



Central Bank of Nigeria Communiqué No 110 of the Monetary Policy Committee Meeting of Monday and Tuesday 21st and 22nd November 2016

The Monetary Policy Committee met on 21st and 22nd November 2016, amidst relatively subdued global and domestic economic and financial conditions. The Committee evaluated the global and domestic macroeconomic and financial developments as well as the challenges to the

domestic economy up to November 2016, and the outlook for the first quarter of 2017. In attendance were 10 out of 12 members.

International Economic Developments

The Committee acknowledged the tapered growth in global output, stemming from relatively unbalanced risks to the global economic outlook. Global recovery remains fragile in the advanced economies while the emerging markets and developing economies (EMDEs) continue to struggle against strong headwinds, including low commodity prices, slowing demand and instability of capital flows.

The path to the modest improvements in the advanced economies has increasingly turned fragile owing to persistent uncertainties. While still being expected to unravel, the BREXIT shocks have been rapidly followed by the outcome of the U.S. Presidential Elections; a development which has created its own uncertainties. Accompanied by the planned referendum in Italy, and general elections in France and Germany, the global political environment could not be more uncertain. In effect, current judgments about growth prospects in the first half of 2017 could be overly optimistic. The IMF's current outlook for global growth for 2016 which was revised to 3.1 per cent in July and retained in

October could be missed by a significant margin. The World Bank has been more cautious in retaining its June 2016 global output growth projection of 2.4 per cent. Headwinds to global growth prospects are also emanating from weak trade and financial conditions. The OECD' Economic Forecast, September 2016 Update, emphasized that both elements underpin the current low-growth trap facing the global economy.

The United States (US) economy exceeded it's growth expectation in Q3 2016, growing at an annual rate of 2.9 per cent, a significant uptick from the average growth rate of 1.1 per cent in H1 2016.

The enhanced performance of the economy was attributed largely to the growth of inventories and robust surge in exports, coupled with improved consumer spending, even as the mining sector recorded a pull back.

Japan's economy grew at a seasonally adjusted annualized rate of 0.2 per cent in Q2 of 2016 compared with 1.7 per cent in Q1 of 2016. The moderation in growth was largely attributed to weak wage growth and a strong yen. The Bank of Japan (BoJ) in a rare move at its September MPC meeting set a target for government bond yields and introduced an inflation-overshooting commitment.

The Bank voted to apply an interest rate of minus 0.1 per cent to the policy rate on balances in current accounts held by financial institutions. The Bank also announced a plan to purchase Japanese Government bonds up to JPY 80 trillion (approximately USD788 billion), among series of policy measures taken towards achieving the price stability target of 2 per cent. The government had, in August, approved a fiscal stimulus of ¥13.5 trillion (US\$132 billion) in a spirited attempt to jumpstart the economy.

Real GDP in the Euro area is expected to maintain or outperform its Q2 growth rate of 0.3 per cent in

the third quarter. While short-term downside risks from the Brexit vote have largely subsided, the long-term potential economic impact remains uncertain. As such, the zone's growth path remains challenged. At its October 20th, 2016 meeting, the Governing Council of the European Central Bank decided to retain its key interest rates on refinancing operations, the marginal lending facility and the deposit facility at 0.00, 0.25 and -0.40 per cent, respectively. The Council also reaffirmed its commitment to sustain its quantitative easing programme of monthly asset purchases of €80 billion (US\$85.6 billion) until March 2017 and beyond, as economic conditions dictate.

The growth outlook for the UK in 2016 was upgraded to 1.8 per cent from 1.7 per cent, although that for 2017 was downgraded to 1.1 per cent from 1.3 per cent. The Bank of England (BoE), at its November 2nd meeting, decided to leave its benchmark interest rate unchanged at 0.25 per cent as part of its earlier commitment to support output recovery in the aftermath of the Brexit vote. In addition, the Committee voted to continue its quantitative easing programme of £435 billion.

Whereas some Emerging Market and Developing Economies (EMDEs) continue to contend with low capital inflow and unstable macroeconomic

environment, the prospects for their recovery look more promising. The IMF (WEO October 2016 Update) projected growth rate of 4.2 per cent, an upward review from 4.1 per cent projected in July 2016 for the EMDEs. The marginal improvement in growth outlook is expected to be powered by improvements in India and China.

