (i) less dependence of DMBs on government

securities; (ii) improved efficiency in the pricing and allocation of credit; (iii) transition from crowding-out effects of borrowing to crowding-in effects of government lending; (iv) rise in money multiplier through increased intermediation by DMBs; (v) potentially lower interest rates; (vi) less dependence on portfolio flows; (vii) more efficient pricing and allocation of financial assets and (viii) reduced risks of financial contagion."

#### 4.0 MOGHALU, KINGSLEY CHIEDU

The Monetary Policy Committee meets at a time of significant uncertainty in which the immediate horizon for monetary policy is faced with strong challenges. In arriving at my vote I have taken into consideration the following factors:

- The role of fiscal factors in the current difficulties, marked by a severe decline in the Excess Crude Account over the past year, thus leaving the country dangerously vulnerable to external shocks as a result of the lack of fiscal savings. There is no indication that this situation will change in the near to medium term.
- Sharp declines in Foreign Direct Investment and portfolio inflows as a result of the commencement of a tapering of quantitative easing (QE) by the United States Federal Reserve

Bank, but also partly owing to the depleting ECA.

- The difficulties that have buffeted the naira as an anchor of price stability, with the increased gap in rates between the official and parallel markets owing to bottlenecks in supply to bureau de change.
- The rise of core inflation, headline inflation, and staff projections of inflation heading upwards in the next six months. These forecasts are based largely on BDC rates for the naira, net credit to the government, and on the quantum of reserve money. Against this background, the options before the MPC appear to be mainly between an intervention in monetary conditions through the Monetary Policy rate and/or the Cash Reserve Ratio by increasing either of both, or depreciating the naira while maintaining monetary conditions.

In favour of a currency depreciation we have the argument that the difference between the official and parallel rates has persisted for the past few months, and the CBN has spent significant amount of reserves to maintain the value of the currency, suggesting that perhaps the exchange rate may be artificial and there is a need to "bite the bullet" of

depreciation. This is especially so when we consider that the CBN has for the last few years defended the value of the naira not in terms of seeking a fixed exchange rate but of a predictable band within which the naira can be traded, thus facilitating effective currency planning by economic actors. In this context the question becomes not if, but when will the CBN depreciate the naira – most likely by moving the mid-point of the band. But the other side of this debate is question of whether, beyond the gap between the parallel and official markets, caused mainly by supply-side factors owing to controls imposed by the CBN on the importation of US dollars and restrictions on sales by banks to BDCs, there has been any change in the economic fundamentals to support a depreciation of the naira. In this context I note that the price of oil, the most important factor, has remained strong. And the role of the naira as an anchor of stability and its characteristic as a major pass through channel of inflation, the need to manage expectations for the year 2014 - a sensitive year in Nigeria's political economy- and the unpredictability of the fallout of a naira depreciation, all argue for a response through monetary conditions and not the exchange rate at this time. In the absence of a fundamental change of circumstance in the fundamentals that support the value of the naira, a depreciation of the currency is not

called for at this time and devaluation should be a last option.

Monetary tightening through the CRR will help control liquidity and contribute further to structural reform of bank lending to the real sector instead of the pursuit of public sector deposits. It will also help conserve declining foreign reserves. Here, however, it is important to keep concerns about financial stability in mind, as banks and bank borrowers have long borne the brunt of fundamental structural problems in the decision-making paradigm of the MPC.

Based on the foregoing considerations, I vote to:

- Increase the CRR for public sector deposits from 50 per cent to 75 per cent, and the CRR for private sector deposits from 12 per cent to 15 per cent.
- Maintain the MPR and the minimum Liquidity ratio at their present levels of 12 per cent (with the corridor at plus or minus 2 per cent) and 30 per cent respectively.
- Maintain the present band of the naira exchange rate and take administrative measures to close the gap between the RDAS and BDC rates of exchange of the naira.

## 5.0 ORONSAYE, STEPHEN OSAGIEDE

Statistics from the National Bureau of Statistics (NBS) since the last Monetary Policy Committee (MPC) meeting in November 2013 projected fourth quarter Gross Domestic Product (GDP) for 2013 to grow by 7.67 per cent compared to 6.58 recorded in the corresponding period of 2012. Although all measures of inflation remained within single digit, headline inflation appears to be on the rise. The Naira has continued to enjoy a great deal of stability because of the intervention of the CBN, however, the Bank may not be able to sustain this for a long time unless certain structural challenges are addressed. There is huge disparity between the official exchange rate of the Naira and the rate at Bureaux de Change (BDCs), which needs to be addressed to avoid the pass-through inflation. Therefore, we need to take appropriate steps to check the wide gap in the exchange rates. While we must remain committed to a stable exchange rate, I do not support depreciation in the value of the Naira. For me, the fundamentals on ground do not support such a move: oil prices are still high and there are no threats presently. I believe that the cost of a weaker currency far outweighs the benefits to the economy.

The MPC noted that Broad money supply (M2) shrunk by 4.82 per cent in December 2013 compared to the growth of 16.39 witnessed during the

corresponding period of 2012. We also noted that the aggregate domestic credit at the end of December 2013 was below the provisional benchmark of 22.98 per cent for 2013. The decline in Broad money supply is attributable to a fall of 5.86 per cent in the country's net foreign assets. This calls for greater fiscal discipline and monetary tightening.

The bulk of public sector funds are still in Deposit Money Banks (DMBs) and I do not think there is any reason why all public sector funds should not be back to the CBN. I am of the view that the CBN should have a deliberate constructive engagement with the Federal Ministry of Finance in order to address areas of concern, if any. We have consistently held MPR at 12% and achieved stability. Those conditions for maintaining the rate at that figure have still not changed. Therefore I support the view that we do not tamper with the rate at this point in time.

On the Cash Reserve Requirement (CRR) on deposits from the Public Sector, I think that the impact has been positive on the financial system. Consequently, I am persuaded to support an increase in the CRR on public sector deposits from 50% to 75%.

### Votes

Based on the foregoing, I voted for the following:

- a) Holding the MPR at 12%;
- b) Retaining the symmetric corridor of 200 basis point around the MPR;
- c) Retaining the Cash Reserve Requirement (CRR) at 12% for deposits from the private sector;
- d) Increasing the Cash Reserve Requirement (CRR) on deposits from the Public Sector from 50% to 75%; and
- e) Maintaining Liquidity Ratio at 30%.

I also voted that the Central Bank of Nigeria urgently addresses the imbalance in the BDC segment while also stepping up its anti-money laundering (AML) activities.

## 6.0 SALAMI, ADEDOYIN

Headline inflation in December 2013 ended the year at 8 per cent, which, though marginally higher than the 7.9 per cent reported for the previous month, took the average for the year to 8.5 per cent a position much better than the 12.2 per cent average for 2012. Notwithstanding the continuous deterioration in Core inflation from its mid-year low of 5.5 per cent to 7.9 per cent at year end, its average for the year of 7.7 per cent also marks an improvement on the 13.9 per cent in the previous year. The satisfaction of that position is however slightly

undermined by realization that Core inflation continued to edge higher since July 2013. The nature of challenges to confront monetary policy making in Nigeria this year began to define themselves last year. It had already been apparent before the close of 2013 that the key factors to take shape the direction and nature would include –

- Pace of and reaction to the tapering of Quantitative Easing by the Federal Open Markets Committee of the US Federal Reserve;
- Fiscal Dominance arising from dwindling revenues and its implication for Reserves and currency management;
- The dynamics and impact of risks related to the electoral cycle.

It was already clear that 2014 would be a challenging year for making monetary policy. Whilst the questions already suggested themselves, the most pervasive being around currency rates and the implications for policy credibility, there were few answers. The wall of data provided for this meeting provided cold comfort. The first conclusion from the data is a worsening outlook for inflation. Six month forecasts provided by Bank Staff for the meeting in November suggested would drop from 8.3per cent in December 2013 to 7.2 per cent in March 2014 before rising to 8.1 per

cent the following month. Bank Staff now expect Headline inflation to be 8.4 per cent in April 2014 and further increase to 9.2 per cent by June 2014. A similar trend is expected for Core and Food inflation. Indeed, the rate of increase in food prices is expected to cross into 'double digits' in May 2014. Beyond the worsening prospects for inflation, available data show a continuing deterioration in fiscal performance. A sharp increase in expenditure, especially ahead of an election, is the typical fear on the fiscal side. Available data shows continuing revenue weakness. Data from the Office of the Accountant General of the Federation (OAGF), the Central Bank of Nigeria (CBN) and the National Bureau of Statistics (NBS) show that between 2011 and 2013, average crude oil prices and production dropped by 1.02 per cent and 5 per cent respectively. In the same period the average annual decline in revenue from Crude oil dropped almost 12 per cent. In consequence of this, our fiscal savings, represented by the Excess Crude Account, dropped from NGN1.551trn in Dec 2012 to NGN0.434trn in Dec 2013. A continuation of this trend almost certainly implies higher levels of government borrowing putting worsening the challenge of 'crowding out' amongst others. Failure to rebuild fiscal buffers is also reflected in the FOREX Reserve data. At US\$43.8bn in mid-Jan 2014, forex reserves are almost 10 per cent lower than the 2013 high of

US\$47.8bn in March. Furthermore, the Federation Reserves component, which represents Excess Crude savings, amounted to US\$42.48bn – down from US\$11.46bn in December, 2012. The deterioration in Foreign Reserve position also reflects a slowdown in inflows from Foreign Portfolio investors (FPI). Whilst FPI inflows, at US\$19.182bn in 2013, accounted for approximately 82 per cent of capital importation in 2013, there was a noticeable slowdown in the Q3-2013. Indeed, both FPI and Foreign Direct Investment (FDI) slowed significantly. It is not unlikely that QE tapering by the US Federal Reserve is a contributory factor in the slowdown of FPI flows. Recent pressure on the Naira at the Foreign Exchanges reflects a combination of restricted supply to the Bureau de Change (BDC) segment of the market and heightened expectations of currency depreciation. From the perspective of economics theory, a persistent surplus on our current account, resulting from high oil price, should see the Naira strengthen. However, the failure to build reserves has resulted in strengthening expectation of that the Naira will lose value. This expectation has been manifested in a continuing switch from Naira to foreign currency denominated deposits – a trend I had previously described as 'retail hedging'. Unless the Fiscal side shows significant improvement imminently, the options for monetary policy may become glaringly inconsistent with the objectives and policy direction for the

economy in Nigeria. For monetary policy, the challenge of managing the internal and external value of the Naira is a core element of its mandate. Achieving inflation rate of 6-9 per cent in 2014 requires a stable currency. The model articulated, in various documents, for the growth and development of the larger economy in Nigeria is predicated on Import substitution. Similar to attainment of the mandate that the Central Bank of Nigeria (CBN) achieve price stability, import substitution requires a stable, even strong currency!!

Given the data and information laid before my colleagues and I on this occasion – in particular, the immediate and emerging build-up of banking system liquidity, it is clear that there is a need to respond to the pressure on the currency and forestall the build-up of further pressure.

The measures which I have supported, further sterilizing government deposits by raising the Cash Reserve Ratio to 75 per cent and easing the constraint on supply to the BDC segment of the forex market, should, in the short term, achieve the objectives set. However, it is increasingly clear that we are approaching the limits for using the cost of credit as a management tool without inflicting damage on the growth and development aspirations of the economy.