Global inflation rose moderately in response to rising prices in the advanced economies due to the modest recovery in oil prices. However, their central banks are expected to stay the course on accommodative monetary policy. Following the Brexit vote and the recent outcome of the US

Presidential Elections and uncertainties surrounding both events as well as the regime of negative interest rates and heavy fiscal and monetary stimuli in Japan and elsewhere, we expect a resurgence of aggregate demand and even higher price increases.

Domestic Economic and Financial Developments

Output

Data released by the National Bureau of Statistics (NBS) in August showed that the economy slipped into recession following a second consecutive contraction in Q2, 2016. Domestic output contracted in the quarter by 2.06 per cent. The latest release in

November 2016 by the NBS shows that real income actually worsened in Q3, 2016 as output contracted further by 2.24 per cent relative to its level in the previous and corresponding quarter of 2015. The non-oil sector grew by 0.03 per cent, driven by Agriculture which grew by 4.54 per cent, following the 0.38 per cent contraction in Q2 2016,.

The MPC noted that the key undercurrents – shortage of foreign exchange, low fiscal activity, high energy prices and the accumulation of salary arrears, especially at the sub-national levels of government – continued in the third quarter of the year. Members also noted that those conditions

could not have been ameliorated directly with monetary policy instruments. It, however, recognized the need to continue to engineer monetary policy in such a way as to enable fiscal policy the required space to improve public investment in infrastructure.

Prices

The Committee noted that headline inflation (year-on-year) continued to rise in October 2016 to 18.3 from 17.9 per cent in September and 17.6 per cent in August, 2016, thus maintaining the upward momentum since January 2016. The increase in headline inflation in October reflected increases in

both the food and core components of inflation. Core and food inflation increased from 17.7 and 16.6 per cent in September to 18.1 and 17.1 per cent, respectively, in October, 2016.

The Committee also noted the less rapid movement in the month-on-month CPI between September and October. Headline inflation index (month-on-month) rose by 0.83 per cent in October, from 0.81 per cent in September, contrasting the successive declines since May 2016. Similarly, the core index has been increasing at a slower pace since May when it rose by 2.7 per cent. It moderated to 0.75 per cent in October from 0.96 in September. A similar pattern is noted with the food (month-on-month) index which

rose by 0.86 per cent in October from 0.81 per cent in September.

The MPC observed that the incessant pressure on consumer prices continues to come from structural factors including high cost of power and energy, transport, production factors, as well as rising prices of imports.

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Monetary, Credit and Financial Markets Developments

Broad money supply (M2) grew by 10.50 per cent in September, 2016, compared with the 8.08 per cent in August, 2016. When annualized, M2 grew by 14.0

per cent in September 2016, above the growth benchmark of 10.98 per cent for 2016. Net domestic credit (NDC) grew by 21.88 per cent in the same period, annualized at 29.17 per cent. At this rate, the growth rate of NDC was above the provisional benchmark of 17.94 per cent for 2016. The development in NDC, essentially reflected the relative growth in credit to the private sector of 20.69 per cent in September, annualized to 27.59 per cent. Credit to government grew by 29.57 per cent in the review period, which annualized to a growth of 39.43 per cent compared with the growth benchmark of 13.28 per cent for fiscal 2016. The growth in

government borrowing was largely to compensate for the continued decline in oil receipts.

Money market interest rates oscillated in tandem with the level of liquidity in the banking system. Thus, average inter-bank call rate, which stood at 11.50 per cent on 11th October 2016, closed at 15.02 per cent on November 17, 2016. Between these periods the interbank call rate averaged 11.68 per cent. However, the average interbank call rates fell to 10.00 per cent on October 24, 2016, following net government financing of N149.00 billion between October 18 and 28, 2016 and the payment on October 24th 2016 from statutory revenue allocation of N174.00 billion.

The Committee noted a decline in the equities segment of the capital market as the All-Share Index (ASI) fell by 7.33 per cent from 27,839.93 on September 19, 2016, to 25,797.88 on November 16, 2016. Similarly, Market Capitalization (MC) declined by 7.11 per cent from N9.56 trillion to 8.88 trillion during the same period. In addition, relative to end-December 2015, the capital market indices fell by 9.93 per cent and 9.85 per cent, respectively, reflecting the challenges facing the economy.