## 7.0 UCHE, U. CHIBUIKE

In previous MPC meetings, I have consistently argued that poor fiscal management remains the major impediment to the promulgation of effective monetary policy in our country. In the past, such poor fiscal management practices which include increasing levels of oil theft and excessive and sometimes unnecessary borrowings have contributed materially to monetary tightening by MPC. While such tightening may have helped achieve the desired single digit interest rate which has lasted for some time now, the fact remains that this has to a great extent been done at the cost of growing the real sector of the economy. Government has for instance increasingly, directly and indirectly, crowded out the private sector in the market for loans and advances. The primary goal of monetary stability, which is the promotion of real sector economic development, has therefore been subordinated to funding government fiscal indiscipline. At the November 2013 MPC meeting, for instance, I explicitly asserted thus: The danger fiscal policy poses to development of effective monetary policies in Nigeria becomes stark when one considers the mechanism of cash management by government. For over one decade, all parties are in agreement that a Treasury Single Account (TSA) will provide the most effective platform for managing government funds. At the very least, the incessant practice of

unnecessary borrowings at high interest rates while simultaneously holding huge balances in non interest yielding deposits will be greatly curtailed. Despite this simple logic, government is yet to implement the TSA. This has led to widespread allegations that private interests within government policy making circles are colluding with banks and benefitting handsomely from the status quo through the receipt of deposit brokerages. It was because of my above view that I voted for an increase in CRR on public sector deposits at the said meeting. Although I was in the minority at the time, I still believe that this is the way to go. Available evidence from our decision to increase CRR on public sector deposits to 50 per cent in July 2013, for instance, show that this is one form of monetary tightening that has led to increased lending to the real sector by banks. This is so because the incentive for banks to earn rent income by simply colluding with government officials to privately place government deposits in such banks has been reduced. Banks have therefore been forced to focus more on their intermediation function which is what leads to economic development.

Another way of making the above point is to argue that increasing CRR on public sector deposits will reduce the incentive for government officials to make suboptimal decisions in the management of government funds for personal interests. In other words,

increasing CRR on public sector deposits will have a direct impact on government fiscal management. An obvious consequence of the above will be the reduction in government debts.

I am aware that some stakeholders are very critical of the use of CRR because of its blunt nature and direct impact on the cash-flow of banks. It is however important to note that the use of CRR on public sector deposits is in itself an anomaly. If, for instance, a TSA is in place and all government deposits domiciled in the CBN which is the official banker to Government, the issue of using CRR on such public sector deposits will not arise in the first place. It is also pleasing to note that the tightening of monetary policy through increasing CRR on public sector funds at the present time is unlikely to attract further speculative foreign capital. This is especially so given the fact that available statistics suggests that recent international developments have already ensured a slowdown in the inflow of such speculative capital. Despite this, I find it prudent to continue to express my concern about speculative capital. This is because the vulnerability of the value of our currency in recent times has at least in part been as a consequence of the unstable nature of such speculative FDI. The earlier we begin to discourage such capital flows, the better. Admittedly, this has to be gradually and skillfully done to prevent

sudden capital flight. While FDI is desirable, it only makes sense when it is invested in the real sectors of our economy. As already mentioned, increasing CRR on public sector deposits will make banks to focus more on their intermediation function. An obvious consequence of this will be enhanced competition amongst the banks which will at least in the medium term begin to reduce the unacceptable wide spread between deposit and lending rates in the country. Another issue of concern for me is the widening gap between the r/wDAS exchange rate and the Bureau de Change exchange rate for the Naira. This creates huge incentives for banks and regulators to exploit the system and earn arbitrage profits. This is even more troubling in an import dependent economy like ours where the BDC rate is gradually becoming the benchmark for prices of imported commodities. This might explain why core inflation is gradually inching up. I therefore believe that the time has come for us to rethink our BDC policies with the objective of reducing the gap between BDC and r/wDAS exchange rates. Surely there must be effective ways of curtailing money laundering in our economy without materially affecting the supply of foreign exchange to Bureau de Changes. In conclusion, I am convinced that the greatest threat to effective monetary policy in the country is the way government conducts its fiscal policy. Government fiscal management

problems have increasingly made it difficult for monetary policy to be effective. Thankfully, monetary policy is not altogether helpless. Using monetary policy to force government to implement the TSA will, at least to some extent, help improve government fiscal policy management. Equally important is the fact that it will help to refocus banks on their intermediation function which is central to promoting economic development. In the light of the above factors, I hereby vote as follows: (1) to retain MPR at 12 per cent with interest rate corridor of + 200/- 200 basis points; (2) to retain CRR at 12 per cent but increase CRR on government deposits from 50 per cent to 75 per cent; and (3) to retain Liquidity Ratio at 30 per cent.

## **8.0 SANUSI LAMIDO SANUSI, GOVERNOR AND CHAIRMAN, MONETARY**

### **POLICY COMMITTEE**

Barely a few weeks before this MPC meeting, one was looking forward to a very routine meeting at which we would review the economic environment and outlook, congratulate ourselves for a job well-done, and leave everything unchanged. The sense of calm is not entirely without basis. GDP growth has remained robust in spite of high interest rates. Inflation remained firmly in single-digit range for the entire year 2013, the first time this has happened since 2007.

The equity market is doing extremely well and is performing almost as well as it did before the financial crisis. AMCON has reduced its indebtedness by about N1trillion. As we predicted, there was no disruption to the market despite the unfounded but understandable alarm raised by many analysts. Yet, complacency and self-congratulation are extremely dangerous and if unchecked could turn stability into the calmness before a storm. Our task is to always look out for red flags and anticipate the possible impact on stability. The most obvious red flag is the fiscal space. In January 2014, we are yet to have a budget approved, and there is no end in sight to high recurrent spending. The Federation has squandered its Excess Crude Savings, from \$11.5billion at the beginning of 2013 to under \$2.5billion today. This, moreover, has happened in a period of high and stable oil prices and high levels of production and crude lifting, in spite of losses due to oil theft and vandalism. Clearly, huge fiscal leakages continue to exist in the oil sector as will become manifest at the conclusion of ongoing debates around NNPC remittances to the Federation Account. To compound the problem, we saw in Q4:3 a significant collapse in portfolio and FDI flows as a result of QE tapering in the US, concerns over leadership transition at the Bank and alarm at the rate of depletion of fiscal savings. As a result of the above, the Bank has had to increase funding of the forex market to

avoid currency depreciation. But this has also meant a return to the era of attrition of foreign exchange reserves. On the monetary side, measures aimed at curbing money laundering disrupted the equilibrium in the BDC market through curbs on supply, leading to the emergence and widening of a gap between exchange rates in the inter-bank and BDC segments. The weak naira at BDC has fed into costs and creeping inflation and threatens to reverse some of the progress made in the recent past. The BDC rate is also not helped by ill-advised tariff regimes which force eligible demand onto the parallel market thus compounding the shortage in that segment. It is therefore not entirely surprising that exchange rates, reserves and fiscal leakages formed the fulcrum for our discussions these past two days. We have had to deal with a number of difficult questions: Do we need a monetary response now, or do we wait until next MPC? If we chose to respond, should we allow the Naira to depreciate or reaffirm our commitment to keeping it stable within current range? If we opted for the latter in the wake of declining foreign currency inflows and savings, how could we best defend the Naira? Do we deplete our reserves and expose the economy to greater risk; or tighten money at the risk of a big public and political outcry? These decisions are never easy.

**My position is as follows:**

On the exchange rate, I continue to maintain that stability must continue to be the lodestar of monetary policy and a weak naira will wipe out investor profits, lead to a bearish run on the stock exchange, stoke up inflation and ultimately result in even more extreme tightening without offering any tangible benefits. For me, letting the naira depreciate is an absolute last resort after all attempts at stabilizing it have failed, or where the cost of supporting the currency becomes unbearable. I also do not see any wisdom in depleting reserves to support the currency. In any case, this strategy fails once reserves fall to a level where investors believe we do not have the ammunition to support the currency.

I have never believed we were at the end of our tightening cycle. Pushing up interest rates may not be a priority given the already high yields in our market and given that only about 10% of portfolio flows are in fixed income instruments. But we need to continue attacking the structural liquidity surfeit in the system. By tightening monetary conditions and increasing the supply of dollars to the BDC segment we can stabilize the currency and achieve convergence.

**My vote is**

- i. To increase CRR on Public Sector to 75% for now, with a view to

getting to 100% if need be later in the year;

- ii. I also vote with the minority for increasing Private Sector CRR to 15% as this reduces incentive for arbitrage and adds bite to the tightening measures;
- iii. I support retention of MPR and LR at current levels;
- iv. Administrative measures should be taken to restore equilibrium to the BDC segment. I vote accordingly.

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

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

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**International Economic Developments**

The Committee noted that the recovery of the global economy could accelerate further in 2014 relative to 2013 as a result of increased domestic demand in the advanced economies and the rebound of exports in emerging markets. The IMF has projected global growth to increase from 3.0 per cent in 2013 to 3.7 per cent in 2014 and then to 3.9 per cent in 2015. In the US, growth is expected to be 2.8 per cent in 2014, compared with 1.9 per cent in 2013, driven by increased domestic demand as well as reduction in the fiscal drag due to the recent deal brokered on the Federal Budget. Although, the euro area has continued to adjust to a high level of indebtedness and financial fragmentation in some countries,

growth is expected to recover in the coming years. Thus, growth is expected to rise from 0.4 per cent in 2013 to 1.0 per cent in 2014. This is buoyed by easier credit conditions, increased investor confidence, and expansion in exports. Tight financial conditions since mid- 2013 as well as political uncertainty were a drag on growth in most of the emerging markets and developing economies.

Notwithstanding, overall growth in this group of countries is expected to increase from 4.7 per cent in 2013 to 5.1 per cent in 2014. Reflecting the expansion in economic activities, an upward pressure is expected in global price levels in 2014. Global inflation is projected at 2.71 per cent in 2014, representing an increase of about 40 basis points in relation to the estimates for 2013. It is expected, however, that favorable developments in the prices of food and fuel will help contain the upward movement in the prices of major commodities. The Committee observed an emerging variance between advanced and emerging market economies (and developing economies) in terms of monetary policy stance since the beginning of 2014. While central banks in a number of advanced economies maintained the cautious posture adopted in 2013 and in Q1 of 2014, the emerging economies and developing countries have apparently switched to more aggressive monetary policy tightening to support domestic currencies and

retain foreign investments by raising interest rates. South Africa, Ghana, Brazil and Russia were among countries that tightened monetary policy to address concerns over rising risks to inflation and exchange rate stability.

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### Domestic Economic and Financial Developments Output

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Growth remains robust. The National Bureau of Statistics (NBS) has estimated real Gross Domestic Product (GDP) growth rate at 7.72 per cent for the fourth quarter of 2013, which was higher than the 6.81 per cent, recorded in Q3, 2013 and 6.99 per cent in the corresponding period of 2012. Thus, in 2013, GDP grew at an estimated 6.89 per cent, up from 6.58 per cent in 2012. In line with recent trends, the non-oil sector continued to be the main driver of growth in Q4, 2013, recording 8.76 per cent. The growth drivers in the non-oil sector in Q4, 2013 remained wholesale and retail trade, agriculture and telecommunications which contributed 2.57, 2.27 and 1.97 percentage points, respectively. Based on the 2013 favorable performance, output growth has been projected at 7.7 per cent for fiscal 2014. The Committee observed that the relatively robust growth projections, despite the sluggish global recovery, reflected the continuing favorable conditions for increased agricultural production, sustained outcome of the banking sector reforms as well as the initiatives of the government to stimulate the real

economy. In particular, the Committee noted with satisfaction the rise by about 10 per cent in the national average electricity generation in Q4, 2013; a development which provided impetus for improved economic activities during the period.