External Sector Developments

The average naira exchange rate weakened at the inter-bank segment of the foreign exchange market

during the review period. The exchange rate at the interbank market opened at N305.00/US\$ and closed at N305.90/US\$ between September 1st and October 27, 2016. The Committee observed that total foreign exchange inflows through the CBN decreased by 31.85 per cent, from US\$1,404.84 million in September to US\$957.37 million in October 2016. The decrease was due to lower crude oil and other government revenues in the period under review. In spite of the resumed Joint Venture payments in October, total outflows also continued to decrease, dropping significantly by 58.68 per cent from US\$2,456.86 million to US\$1,015.08 million during the same period.

The Committee also implored the Management to continue to direct more focus at making foreign exchange available to agriculture and manufacturing sectors of the economy by enforcing its policy directing DMBs to allocate 60 per cent of the FX available to these sectors.

The MPC believes that the Security agencies should sustain their checks on the activities of illegal foreign exchange operators in order to bring sanity to that segment of the market. The Committee reiterated that the extant foreign exchange regulation outlaws the trafficking of currency on the streets as some unlicensed operators currently do. Thus, to evolve

an appropriate naira exchange rate that stabilizes the foreign exchange market, BDC operators must strictly observe the terms and conditions of their license.

The Committee's Considerations

The Committee assessed the fragile macroeconomic conditions and the strong headwinds confronting the economy. In particular, the Committee considered the implications of the twin deficits of current account and budget deficits, the rise of nationalist sentiments across the West and implications for national elections in France and Germany as well as

the forthcoming referendum in Italy. Other considerations include the yet to be unveiled long term uncertainties of Brexit and expectations of significant shifts in US economic policy. The Committee reaffirmed the urgency of prioritizing the diversification of the economy given the emerging gloomy protectionist outlook of the global economy.

The Committee also evaluated the impact of its July and September 2016 actions on the macroeconomy noting that while foreign exchange inflows into the economy had improved significantly in July and August, it declined after the September MPC meeting, leading to rising inflation and increasing

negative real interest rates. However, outflows significantly dropped, lending credence to the propriety of the decisions of the July and September MPC meetings.

The MPC reiterated the limitations of monetary policy in reversing the current stagflationary condition in the economy, which it traced to supply and demand shocks. Members stressed the need for a robust and more keenly coordinated macroeconomic policy framework that would restart output growth, stimulate aggregate demand and rein in inflation expectations. Consequently, the MPC welcomes efforts at resuscitating planning, noting

the progress made in developing the medium term economic recovery plan. The MPC urged the Federal Government to urgently assess the extent of its indebtedness to domestic economic agents and develop a framework for securitizing the debts in order to settle its outstanding domestic contractual obligations which cuts across all sectors of the economy. These accumulated debts have slowed business activities of economic agents; most of who are indebted to the banking system, thus compromising the integrity of the financial system. It also advised the Bank to commit to greater surveillance and deployment of early warning systems in managing the banking system.

Overall, members called for an enrichment of fiscal and other sector initiatives and interventions towards resolving the growth challenges in the economy in order to promptly revive confidence in the economy.

Outlook

Available data and forecasts of key economic variables indicate that the outlook for growth and inflation in the medium term continues to be challenging. Growth is expected to remain less robust given the absence of sufficient fiscal space while the current tight stance of monetary policy and

improved agricultural harvests are expected to contain further price increases and moderate price expectations as the trend has already revealed.

The Committee's Decisions

The Committee assessed the relevant risks to the global and domestic economy and concluded that the risks to the economy remained highly elevated on two fronts (price and output). However, considering the importance of price stability, and being mindful of the limitations of monetary policy in influencing output and employment under conditions of stagflation, the Committee decided unanimously in favour of retaining the current stance of monetary policy, thus keeping the MPR at 14.0 per cent alongside all other policy parameters.

In summary, all 10 MPC members voted to:

- (i) Retain the MPR at 14 per cent;
 - (ii) Retain the CRR at 22.5 per cent;
 - (iii) Retain the Liquidity Ratio at 30.00 per cent;
- and
- (iv) Retain the Asymmetric Window at +200 and
-500 basis points around the MPR

Thank you for listening.

Godwin I. Emefiele

Governor, Central Bank of Nigeria

22nd November 2016