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### Prices

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Inflation has remained in the target range. The downward trend in inflation, which commenced in December 2012 continued up to February 2014. The year-on-year headline inflation fell consistently from 9.5 per cent in February 2013 to 7.9 per cent in November 2013, but rose marginally to 8.0 per cent in December 2013 and January 2014. In February 2014, however, it moderated to 7.7 per cent. The deceleration was largely due to the moderation in food inflation, which moved from 9.3 per cent in January 2014 to 9.2 per cent in February 2014. Core inflation, on the other hand, exhibited a fair degree of volatility during the period; having declined up to the first half of 2013. It commenced an upward trend in the latter half of the period but declined 7 to 6.6 per cent in January 2014, before inching up to 7.2 per cent in February 2014. Noting the continued commitment of price stability within the CBN range, the Committee; emphasized the need to maintain the current monetary policy stance. In all, the Committee expressed satisfaction over the sustenance of single digit of all measures of inflation. The Committee,

therefore, restated its commitment to sustaining the price stability objective.

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### Monetary, Credit and Financial Markets' Developments

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Broad money supply (M2) contracted by 2.24 per cent in February 2014 over the level recorded at end-December 2013, which, on annualized basis, translated to a contraction of 13.42 per cent as against a growth target of 15.52 per cent for fiscal 2014. Net domestic credit grew marginally by 0.86 per cent in February 2014, translating to an annualized growth rate of 5.15 per cent. The annualized growth in net domestic credit is significantly lower than the provisional benchmark of 28.5 per cent for fiscal 2014. The sluggish growth in aggregate credit was traced mainly to the decline in Federal Government, borrowing which contracted by 2.02 per cent in February 2014 or 12.14 per cent on an annualized basis. During the review period, money market interest rates remained within the MPR corridor, oscillating in tandem with the level of liquidity in the banking system. The average interbank call rate for the period was 10.17 per cent while the OBB rate was 11.01 per cent. The weighted average inter-bank call and OBB rates which closed at 10.86 and 10.46 per cent in December 2013, respectively, rose to 11.27 and 10.5 per cent in February 2014. Activities in the capital market, however, were bearish as the All-Share Index (ASI) moderated from 41, 329.19 at end-December 2013

to 39,269.4 on March 11, 2014 with market capitalization exhibiting similar trends.

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### External Sector Developments

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The end-period exchange rate remained stable at the rDAS window but depreciated at the interbank appreciated at the BDC segment of the market. The exchange rate at the rDAS-SPT during the review period opened at N157.61/US\$ 10 (including 1% commission) and closed at N157.26/US\$, representing an appreciation of N0.35k or 0.22 per cent. At the Interbank foreign exchange market, the rate opened at N158.83/US\$ and closed at N164.90/US\$, averaging N161.89/US\$, representing a depreciation of 3.68 per cent or N6 for the period. At the BDC segment of the foreign exchange market, the selling rate opened at N173.00/US\$ and closed at N172.00/US\$, representing an appreciation of 0.58 per cent or N1.00k. The BDC segment averaged N170.44/US\$, representing an appreciation of 0.06 per cent. Gross official reserves as at March 2014 stood at US\$37.83 billion compared with US\$42.85 billion at end-December 2013. The decrease in the reserves level was driven largely by the increased funding of the foreign exchange market in the face of intense pressure on the Naira and the need to maintain stability.

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### The Committee's Considerations

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The Committee unanimously agreed that a continuation of a tight monetary policy was needed to consolidate recent gains. Recent resurgence of core inflation in spite of the downward trend in headline inflation reinforces this position. Thus, prudent monetary stance would also facilitate better reserve and exchange rate management in an environment where Fed tapering increases pressure on emerging economies financial markets. The MPC welcomed the growth expectations but expressed concern that the industrial sector has continued to lag behind. The Committee noted that growth remained consistently in favour of the agricultural sector, noting that the continued achievement of relative exchange rate stability and single digit inflation in 2014 given the risks in the horizon will require extra-ordinary measures. The Committee viewed some of the developments as positive optimism by the market relative to other emerging market economies. While tension in Ukraine over Russia's claims to Crimea remained serious, direct trade and financial links between Nigeria and the duo remained largely limited. Thus, the risk premia could come from rising oil and gas prices which were deemed positive shocks. On the other hand, the Committee noted that the recent pressure in the foreign exchange market was in response to key developments in the US over the Fed's

unwinding of its assets purchase programme. In addition, the pressure on external reserves was deemed to be consistent with the seasonal annual payment of dividends to foreign investors. On a positive note, inflation forecasts indicate that food inflation may not grow beyond current levels, especially with bumper harvests expected in 2014. However, core inflation could rise. The Committee noted that frontier markets were positioning themselves to attract higher capital inflows by raising their policy rates to contain inflation and also remain competitive. Oil prices remained relatively high while production was improving, and there were signs of accretion to external reserves. The Committee also expressed concern over the sudden surge in domiciliary account balances which may offset the gains from imposing 75 per cent CRR on public sector funds. The Committee commended the Bank for its continued commitment to exchange rate stability in the face of undue pressure on the Naira. It noted with satisfaction the calm in the foreign exchange market and the relative stability in the interbank exchange rate after the initial turbulence. The Committee acknowledged that while this stability was at a high cost, safeguarding short run macroeconomic stability under the circumstance required firm and bold measures. In the light of the foregoing, the MPC considered the success of Monetary Policy in attaining price and

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

**Sarah O. Alade**

Acting Governor  
Central Bank of Nigeria  
25th March, 2014

- (1) Five (5) members voted to keep MPR at 12%, while four (4) members voted for an increase in MPR.
- (2) Seven (7) members voted to retain the MPR corridor at +/-2%, while two (2) members voted for an asymmetric corridor.
- (3) Seven (7) members voted to increase CRR on private sector deposits by 300 basis points to 15%, while two (2) members voted to retain the CRR on private sector deposits at 12%. The Committee, therefore, decided by a majority vote of 5 to 4 to hold the MPR and its corridor at current levels but raised the CRR on private sector deposits by 300 basis points to 15 per cent.

## PERSONAL STATEMENT BY THE MONETARY POLICY COMMITTEE MEMBERS:

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

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

**There are some uncertainties in the domestic and international market environment.** Although some pressure has reemerged in the last couple of weeks, the Central Bank's resolve to

defend the currency has brought some level of stability to the market. In addition, the bond yields have seen some improvement, with a positive yield of over 5 percent, making Nigerian assets more attractive. With this development, the expectation is that foreign interest in Nigeria assets will start rising again as the foreign exchange market stabilizes. In advanced economies, some stability in the US with improved unemployment numbers and investors' confidence is directing the pace of tapering even in an uncertain political environment. In the Euro zone, the political disagreement over Crimea Peninsular with Russia could have far reaching consequences for the economy of the zone, and their trading partners if not handled diplomatically.

**Global economic growth projection is showing some improvements boosted by recovery in major economies especially in the United States.** The IMF upgraded the global economic outlook to 3.6 percent from 2.9 percent projected in the April World Economic Outlook (WEO) citing stronger US economy and return to positive but subdued growth in the euro zone. However, growth in emerging markets could be impacted negatively due to capital reversal on the back of tapering in the United States. As unemployment numbers continue to improve in the US and tapering continues unabated, their

effects in emerging market countries are already being felt. Each country will have to find an orderly way to manage the capital reversal, and remaining competitive should be one of the options. This suggests that tight monetary policy stance should be maintained.

**Headline inflation softened to 7.7 percent in February compared to 8.0 percent recorded in January 2014.**

This number is within the Central Bank target of between 6- 9 percent and the goal of single digit inflation. Core inflation rose slightly to 7.2 percent in February from 6.6 percent recorded in January, 2014, while food inflation decreased slightly to 9.2 percent from 9.3 percent recorded in the previous month. The decrease in food index is driven mainly by slowdown in prices of locally produced foods such as potatoes, yams, other tubers, prices of other items such as fruits and vegetables rose at a faster pace. Despite this downward trend in inflation, there are still pockets of risks in the short term. These include the upcoming planting season and the fiscal risk as a result of pre-election spending. Additional risks include reduction of the fiscal buffers and its impact on the investors/consumer confidence and exchange rate stability. Based on this, monetary policy should remain restrictive to forestall the anticipated impact of fiscal risks and food supply seasonality. It is important to note that the

downward trend in inflation was achieved as a result of past monetary tightening and other reform measures and letting go of these measures at this time could be counterproductive. Therefore monetary policy should do all it can to safeguard stability.

**Like in other emerging markets, the Naira exchange rate has witnessed increased pressure, but some level of stability has returned to the market.**

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

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

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

impediments to credit growth in the economy. In addition, pressure on the exchange rate window is impacting the foreign exchange reserves negatively; therefore efforts at rebuilding the fiscal buffers must be intensified.

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

## 2.0 BARAU, SULEIMAN

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

**Headline Inflation declined relative to its level in January 2014.** With Headline Inflation (HI) at 7.7% in February, marginally down from 8% in January, inflation has largely been subdued at single digit over a very comfortable

period. The decline in HI was largely as a result of the decline in Food and Non Alcoholic Beverage, Clothing and Footwear, Housing, Water, Electricity, Gas and other Fuel segments. Food Inflation (FI) also showed a decline from 9.27% to 9.21% in January and February respectively. The Core measure however increased over the same period from 6.65% to 7.17%. However, the mixed signals in the different inflation measures and Staff Report indicating the upside risk to inflation in the medium term is a source of concern.

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

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

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

**Global growth forecast for 2014 is optimistic.** Global recovery at 2.1% in 2013 was remarkable but growth was also uneven. The global output is estimated at 2.4% for Q1. The US economy, which grew at 1.9% in 2013, is estimated by the IMF, to accelerate to 2.8% in 2014. Similarly, in the Euro Area, GDP is projected to rise by 1.2% from -0.4% in 2013. In Sub Saharan Africa, the picture is also optimistic with GDP projected to grow by 6.1% in 2014 from 5.1% recorded in 2013.

## CHALLENGES

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

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

## DISCUSSIONS

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

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

In responding to the first question, I like to restate my earlier position that the pressure on the Naira is largely supported by the existence of substantial liquidity in the system, the tapering of QE in the US and consequent reduction in portfolio inflows, and market expectation that the Naira would depreciate. These have made end users to bring forward their demand for foreign exchange and currency speculators to see a window for making substantial exchange gains. This has therefore put undue pressure on the level foreign reserves, a development that has further driven market sentiments unfavourably. I am therefore still convinced that developments at our foreign exchange market are not driven by fundamental factors in the economy but by substantial market liquidity and observed change in market sentiment regarding the ability of the Naira to hold out at current rate.

With respect to the second question, I think the time is not appropriate to elicit a radical depreciation. Besides,

MPC should ensure orderly and structured depreciation of the Naira that is driven by fundamentals, given its effect on inflation and other macroeconomic variables.

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

This situation has been compounded by the increased fiscal spending over the years. The successive tightening stance of policy since 2012 has been the right prescription aimed at unwinding QE of several prior years.

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

## RECOMMENDATION

In the light of the foregoing, I voted for;

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

### 3.0 DANIEL-NWAOBIA, ANASTASIA

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

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

The fear being expressed on possible increased government spending in this pre-election year may be misplaced after all. Sequel to the dwindling Government revenue induced by both global and domestic factors, the Government has developed a tight 2014 Budget aimed at optimizing value for its spending and controlling the cost of governance. The planned net

borrowing for 2014 (N571.99 billion) is lower than that of 2013 (N577.07 billion). Consequently, the implication of the 2014 Budget for liquidity management may be similar to that of 2013 which is supportive of the monetary policy stance of the Bank.

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

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

Bank, it is advisable to sustain the current policy stance.

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

(i) The Monetary Policy Rate (MPR) to be retained at the current level of 12% and corridor of +/- 2% for the intervening period in order to maintain price stability.

(ii) The Private Sector CRR to be increased from 12% to 15% in order to strengthen the tightening measures.

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

#### 4.0 GARBA, ABDUL-GANIYU

At this March 2014 MPC, five key issues were critical for me: (1) implementation effectiveness; (2) policy impacts (general equilibrium, macro and game theoretic -strategic response of players to AMCON payments and 75% CRR on Public Sector Deposits); (3) initial conditions

and outlook (national and global); (4) short-term and medium term policy issues (national and global) and (5) implications of the monetary policy framework MPC has committed itself to. My vote is anchored in (1) the empirical evidence on implementation and impacts; (2) analysis of key short term and medium term issues and (3) cost-benefit analysis of policy options.

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

The key issues generated by the responses of banks to the AMCON effects and to the 75% CRR on Public Sector Deposits are: (1) decreased activities in the interbank market, (2) uptick in Standing Deposit Facility (SDF) placements, (3) some growth in loans albeit to non-growth driving sectors and (4) negative growth in money supply (M1, Quasi Money and M2) and in the money multiplier. Because the increased liquidity is not raising money supply, it is not inflationary. Neither is it growth or employment generating. Moreover, it is not enhancing the

proper functioning of Nigerian financial markets.

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

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

The data suggests that the **pressure on the Naira is not driven by fundamentals**: net exports, current account balances and net financial flows are all positive despite the negative growth in portfolio flows in

recent months. The evidence is indicates that a significant part of the demand for forex is speculative and that it is this speculative component that is volatile. Devaluation is not the right response in the circumstance of Nigeria for at least two reasons. First, it easily becomes a self-fulfilling prophecy hence, self-propelling. Second, devaluation will not solve an institutional problem. Rather it will simply shift the problem to a new band. The fundamental problem I believe is institutional. The key solution therefore, is to eliminate the arbitrage opportunities being exploited by rational agents. The appropriate response obviously is mechanism re-design as a key part of a creative package.

These are challenging times for all monetary authorities all over the world primarily because the world is in unfamiliar territories in which unconventional monetary policy instruments have been deployed in the post-2007 global financial crisis by the most powerful Central Banks. In the process, they have created financial and economic challenges of unprecedented depths, scope and length. While some monetary authorities face a *low interest rate/quantitative easing trap*, others face a *high interest rate trap*. Fortunately, the two traps are linked as I have argued in previous personal statements. Unfortunately, many global players do not (1) see the linkages and

the medium term strategic implications and/or (2) have no interest in the **global commonwealth**. For such short-sighted players, exploiting the asymmetries at the nexus points is fair game (rational) regardless of the resulting turbulence and the social, political and economic consequences. Yet, unless many Central banks and market players see, understand and submit to the good of the global commonwealth, the turbulence in the global economy and its disturbing consequences will persist for a very long time to come. A beggar thy neighbour policy environment is **globally inferior** to a mutually beneficial cooperative environment.

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

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

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

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

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

My vote therefore is for:

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

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

arbitrage opportunities in the financial markets more especially, in the forex market.

## 5.0 MOGHALU, KINGSLEY CHIEDU

### Considerations

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

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

rate to 18% while its inflation rate is 14%, South Africa's MPR was increased to 5.5% while inflation is 5.9%; Kenya's MPR has remained at 8.5% since May 2013, Brazil raised its MPR to 10.75% in February 2014 from 10% in January 2014. India raised its policy rate to 8% in February 2014 while inflation is 4.68%.

- **Foreign reserves and exchange rate pressures.** Nigeria's foreign reserves have suffered a sharp decline over the past three months, dropping from US\$42.85 billion at end – December 2013 to US\$37.83 billion as of March 20, 2014. This erosion has been brought about by pressures on the naira and the determination of the Central Bank of Nigeria to maintain foreign exchange stability through repeated interventions in the forex market. This pressure on the naira has been sustained for several months now, raising questions about whether or when the currency should be officially depreciated, ideally through adjustments to its trading band.
- **Leadership transition in the CBN.** This consideration has also contributed to a certain nervousness in the global investor community in the wake of the suspension of the Governor of the CBN. However, while it raises the

stakes for consistency in monetary policy, the Bank's senior management has successfully calmed investors' nerves through communication and policy actions that suggest a strong institutional continuity and consistency in monetary policy that is based less on individual actors than many investors had perceived. This therefore, is a time for the MPC to demonstrate clearly its commitment to stability, a tight monetary policy, and its independence, in a clear and decisive manner.

- **Fiscal outlook.** Revenue leakages from oil theft have continued, and uncertainty remains over the fate of the yet-to-be adopted Petroleum Industry Bill. The Excess Crude Account has been severely depleted in recent months, resulting in marked domestic and international concerns over the absence of safety buffers for the Nigerian economy in the event of any shocks. The factors are balanced, however, even if tentatively at this time, by higher oil revenues and new inflows to the ECA, accompanied by increased crude oil production by 30,000 barrels per day in February 2014 to 1.928 million barrels per day compared to 1.898 million barrels per day in January 2014. These increases

would have to be sustained over a significant period if confidence levels are to be restored.

- **Domestic Inflation.** While headline inflation in February 2014 fell to 7.7 % from 8% in January 2014, core inflation has inched higher from 6.65% in January 2014 to 7.17% in February 2014. Moreover, staff estimates project headline inflation at a range between 8% and 10% over the next six months, based on factors including fiscal spending and the impact of the planting season. This projection clearly indicates that an inflationary threat remains real, and the beast of inflation is yet to be slain decisively. The policy implication is that the MPC must maintain a tight monetary policy at this time. This is more so when we consider the global conditions noted earlier.
- **Expectations.** This is a vital consideration, in particular at a time such as this. Considering the transition in the CBN leadership and the recent demand pressure on forex combined with weak fiscal savings and falling reserves, there clearly is an expectation that the naira will depreciate in the near-to-medium term. But, given the absence of any change in fundamentals in light of the price of crude oil, this expectation need not become a self-fulfilling prophecy. Rather the MPC should confront and reverse these expectations with strong policy actions that attack the basis for such expectations. This means policy action that makes Nigeria's economy an attractive destination for capital, in the medium term, while attracting not just hot money but more real investments in the economy that should reduce the country's reliance on portfolio flows in the longer term. Dealing effectively with expectations means, as I see it, going beyond merely maintaining the status quo in monetary policy.
- **Financial Stability.** It is important always to weigh the impact of monetary policy actions on the banking system if financial stability is not to be sacrificed at the altar of price stability. This means that, while I will vote for continued tightening, the question is: how do we do so without maiming the banks? The path to balance is not to continue to raise the Cash Reserve Ratio on public sector deposits beyond the present 75%, but rather to focus on tightening liquidity through the private sector CRR and addressing the concerns about the level of reserves and the exchange rate through the MPR.

- Conclusion.** The Nigerian economy remains a promising one in the longer term when structural reforms reach a more advanced stage based on a deepening of the power sector reforms and the construction of private sector refineries – and perhaps even new possibilities that may arise from the ongoing National Conference that may have far-reaching economic implications. For now, however, while we work on the longer term, we need to maintain price and forex stability in the face of recent challenges. I note the simulated options for the MPR contained in the report of the CBN Macroeconomic Model of the Nigerian Economy (CBN MAC II) prepared by the Center for Econometric and Allied Research (CEAR) at the University of Ibadan, Nigeria, and the “Policy Simulation for MPR and CRR” prepared by the CBN Research Department.

The CEAR study demonstrates the impact of MPR increases of differing steepness on both output growth and on lending rate. As is always the case with monetary policy, hard choices have to be made by the MPC between achieving exchange rate appreciation or at least ensure stability, or lowering the lending rate. I believe the focus at this time should remain that of attracting and retaining foreign capital

and maintaining a healthy level of foreign reserves. The CEAR study also indicates that even the most radical hike in MPR would have only a marginal impact on output growth, which in itself is a valid concern, but one wrongly understood by many in terms of the correlation between policy rates and output growth rates. I continue to believe that, while high lending rates are a Faustian bargain to achieve a tight monetary policy that remains essential for now, and that lending rates need to move downward in the medium to longer term, infrastructural and other constraints are a more important restraint on real sector activity and output growth in the Nigerian economy.

#### Vote

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

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

#### **6.0 ORONSAYE,STEPHEN OSAGIEDE**

Figures from the National Bureau of Statistics (NBS) indicate that our domestic economic outlook remains healthy in the face of certain risks to development in emerging economies

across the globe. According to the NBS statistics, Gross Domestic Product (GDP) grew at an estimated 6.89 per cent in 2013, compared to 6.58 per cent in 2012. The Bureau indicated that the non-oil sector retained its status as the main driver of growth in Q4, 2013, recording 8.76 per cent. Relying on these figures, the Bureau has projected a 7.7 per cent growth for the 2014 year.

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

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

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

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

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

On the Cash Reserve Requirement (CRR) on deposits from the Public Sector, I do not see the reason for any increase at this time considering the fact that the fiscal authorities have concluded on implementing the Single Treasury Account. The Committee also

expressed concern over the sudden surge in domiciliary account balances which may offset the gains from imposing 75 per cent CRR on public sector funds.

### Votes

Based on the foregoing, I voted for the following:

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

### 7.0 SALAMI, ADEDOYIN

At 7.7percent in February 2014 – declining from 8 per cent the previous month, the average value for Headline inflation in the 1st two months of 2014 is 265 bps below the same period last year. For the other measures of inflation, the rate of increase in Food prices eased only marginally, from 9.3 per cent to 9.2 per cent, over the same period. Core inflation, unlike the other two measures, accelerated from 6.6 per cent to 7.2 per cent.

By commencement of the MPC meeting for March, the implications of easing inflationary pressure in February had been drowned out. The background for this meeting had been framed by the noise generated from a potent combination of factors – the on-going leadership transition at the

Central Bank; devaluation of the Naira since the meeting in January; diminished Forex Reserves as inflows declined whilst outflows rose very sharply; and continuing currency substitution.

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

The import of QE tapering is its anticipated impact on portfolio flows, commodity prices, reserve strength and exchange rates as US yields rise. As data shows, the impact of QE tapering is already being felt by Nigeria. In the opening two months of 2014, at US\$1,886mn, portfolio inflows amounted to 44percent of what it had been in the same period the previous year. Net Foreign Exchange Cash-flow through the Central Bank continues to worsen – touching a new low of \$-3,815mn in Feb., 2014. In addition,

FOREX Reserves have diminished 12 per cent from the 2013 year end to \$37.83bn. It is pertinent to note that while the monthly average price of Bonny Light crude eased 2.8 per cent in the same period - dropping to US\$111.34/barrel, the outlook, provided by NYMEX Forward prices, is for further easing in oil prices.

Domestic parameters paint a mixed picture. While projections for output growth in 2014 remain around 7 per cent, liquidity – irrespective of definition – continues to contract while credit to the private sector, annualized at current year-to-date basis, continues to grow slower than inflation. While growth in Quasi Money continues largely flat, Demand Deposits continue to contract. Having alluded to currency substitution earlier, Domiciliary Account balances now account for 20.59 per cent of total deposits. Retail lending rates remain in the range between 16-26 per cent. Whilst it would have been convenient to explain the sharp reduction in both volume and value of transactions at the interbank window to overhang of liquidity from AMCON payments at the end of 2013, however, the volume of patronage of the CBN's Standing Lending Facility (SLF) and Standing Deposit Facility (SDF) may be a reflection of confidence issues amongst operators.

Shifting focus back to our principal mandate of price stability and noting that Monetary Policy strategy requires

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

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

An outlook which projects lower oil prices, faster tapering of Quantitative Easing resulting in Capital Outflows, prospect of rising deficit as revenues continue to slip, further currency

substitution and worsening inflationary pressure points to the need for further restriction in the monetary policy regime. Though the direction of policy is clear, I am less sure about the appropriate choice of instrument.

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

I am not unaware that the value of maturing bills will almost neutralize the impact of the higher CRR imposed on non-government deposits. I expect that the process of policy implementation will ensure effectiveness of the measure. The option of raising the Monetary Policy Rate (MPR) is one I have been unable to support on this occasion. Whilst an increase in MPR, by raising the

sovereign rate, will make government bonds attractive and **may** serve to improve our chances of slowing the outflow of 'hot money', I am increasingly of the view that this is the time to deal with causes rather than symptoms. **The case for adjustment by rebuilding eroded fiscal and forex buffers is uncontested.** If we are not to raise costs thereby undermining the competitiveness of our economy, fiscal consolidation – however difficult – offers the most suitable option.

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

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

countries for retention of portfolio inflows leads us into a high interest rate trap which will be difficult to handle.

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

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

## 8.0 UCHE, U. CHIBUIKE

In my view, the March 2014 MPC meeting was a very difficult one. Evidence before the Committee showed that interest rates, exchange rates and our national reserves all came under immense pressure after the January 2014 MPC meeting. Although some of these pressures may be based on economic fundamentals, I am convinced that most of it was as a consequence of recent developments in the Nigerian financial system. This has led some investors to question the continued commitment of CBN [and the Government of Nigeria] to macroeconomic stability. Thankfully, as

the statistics on capital flows demonstrate, such noises have started to quieten down in the last couple of weeks. Despite this, the dangers of depending on foreign capital inflows, especially portfolio flows remain real for monetary stability. This is especially so because the incentive structure behind the deployment of such funds is purely their ability to earn short term returns rather than cause real sector economic development in recipient countries.

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

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

For some time now there has been consensus among MPC members that fiscal policy remains a major threat to the promulgation of effective monetary policy in Nigeria. Poor fiscal management and excessive borrowings by government have resulted in financial repression. In other words the more we tighten the more the real sector of the economy is crowded out of the credit market by government and its agencies. The consequence of this is that although monetary policy tightening has consistently achieved single digit inflation for some time now, this has been to the detriment of the real

sector of our economy. Thankfully, monetary policy is not altogether helpless in tackling poor fiscal management policies and practices of government.

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

outside the commercial banking system.

So far, our strategy has yielded encouraging results. Available statistics however show that some banks are now taking advantage of the fact that we have thus far not applied CRR on public sector deposits held in foreign currency domiciliary accounts. The result is that government domiciliary account deposits have increased sharply. This no doubt is a constituent part of the pressure that is increasingly being applied on our Naira exchange rate. The above has influenced my view that there is now need to block this emergent arbitrage loophole. In reaching this decision, it is important to reiterate that the charging of CRR on public sector deposits is an explicit anomaly. This is so because, by law, the Central Bank of Nigeria is the banker to the government. If, as is normal, all government funds are domiciled in the CBN, the issue of CRR on government deposits will never arise in the first place.

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

account deposits of government agencies, this must be pursued in a gradual fashion.

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

#### 9.0 YAHAYA SHEHU

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

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

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

flows, stock markets, reserves and put considerable pressure on the foreign exchange market in developing countries.

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

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

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

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

At the fiscal level, government revenue targets for 2013 were not fully met, but there was also restraint from the fiscal authorities, so that the budget deficit for 2013 was only slightly higher than the figure for 2012. Concerns regarding government spending relate mainly to the very low share of capital expenditure (less than 20%), which will negatively affect future growth. The second concern is the relatively low level of mobilization of domestic revenue. This is a critical issue in view of the threats to future demand and revenue from the sale of Nigerian oil and gas emanating from the shale oil production in the US, tar sands oil from Canada and oil and gas discoveries in a number of African countries. Furthermore the prospects for an elevated level of spending in the next one year due to the impending elections pose concerns for inflationary pressure.

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

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

In consideration of the above, it is necessary to act to try and stave off pressures on the foreign exchange market, with its inflationary implications. Available information suggests that the increase in CRR on public sector deposits decided in previous MPC meetings and implemented since August 2013 has had some effect in reducing excess liquidity. However, part of this effect was muted by currency substitution of public sector deposits into foreign currency.

It is therefore proposed that the CRR for all private sector deposits should now be increased to 15%. This should help stem liquidity and ease pressure on the foreign exchange market without impacting too much on banking sector liquidity ratios.

Admittedly, the CRR will impact mainly on domestic liquidity. It will do little to reverse net capital outflows, which will be more affected by domestic interest

rates and therefore the MPR. However, the use of this instrument also has implications for growth, jobs, NPLs in the banking sector, provisioning and capital adequacy. On this issue therefore, it is judged prudent to observe the direction and speed of the quantitative easing in the US and then deploy the necessary instruments to address the challenge.

**Central Bank of Nigeria Communiqué  
No. 95 of the Monetary Policy  
Committee Meeting of May 19 and 20,  
2014**

The Monetary Policy Committee (MPC) met on 19th and 20th May, 2014 against the backdrop of continuing modest recovery in the US economy, lingering fragile recovery in Europe, slowing output growth in the emerging market economies and possible risks to domestic price stability. In attendance were 9 members including Mr. Adebayo Adedun, the new Deputy Governor, Financial System Stability. The Committee considered major developments in both the global and domestic economies up to May 2014, and the outlook for the rest of the year.

**International Economic Developments**

The Committee noted the prospects of improved global growth in 2014 predicated on expectations of sustained favorable developments in the US and the euro area. Driven by the recovery in the advanced economies, global growth strengthened in the second half of 2013, averaging 3.6 per cent from the 2.6 per cent recorded during the first half. In the United States, improved domestic demand continues to strengthen growth outlook. In Europe, a pickup in growth in the core states continued to compensate for the decline in most of the peripheral states even as debt, low inflation, financial fragmentation and unemployment

persisted as threats to sustainable long term economic recovery in the region. Growth in the emerging markets and developing economies is projected to rise from 4.7 per cent in 2013 to 4.9 per cent in 2014. The effects of tighter financial conditions in these economies are expected to be moderated by improved external demand from the advanced economies. Global inflation is generally expected to remain subdued in 2014 with sustained sizable negative output gaps in the advanced economies, weaker domestic demand in several emerging economies, and falling commodity prices. In the euro area and the United States, headline inflation at about 1.5 per cent is projected to remain below the long-term inflation expectations. Lower world commodity prices in U.S. dollar terms would help reduce price pressures, although in some economies, exchange rate depreciation continues to pose a threat to consumer price stability. The Committee noted that monetary policy stance across the advanced economies could begin to diverge in 2014/15. In the United States, the Federal Open Market Committee (FOMC) rate is expected to increase, post-tapering, in 2015. On the contrary, markets continue to expect a prolonged period of low interest rates and supportive monetary policy in the euro area and Japan. In the emerging market economies, there has been a tightening of monetary and financial

conditions since mid-2013, owing to the combined effect of spillovers from rising bond rates and better economic prospects in the advanced economies based on the markets' reassessment of medium-term growth prospects. The risks posed to the emerging economies by capital reversals in the posttapering era remain a major challenge to the outlook. Overall, global economic outlook remains benign with prospects of steady and gradual improvements in the major economies, as well as slowing but sustained healthy growth in the emerging markets and developing economies.

### **Domestic Economic and Financial Developments Output**

The Committee noted that real Gross Domestic Product (GDP) growth remains robust. The recently rebased GDP figures released by the National Bureau of Statistics (NBS) indicated that real GDP grew by 7.41 per cent in 2013, compared with the 5.09 and 6.66 per cent recorded in 2011 and 2012, respectively. From the rebased GDP, the new major sectors of the economy in 2013 in terms of their share in GDP were: Services (36.08%); Industry (21.73%); Agriculture (21.50%) and Trade (17.06%). Figures for the first quarter of 2014 based on the rebased GDP are yet to be released by the NBS. The non- oil sector remained the main source of overall growth performance (7.77%), driven largely by: agriculture (0.43%), industry (1.28%) of which manufacturing was 1.26% and

construction (0.62%); trade (1.54%) and services (3.89%).

### **Prices**

Inflation has remained within the indicative benchmark target range of 6.0-9.0 per cent during the first four months of 2014. On a year-on-year basis, however, headline inflation inched up to 7.9 per cent in April from 7.8 per cent in March 2014. Food inflation, which was 9.3 per cent in January, declined to 9.2 per cent in February and slightly increased to 9.3 and 9.4 per cent in March and April, 2014, respectively. Core inflation, which declined to 6.6 per cent in January, increased to 7.2 per cent in February, and rose further to 7.5 per cent in April, 2014. The Committee noted that headline inflation has remained within single digit in the last sixteen months and stressed its commitment to sustain price stability; defined by the Bank's indicative benchmark range.

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

Broad money supply (M2) increased by 1.94 per cent in April, over the level at end-December 2013. When annualized, M2 increased by 5.83 per cent. M2 was however, below the growth benchmark of 15.52 per cent for 2014. The increase in money supply reflected the growth in the net domestic credit (NDC) of 1.62 per cent in April. Annualized, NDC grew by 4.85 per cent over the end- December, 2013 level. It is, however, below the

provisional benchmark of 28.5 per cent for 2014. The slow growth in aggregate credit was traced mainly to Federal Government borrowing which contracted by 18.06 per cent in April 2014 or 54.18 per cent on annualized basis. In the period under review, money market interest rates remained within the MPR corridor of +/- 200 basis points; oscillating in tandem with the level of liquidity in the banking system.

The inter-bank call and OBB rates averaged 10.5 and 10.59 per cent, respectively, in April. As at mid-May, the inter-bank call rate stood at 10.57 per cent while the OBB rate was 10.32 per cent. The Committee noted the modest improvement in the equities segment of the capital market in the review period. The All-Share Index (ASI) rose by 0.7 per cent from 38,748.01 on March 31, 2014 to 39,018.34 on May 16. Similarly, Market Capitalization (MC) increased by 3.3 per cent from N12.45 trillion to N12.85 trillion in the same period. However, relative to end-December 2013, the indices declined by 5.6 and 2.8 per cent, respectively. This was traced partly to the impact of the response of global financial markets to Q.E. tapering by the US Fed, weak economic performance in the emerging markets and fragile recovery in the Eurozone.

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### External Sector Developments

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The naira exchange rate remained stable at the rDAS window but appreciated at the interbank and the

BDC segments of the market. The exchange rate at the rDAS-SPT during the review period (March 26,-May 16, 2014) strengthened to N157.29/US\$ from N157.30/US\$, representing an appreciation of N0.01k or 0.01 per cent. At the Interbank foreign exchange market, the selling rate opened at N164.65/US\$ and closed at N162.33/US\$, representing an appreciation of 1.41 per cent or N2.32k in the same period. At the BDC segment of the foreign exchange market, the naira which sold at N172.00/US\$ on March 26, closed at N167.00/US\$ on May 16; indicating an appreciation of 2.91 per cent. Gross official reserves as at May 15, 2014 stood at US\$38.30 billion compared with US\$37.40 billion at end-March and US\$42.85 billion at end-December 2013. The current level of the country's external reserves could provide approximately 9 months of imports cover.

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### The Committee's Considerations

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The MPC noted the mixed signals over the global growth prospects in the advanced, emerging markets and developing economies. From the United States, the continued gains in employment, rising inflation and growth stability could soon pave way for policy tightening. On the contrary, the outlook for monetary policy appears biased towards sustaining easy monetary stance in the euro area and Japan against the backdrop of slow and uneven recovery in the

region. For the emerging markets and developing countries, the Committee was concerned that the current underlying pressures on their currencies arising from capital flow reversals, increases in consumer prices and declining inflows, which preclude the use of expansionary monetary policy to stabilize domestic output and employment in the short run, could dampen growth prospects. The Committee noted with satisfaction Nigeria's overall domestic economic environment which has remained stable with inflation contained within the target range, the recent stability in the foreign exchange market, stable interbank rates and strong growth outlook. The key challenge for policy, in the Committee's view, was that of sustaining and deepening the outcomes of existing policies. It noted, also, that over the medium term, the major risks to price stability appeared to be emanating from both external and internal sources. From the external environment, risks to the domestic economy include the prospects for increased yields and interest rates in the US and the rather low level of economic activity in the emerging markets; both of which could have repercussions for foreign exchange inflows (private and official) and stability of the naira exchange rate. Internally, the key risk factors include the high systemic banking system liquidity, elevated security concerns and anticipated high election-related spending in the run-up to the 2015

general elections. High domestic liquidity could exert sustained pressure on both the exchange rate and consumer prices, as well as accentuate the already high demand for foreign exchange, further depleting the country's external reserves. In addition, core inflation has continued to send conflicting signals since January 2014. If the upward trend continues as observed in April 2014, it could be a major factor in the upward trend in prices. The Committee also expressed concern over the eroded fiscal buffers which have exposed the economy to vulnerabilities arising from both domestic and external shocks. The erosion has accentuated the regime of persistently high interest rates, elevated demand for foreign exchange and declining reserves accretion. The Committee enjoined the Management of the Bank to continue to monitor developments in the fiscal space with a view to taking appropriate monetary policy actions. In the light of the foregoing, the Committee acknowledged the success of monetary policy measures in attaining price and exchange rate stability and considered: the potential headwinds in 2014, the ultimate goal of transiting to a truly low-inflation environment; and the need to retain portfolio flows. The Committee unanimously voted to retain the current stance of monetary policy. In addition, one member voted for an asymmetric corridor around the MPR.

Consequently, the Committee voted to:

- hold the MPR at 12%;
- keep the CRR on public sector deposits at 75% and CRR on private sector deposits at 15%;
- retain the MPR corridor at +/-200 basis points.

**Sarah O. Alade**

Acting Governor  
Central Bank of Nigeria  
20th May, 2014

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

**1.0 ADELABU, ADEBAYO**

Macroeconomic outcomes have remained relatively good since the beginning of FY 2014. Headline inflation, though inched up to 7.9 per cent in April 2014, is still within the long term target of the Bank while real output growth at 7.94 per cent in 2013 is higher than the last 5-year average of 6.93 per cent. Besides, real output growth in FY 2013 confirms that the economy is firmly on recovery path, following the slowdown of 2011. The exchange rate at the rDAS market has remained within the Bank's target of +/-3.0 per cent while a modest appreciation has been observed in the interbank and BDC markets. Furthermore, volatility in the money market rates has largely been subdued. These outcomes reflect the proactive nature of the monetary policy of the Bank, which should be consolidated.

The sustainability of these gains, however, is confronted with a number of challenges. With respect to the consumer price level, although the various measures of inflation are still within the single digit target, an upward trend appears to be firming up for the core component since the beginning of FY 2014. The elevated banking system liquidity, evidenced by an average of N400 billion in daily SDF since January and aggregate

spending in the run-up to the 2015 general elections may pose significant risk to inflation. To underscore this point, staff forecasts indicate that headline inflation could rise to around the border of single digit as early as June. Consequently, policy response to rein in inflation expectation could not be completely ignored at this point in time.

Closely related to this is the declining external reserve and implication for exchange rate stability, which is a major challenge to nearly all developing economies at the moment. For us, the pressure is from both supply and demand sides. The recent upward adjustment of Cash Reserve Requirement (CRR) on both the public and private sector deposit has largely curtailed the demand pressure in the foreign exchange market by modifying the behavior of the DMBs. This notwithstanding, a slight degree of volatility was still noticeable in the interbank market particularly in May 2014. Further increase on CRR may pose some risks to the stability of the banking system as threats to the system are gradually seen in the reduction of interbank transactions since the beginning of the year. This suggests that the supply side of the foreign exchange market deserves further policy attention.

There are two major issues on the supply side of the foreign exchange market. Accretion to the external

reserves from oil has not been significant in the recent past though data in the last few months showed that oil production volumes has started to recover. With increased global demand for oil due to recovery in the advanced economies, oil price would likely remain firm over the medium term. In effect, accretion to reserves is expected to improve. The other major issue is the ongoing tapering of the QE3 by the Federal Reserve which has revised investors' sentiment against emerging and developing economies in general. Besides, I am also of the view that developing economies including Nigeria should be preparing for the post tapering era in the US and other developed economies. With unemployment in the US inching towards the long term trend a switch to a tightening mode appears very likely in the medium term. The cumulative effect of this development is that capital outflow from emerging economies could continue for some time to come.

In a nutshell, the foregoing analysis presents the need to continue to maintain a tight monetary stance either by holding steady the current measures or by strengthening them. The impact of the tightening measures on growth, however, could not be completely discounted, particularly when consideration is given to rising lending rates to small and medium scale borrowers. This notwithstanding, the position of the monetary authority

must be without ambiguity whenever there is the delicate tradeoff between price stability and other goals.

In sum, on the basis of the need to manage inflation expectation, address the vulnerability of the economy to capital flow, build up external reserves without undermining the stability of the banking system, the subsisting monetary policy measures should be maintained.

Consequently, I vote for retention of the current monetary policy measures: MPR at 12 per cent with a symmetry corridor of 2 per cent, Private Sector CRR at 15 per cent, and Public sector CRR at 75 per cent.

## 2.0 ALADE, O. SARAH

*Global economic growth is projected broadly to strengthen to 3.6 percent in 2014 from 3.0 percent recorded in 2013, with much of the momentum coming from advanced economies according to the April 2014, World Economic Outlook (WEO). In emerging markets, while earlier projected risks have diminished, new ones have emerged as a result of lower than expected inflation in the advanced countries, which will impact output demand and prices, and geopolitical risks. In the domestic environment, although stability have returned to the foreign exchange market after some periods of turbulence, increased political risk and uptick in inflation due to seasonal planting period calls for a*

*hold on monetary policy rate to safeguard the gains made. Based on the above, I support a hold in Monetary Policy Rate (MPC), maintenance of a 75 percent increase in public sector deposits Cash Reserve Requirement (CRR) and a 15 percent increase in private sector deposits.*

### **Global economic growth has improved albeit with some downside risks.**

Outlook to global growth has turned positive on the recovery from the advanced countries led by United States, United Kingdom and Germany. In the United States, there is a pickup in momentum as disposable income adjusted for inflation grew by a strong 3.8 percent in January through March with strong consumer confidence index. The April surge in job growth to 288,000 confirms a pickup in the economy as monthly job growth so far this year averaged 214,000 a month, above analysts' estimate of 200,000 per month. In the Euro zone, growth is positive but subdued at 0.2 percent in the first quarter with Germany pushing the growth in the region at 0.8 percent. The high growth in Germany was bolstered by industrial expansion and construction activity which benefited from a mild winter. In emerging market and developing economies, growth is projected to pick up to 4.9 percent in 2014. Growth will be helped by stronger external demand from advanced economies, but tighter financial conditions from tapering could have a dampening effect on

domestic demand growth if not handled well. Therefore care must be taken in balancing the dual objective of stability and growth.

**Headline inflation increased to 7.9 percent in April compared to 7.8 percent recorded in March 2014.**

Headline inflation increased to 7.9 percent in April, suggesting that inflation may be expected to stay elevated in the coming months, as local food supply dwindle at the start of the planting season. Although a slight increase, it is still within the Central Bank target of between 6- 9 percent and the overall goal of single digit inflation. Core inflation rose slightly to 7.9 percent in April from 6.8 percent recorded in March, 2014, while food inflation increased slightly to 9.4 percent from 9.3 percent recorded in the previous month. The increase in food index is driven mainly by dwindling local food stocks as planting season commence, suggesting that future increase in inflation is to be expected in the coming months. Aside from the seasonal factors, there is still fiscal risk as a result of pre-election and increased security spending. Based on this, monetary policy should remain restrictive to forestall the anticipated impact of fiscal risks and food supply seasonality.

**Stability has returned to the domestic market.** Foreign exchange reserves increased to \$38.30 billion as at May 15, 2014, after declining in February

and March as investors react to the perceived uncertainty in the market. This is as a result of increase revenue from oil and an attempt to strengthen the fiscal buffer by the government. Excess Crude Account (ECA) increased to \$4.1 billion as at May 16, 2014 from \$2.5 billion at the end of 2013, as government intensifies effort at rebuilding the fiscal buffers to forestall the downside risk to the domestic economy through foreign reserve depletion. The projection is that reserves build-up in the coming months will be sustained if prices stay steady on the back of high production and stable prices. The Naira has strengthened by 2% in the past 3 months to reach NGN/USD162.4 as foreign investors return to the local bond market. Proper coordination between the fiscal and monetary authority have helped stir the economy safely out of the temporary macroeconomic shock it experienced earlier on the year.

**Domestic growth has remained robust but downside risks remain.**

The forecast for 2014 GDP growth ranged from 6.75 percent to 7.41 percent but there are risk to this projection. While the rebased GDP suggest that the economy is now more diversified and broad-based, sustaining the momentum and creating inclusive growth is the task all policy makers should take seriously. This will require creating an environment that is competitive and attractive to both foreign and

domestic investors. The security challenges in the country could impact growth negatively, although the effort at dealing with the issue with international help is a welcome development with the potential of achieving positive results.

**Pressure in the foreign exchange market has eased and some level of stability has returned.** Pressure at the foreign exchange market window has eased as the diligent and coordinated efforts by the Central Bank to restore stability paid off. This has been helped by the foreign exchange inflows by foreign investors who are now returning to the country in the local bond market and other portfolio flows. Rates at the Interbank and Open Buy Back (OBB) rate have remained within the band at 10.55 and 10.29 percent respectively as at May 16, 2014. These indicate excess liquidity in the system as banks accessed the Standing Deposit facility (SDF), but were rarely at the Standing Lending Facility (SLF) window since the last MPC in March. In addition, lending rates eased to 21 percent, suggesting that care must be taken to manage the structural liquidity and the structural impediments to credit growth in the economy.

**Although** pressure on the foreign exchange has eased, there are some downside risks to the growth and stability prospects, and now is not the time to start easing. Base on this, I vote for a hold on Monetary Policy Rate, the

maintenance of 75 percent increase in public sector deposits Cash Reserve Requirement (CRR) and a 15 percent increase in private sector Cash Reserve Requirement.

### 3.0 BARAU, SULEIMAN

The current MPC meeting is taking place at a time of relative stability in the local environment and when there is no significant development in the global economy to elicit a change in policy.

#### Review of Developments

1.1 **The global economy sustained the momentum towards recovery since the last MPC meeting, with global output estimated at 2.8% in the first quarter (Q1).** The sustained accommodative monetary policy in the Euro area, Japan and the United States of America inspite of 'tapering' is largely responsible for this. It is this and other significant measures implemented particularly in the Euro area that ensured a more optimistic global growth forecast. Consequently, global output growth is projected at 3.6% by the International Monetary Fund (IMF) as against 3.0% achieved in 2013. The projected output growth in the Euro area of 1.2% for 2014 is similarly optimistic, up from minus 0.4% in 2013. Unemployment in the US dropped to 6.3% in April, thus

supporting the strong forecast growth numbers. The Federal Open Market Committee (FOMC) has further reduced the monthly asset purchase programme to \$45 billion effective May, 2013 in the USA. Overall, growth is expected to increase to 2.8% in 2014 compared with 1.9% in 2013. China's Q1 GDP growth reduced to 7.4% compared to 7.7% in Q3. It is however slightly below the 7.5% forecast in 2013 indicating that growth is within forecast. Output in Sub-Saharan Africa is expected to increase to 5.5% in 2014, a stronger prospect when compared with 4.9% in 2013. Overall the global economy is expected to moderately grow in 2014.

- 1.2 **The Nigeria economy, after the recent rebasing of GDP, witnessed substantial growth of 7.94% in 2013 when compared with 6.66% in 2012.** The rebasing of the GDP indicates the fact that our economy is more diversified than we thought it was. Industry and services now accounts for over 57% of GDP up from 39%. The rebasing has however, also thrown up other challenges in terms of strengthening taxes and revenue base to reflect the level of the rebased GDP. Overall, growth outlook remains strong at over 7%

for 2014 inspite of the GDP rebasing.

- 1.3 **Headline Inflation (HI) though largely stable inched up marginally from 7.8% to 7.9% in April, 2014, largely accounted by the surge in Food/Non Alcoholic Beverage and Housing/Water/Electricity/Other Fuels components of that measure.** The Core measure (CI) showed a stronger surge from 6.8% in March to 7.5% in April, 2014. While inflation has largely been subdued, the outlook for the Headline and Core measures indicate a disturbing upside risk. In all, the Headline measure of inflation is expected to remain within single digit level for a large part of 2014 based on staff estimates. However, real interest rate is expected to continue to be positive.
- 1.4 **Interest rates remained largely stable. Market rates, remained within the corridor.** It is however, disturbing that active traders have not resumed in the interbank clean (unsecured) segment of the money market, indicating that inspite of evidence of good liquidity, confidence has not returned. The spread between the consolidated deposit and lending rates also remain a concern. It is hoped that the

effect of the shared services initiatives when fully implemented would help to narrow the spreads through the reduction of cost of doing business of banks and ultimately, lending rates. The more strategic solution to this problem remains the development of a vibrant fixed income segment of the capital market that should radically alter the demand and supply balance for credits in the banking system and favourably lower lending rates.

1.5 **Exchange Rate witnessed substantial appreciation in the Interbank and Bureau De Change segments.**

Interbank Rate appreciated by 1.41% (N2.32) from 164.65 to N162.33 from March 26th to May 16th respectively. The BDC rate also appreciated by 2.91% (N5.00) from 172.00 to N167.00 respectively over the same period. The rDAS rate remained stable at around N157.29 over the same period. The stability and appreciation witnessed in the respective segments was largely as a result of the tight stance in policy, reversal in market sentiment and reversal of portfolio outflows.

1.6 **Foreign Reserves level became stable at \$37 billion.** External reserves at \$38.30 billion as at

May 15th is equivalent to approximately 9 months of import cover. There are a few reasons for this. First, the production level of crude has been largely stable at about 1.876 bpd. Secondly, oil price has maintained a floor above \$100/b. Thirdly, portfolio outflows have reversed and inflows are at pre-February 21 level. Fourthly, and closely related, market sentiments have reversed. Finally, with tax holiday given to the Nigerian Liquefied Natural Gas Company just expiring, inflows from the petroleum sector would be diversified and enhanced. We see overall stability in the level of foreign reserves in the short run given the above demand and supply scenario for foreign exchange.

**Pressure points/challenges**

**Fiscal scenario remains a source of concern from a Monetary Policy standpoint.**

Inspite of efforts towards fiscal consolidation, with impressive outcome, fiscal buffers from the low balances in the Excess Crude Account at a period of high oil price and stable production levels gives me concern. Besides, the budget is yet to be signed into law by the President/C in C as a result of reported issues with respect to the package passed by the National Assembly. It may be true that recurrent spending is being made at current levels but capital expenditure is said to

be at 50% of previous year's numbers. I cannot therefore rule out the possibility of increase/sudden injection of liquidity from spending as the Appropriation Act is signed, due to what one may loosely call 'money illusion'.

**Portfolio inflow trends have favourably reversed recently.** Future trend will depend on FOMC decisions on tapering going forward and indeed on the reversal of quantitative easing in Japan and across the globe. This is an external variable that could potentially impact the success of policy in Nigeria.

**Slow levels of structural reforms due to the known limitations of monetary.** Monetary Policy can only deliver stable prices and monetary variables that are conducive to growth. Growth should ultimately be driven by fundamental and complementary reforms coming from the real sectors. With the recent privatization of the power sector and significant reforms in the agricultural sector, we are heading in the right direction. However, we need to extend these reforms to other sectors and drive them faster as well. It is well known that financial sector and real sector reforms produce best results if they are pursued concurrently.

**Current security challenge is a significant exogenous variable that may hamper the effectiveness of monetary policy if not contained.** Besides, I have not been able to de couple the security challenge that we

have today with significant issues of the current human development indices in Nigeria. In plain terms, significant success in monetary policy, financial and real sector reforms are best delivered in an environment where security of lives and property is guaranteed.

### Recommendation

In the light of the fact that the above challenges are already receiving varying levels of attention from Government, the demonstrated global and domestic macroeconomic stability since the last MPC as well as successes recorded by the MPC, I have no doubt that the sensible course for the current MPC is to hold stance of policy and various measures already in place to support this stance. I therefore voted as follows:

- Keep MPR at 12%;
- Keep Private Sector CRR at 15%;
- Keep Public Sector CRR at 75%;
- Keep the systemic corridor at plus and minus 2% around the MPR; and
- Keep Net Open Position at 1% of Shareholders Funds

### 4.0 DANIEL-NWAOBIA, ANASTASIA

Developments in 2013 indicated that the economy recorded a rebased growth of 7.94 per cent, which was higher than 5.09 and 6.6 per cent recorded in 2011 and 2012, respectively despite continuing security challenges, and weak external

environment. The improved growth outlook was based on sustained implementation of the on-going reforms and the Federal Government's transformation agenda, especially in Agriculture; Energy and Transportation. Government's increased efforts aimed at curbing crude oil theft; critical infrastructure vandalization such as gas and oil pipelines, as well as the general sanitization of the petroleum industry cannot be overlooked.

Headline inflation continued its moderation to single digits, indicating the effectiveness of sustained tight monetary policy of the Bank. Though it rose marginally to 7.8 and 7.9 per cent in March and April, 2014, respectively from 7.7 per cent in February 2014, projections of inflation performance in the next six months indicate that the year-on-year headline inflation would remain within the single digit target.

Stability in the foreign exchange market, as evidenced by the modest appreciation recorded in the three segments of the market during the period under review (March, 26 – April 30 2014) is also worthy of note. The appreciation witnessed in the three segments of the market could be attributed to improved supply following the gradual return of foreign investors to the Nigerian market as a result of the confidence reposed in the economy.

A key challenge to monetary policy in 2014 in the wake of the tapering by the Federal Reserve which is proceeding faster than anticipated with consequences for capital flow reversals relates to a possible instability in our financial markets. However, the recently concluded 24<sup>th</sup> edition of the World Economic Forum Africa (WEFA) is expected to help stimulate investment in the economy, thereby creating job opportunities and reducing unemployment. The result of this is expected soon as understanding and commitments were made during the meeting by several investors, especially in the area of Power, Housing, Education, Agriculture, etc. This is likely to reduce the vulnerability of the economy to shocks, particularly through the diversification of the funding sources away from oil. Attraction of capital will reduce pressure on the exchange rate and also help in external reserves build-up. However, there is need to continue to keep an eye on the areas of vulnerability and intervene when necessary.

In view of the effectiveness of the current tight monetary policy stance in keeping inflation within single digits as well as maintaining stability in the foreign exchange market, it is advisable to sustain the current policy stance.

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 which was increased from 12 to 15 per cent in March, 2014 should also be sustained to enable the market adjust to the new policy.
- iii. The current policy on foreign exchange (mid-point and exchange rate band of N155/US\$1 +/- 3%) should be retained for the next two months when another review will be due for consideration, while effort to rebuild the fiscal buffers is being sustained to further engender stability in the foreign exchange market and build investor confidence.

#### 5.0 GARBA, ABDUL-GANIYU

At the third MPC meeting for 2014 (May 19-20), my decision took account of (1) my previous decisions and the majority decisions, (2) action lag and policy performance, (3) the revealed and expected responses of key players to policy, action lag and policy options, (4) regulatory effectiveness, (5) underlying vulnerabilities in the national and global economy, (6) short-term stability of key variables in March and April and the associated costs and risks, (6) transition issues and (6) underlying trends and fundamental

structural changes in the economy. After due analysis of the underlying evidence and contemplations about the outlook (national and global), I am convinced that it is wise to keep MPR, CRR on private sector deposit and CRR on public sector deposit and the SLF rate unchanged in the short term. This implies the following: MPR (12%), CRR on private sector deposit (15%), CRR on public sector deposit (75%) and SLF rate (14%).

However, I remain convinced of the need for (1) short term responses to the slow-down in the activities in the interbank lending market and (2) medium term planned adaptations to a post- QE world.

In the short term, I am convinced that there is a need for an asymmetric corridor to gradually reduce the incentive for the rapidly expanding activities in the Standing Deposit Facility (SDF) window. It is axiomatic that an active interbank lending market (ILM) is necessary for the efficient pricing of risks and financial assets, for allocative efficiency as well as for the effectiveness of monetary policy to stimulate the growth in investments, employment and economic development. I do not subscribe to the idea of classical dichotomy that is, the idea that monetary policy variables impact only monetary variables in the short run or the idea that monetary policy

variables do not generate hysteresis that is, long lasting impacts.

Indeed, both the interbank lending market and Open Buy Back are pivotal to the transmission mechanism of the monetary policy regime guiding the MPC decisions. Since the interbank call rate became the operating target for monetary policy, the call rate also became the benchmark for short-term rates (prime and maximum lending rates). Until recently, strong linkages were successfully established between MPR, call rate and the short term rates in the tightening regime that began with the September 2010 MPC meeting. When the interbank lending market becomes significantly less active for whatever reason (s), the call rate becomes a less effective benchmark for the pricing of short-term risks and rates and for the efficient allocation of financial assets.

I am convinced based on analysis of available data and from institutional perspectives that (1) the AMCON effects on the interbank market are exaggerated; (2) a 10% rate on SDF has been a consistently strong incentive for inverted intermediation and by corollary, a strong disincentive against the intermediation effectiveness of DMBs and (3) a reduction in the SDF rate along with game changing administrative options will incentivize DMBs away from the highly profitable games of inverted intermediation.

I therefore, vote for a reduction in SDF by 300 basis points that is from 10% to 7%. The risk of a portfolio readjustment into the forex market may exist. However, effective administrative actions including (a) mechanism re-design and (b) more effective surveillance would considerably reduce such risks. The inverted intermediation is a strong vulnerability in the Nigerian economy that must be inverted if monetary policy is to stand a strong chance of sustaining price stability and lowering the sacrifice ratio (employment and growth forgone in disinflation regimes). Besides, analysis of available data convinces me on a sustained basis that the **pressure on the Naira is not driven by fundamentals** (net exports, current account balances and net financial flows have been positive from 2011). For instance, in the first quarter of 2014, the average monthly trade balance and net financial are respectively \$3.34 billion and \$4.6 billion respectively. It is clear to me that **“unwise rational greed”** (destructive rationalism) and **asymmetries** (financial power and information) undermine the pricing and allocation of financial assets with adverse effects on employment, investment, development and security. The challenge for MPC and the CBN in collaborations with fiscal authorities is to develop a right mix of policy, administrative effectiveness and institutional changes to tame such behaviors, address the vulnerabilities in the economy that are being exploited

and; to be build resilience into the economy to sustain stability in a post-QE world.

I have always favored a forward-looking monetary policy regime anchored in (1) a creative mix of policies and institutional changes; (2) effective coordination and (3) sound prudential oversights. These ought to be at the core of the conversations and decisions for the post-QE era macroeconomic management of the Nigerian economy.

## 6.0 MOGHALU, C. KINGSLEY

### Considerations

Taking into consideration a combination of monetary conditions and the economic environment, my vote in this MPC meeting appears obvious to me.

At the last MPC meeting there were concerns generated by the leadership transition in the Central Bank of Nigeria. Between then and now, stability has been firmly anchored, and the naira has been stable and even recorded gains vis-à-vis the dollar. But this has been at significant cost to our external reserves owing to the resolute interventions by the CBN in the forex market. Nigeria has had net inflows of foreign capital since April 2014. And with reserves at US\$38.30 as at May 15, 2014, this provides approximately 9 months of import cover.

Against this background, we have a present context in which the economy's growth rate is satisfactory at 7.41 per cent in 2013 driven by non-oil sectors; inflation, though ticking up to 7.9 per cent in April 2014 on a year-on-year basis, remained within the single digit indicative target. Broad money supply (M2) increased by 5.83 per cent on an annualized basis but remained below the growth benchmark of 15.52 per cent for 2014, and net domestic credit increased by 1.62 per cent in April. The interbank market has remained stable. Oil output increased.

On the other hand, two factors suggest the MPC cannot be complacent in the present state of things. The first is that liquidity remains high and inflationary threats remain. The second is that the United States Federal Reserve Bank appears set to increase the pace of tapering and is expected to increase its monetary policy rate in 2015. U.S. interest rate rises, combined with the prospect of increased spending in the Nigerian election period, could place serious pressures on the naira as foreign investors seek what they may perceive to be relative safety, and inflationary pressure may increase.

No matter, the situation at present and the immediate future clearly argues for the maintenance of stability and leaving monetary aggregates as they are at present.

The threat at the last MPC having passed, this is not a time to make changes to the monetary stance of this Committee. Until the structure of the Nigerian economy changes in a fundamental manner, or fiscal buffers increase markedly (or, preferably, both outcomes occur), monetary policy must remain tight. It is a hopeful sign that recent growth has been driven largely by non-oil sectors, and the recent GDP rebasing exercise indicates an increasing diversification of the economy. But, until we achieve economic complexity and import far less than we do today, monetary policy will have to continue to bear a heavy burden. That is the Faustian dilemma – and eradicating that dilemma is a largely fiscal responsibility.

#### Vote

I therefore vote to:

- Maintain the MPR at 12%
- Hold the CRR on public sector at 75% and CRR on private sector deposits at 15%
- Retain the MPR corridor at plus or minus 200 basis points.

#### 7.0 ORONSAYE O. STEPHEN

From the statistics released by the National Bureau of Statistics (NBS), our real Gross Domestic Product (GDP) indicates that our economy is healthy. Specifically, the NBS figures show that the rebased GDP grew by 7.41 per cent in 2013, compared to what the economy witnessed in the corresponding period of last year.

The Year-on-Year (Y-O-Y) headline inflation rose to 7.9 per cent in April, while food inflation stood at 9.4 per cent for the months of March and April 2014, up 0.1 per cent from the figure in February 2014. Core inflation rose from 7.2 per cent in February 2014 to 7.5 per cent. Despite the percentage increases, it is gratifying to note that inflation has remained within the single digit benchmark in the first quarter of 2014. It is also noteworthy that the Naira has remained quite stable in the face of extreme internal and external pressures.

The Committee, in considering the performance of the Nigerian economy in the last three months, equally noted that the country's overall domestic economic environment has remained stable, backed with single digit inflation, as well as stability in the foreign exchange market and interbank rates. These, however, need to be sustained.

Considering the success of monetary policy measures in attaining price and exchange rate stability and the fact that the conditions for maintaining MPR at 12% are still unchanged; there is therefore no justifiable reason to tamper with the present rate.

On the Cash Reserve Requirement (CRR) on deposits from the Public Sector, I do not see the reason for any increase at this time considering the

gains achieved from imposing 75 per cent CRR on the funds.

### Votes

The arguments canvassed for holding the MPR at 12% in March 2014 remain largely unchanged. Given the stability all-round, I do not see reasons why the parameters should be altered at this time.

Based on the foregoing, I voted for the following:

- a) Holding the MPR at 12%;
- b) Retaining the symmetric corridor of 200 basis point around the MPR;
- c) Retaining the Cash Reserve Requirement (CRR) at 15% for deposits from the private sector; and
- d) Retaining the 75% Cash Reserve Requirement (CRR) on deposits from the Public Sector.

## 8.0 SALAMI, R. ADEDOYIN

Despite the marginal increase in Headline Inflation to 7.9percent in April, prices, in the opening four months of the year rose on average by 7.85percent. This places inflation within the 6-9percent target for 2014. Unlike the opening months of 2013 when Core inflation trended lower, there is no immediately discernible trend in the data for Non-food inflation for the 1st four months of 2014. However, the average rate of Core inflation is, thus

far, approximately 200bps lower than it had been for the same period last year. While Food inflation is similarly lower than it had been between January-April 2013, at an average of 9.4 percent, it however continues to rise faster than Core Inflation.

With stability of the exchange rate across segments – indeed, an appreciation in the Bureau de Change market, the background to this meeting of the MPC was devoid of the anxiety which had framed the run-up to recent meetings. The stability which formed the background to this meeting is in no small measure the result of improvement in confidence as the turbulence generated by the transition of leadership at the Central Bank subsided. The slight rise in the stock of Forex Reserves – rising by approximately US\$0.5bn to US\$38.3bn - since our meeting in March, also reduced uncertainty. The recovery in confidence saw a sharp rise in portfolio inflow of US\$2.152bn in April 2014 – an increase of almost US\$1.2bn over the inflow the previous month.

Given the significance of international developments to our economy, the announcement of further tapering in Quantitative Easing by the Federal Open Markets Committee (FOMC) of the US Federal Reserve was perhaps the most significant non-domestic issue to reflect on. With FOMC Asset purchases further reduced by US\$10bn/month from May coupled

with easing short and long term yields in the US the impact on Capital flows continues to be an issue of importance for domestic policy making.

In the absence of data to indicate how the output and expenditure sides of the economy, in aggregate, have fared in the opening months of the year, it is near impossible to authoritatively describe, or indeed assess, domestic non-financial economic conditions. It is thus near impossible to situate developments in the rest of economy in the context of the Monetary Policy Committee's (MPC) primary mandate of ensuring currency and price stability.

Bearing in mind the caveat in the preceding paragraph, liquidity – irrespective of definition – continues to contract when adjusted for increases in prices. In contrast, there appears to be a sharp improvement in credit to the private sector. Not only does its growth rate exceed inflation, industry loan book seems to be growing faster than liabilities. The sharp reduction in both volume and value of transactions at the interbank window continues.

With regard to the MPC's principal mandate of price stability, the six-month ahead outlook for inflation, provided by Bank Staff, shows some improvement relative to the position at our meeting in March. Notwithstanding this, the Outlook is for Headline to worsen slightly from the current

position. Headline Inflation, projected to average 8.7percent between May and October, is expected to show a continuous rise. Over the next six months, Core Inflation is expected to peak at 7.9percent in May/June before decelerating to 6.1percent in Sept. In the same six months, Food price inflation is expected to worsen – averaging 10.6percent, with a peak of 11.1percent.

Staff Outlook for economic conditions hasn't changed materially – characterized by lower oil prices, faster tapering of Quantitative Easing, prospect of rising deficit as revenues continue to slip, and worsening inflationary pressure. Perhaps to these we should add the formal commencement of activities towards the 2015 General Elections. On the positive side, the leadership transition at the Central Bank, a source of very expensive turbulence, should be concluded shortly.

Leaving all monetary policy parameters unchanged, for which I vote, is not to suggest that there are no challenges ahead. The lull currently being experienced simply offers an opportunity to emplace a contingency plan to proactively respond when the next wave comes in.

## 9.0 UCHE, U. CHIBIUKÉ

For some time now I have consistently voiced my concern about the impact of fiscal policy (mis)management on

monetary policy. Although the promotion of price stability is a key mandate of MPC, this is not an end in itself. If it were so it will, in my opinion, be very easy to achieve. The essence of price stability is to help create the enabling environment for economic growth and development to take place. This perhaps explains why it is also the mandate of MPC to determine credit policy. As a consequence of this, we have in the past tried to use monetary policy to force changes in government fiscal behavior which is also critical to economic development and the credit system. A clear example of such monetary policy strategy is the use of CRR to force government to adopt the Treasury Single Account (TSA). Specifically, the CRR on government deposits has since been raised to 75 percent, as against 15 percent for private sector deposits, all in the attempt to promote government fiscal prudence which facilitates the operationalisation of monetary policy.

Although I am pleased with the results thus far from the above policy initiative, available data suggests that some government agencies and banks may be circumventing this strategy by exploiting the arbitrage opportunities that have arisen as a consequence of the fact that there is currently no requirement for CRR to be applied to domiciliary account deposits in commercial banks. The above example clearly shows the limitations of

using monetary policy as a tool to force prudent fiscal behavior on the part of government and its agencies. The fact that there are few viable monetary policy instruments left in a fiscally dominant environment explains my minority vote to extend CRR to public sector domiciliary accounts at the last MPC meeting. To be able to appreciate the difficulties we face in formulating effective monetary policy, it is important to note that the placement of government deposits in commercial banks contravenes the CBN Act which makes it explicit that the CBN is the banker to the government. Placement of government deposits in commercial banks also facilitates poor fiscal management by government and its agencies which in turn complicate monetary policy formulation. Based on the above, I was pleased to learn that the government is now taking the issue of TSA seriously and has indeed given a deadline of May 2014 to all government agencies to comply or face severe sanctions. Once the TSA is achieved, the abnormal practice of applying CRR on public sector deposits will cease to exist.

Another policy development, although considered contentious in some circles, that has positively impacted on monetary policy is the rebasing of the Nigerian GDP. The above exercise has demonstrated that the Nigerian economy is more diversified than previously believed. It is for instance

now known that the manufacturing and service sectors are the leading sectors in the Nigerian economy, not agriculture as previously believed. The implication of the above is that MPC must now do more to encourage the delivery of credit to these important sectors. After all the design of credit policy is also a key mandate of MPC.

The argument that the dominant subsistence practice in the agricultural sector, coupled with its dependence on uncontrollable natural forces like the weather, makes it less responsive to monetary policy manipulation clearly cannot be transferred to the service and manufacturing sectors of our economy. Since the excessive interest rates charged by banks has consistently been a primary concern of both the service and manufacturing sectors, I am of the view that we should do more to bring down the cost of credit to these important sectors of our economy. Using market forces to explain away the widening gap between deposit and lending rates in the country is no longer useful.

Despite the above positive policy anticipations and/or developments, the monetary policy environment in the country remains challenging. This was no doubt brought to a head early in the year by the leadership crisis in the CBN. The subsequent outflow of foreign portfolio investments put pressure on both our external reserves and the value of our currency.

Although these pressures have started to ease, difficulties remain. While the variance between the w/r/DAS, interbank and BDC exchange rates narrowed in the recent past, it remains material. I am also aware that there are concerns about the fact that the 2014 budget has not been signed into law, growing insecurity in some parts of the country and the dwindling government revenues especially in the run up to an election year. Despite these, I am reluctant to vote for further tightening of monetary policy at this point. This is in part because if the planned total implementation of the TSA happens at the end of this month, this will in itself represent an implicit tightening of monetary policy.

Furthermore I am convinced that a lot of the portfolio outflows that negatively impacted on our foreign reserves had more to do with the perceived uncertainties that arose from the recent leadership crisis in the Central Bank and less with the inability of the Central Bank to tighten monetary policy and offer investors better rates of return. The fact that such portfolio outflows have tapered provide support for this view. More important however is the fact that there will be another change in the leadership of the CBN in a couple of weeks.

I am of the view that policy changes should be undertaken at the present time only if absolutely necessary. From

the above analysis, this is certainly not the case at this point.

In the light of the above factors, I hereby vote as follows: (1) to retain MPR at 12 percent with interest rate corridor of + 200/- 200 basis points; (2) to retain CRR at on private sector and government deposits at 15 percent and 75 percent respectively, and; (3) to retain Liquidity Ratio at 30 percent.



