CENTRAL BANK OF NIGERIA COMMUNIQUÉ NO 114 OF THE MONETARY POLICY COMMITTEE MEETING OF 24th AND 25th JULY, 2017

Background

The Monetary Policy Committee met on the 24th and 25th of July 2017, against the backdrop of a relatively improving global economy. However, protectionism in trade and immigration; fragilities in the financial markets, remain the key risks to global economic stability.

On the domestic front, the economy is on a path to moderate recovery with a positive short- to medium-term outlook, premised largely on fiscal stimulus and a stable naira exchange rate. Inflation expectations also appear sufficiently anchored with the current stance of monetary policy.

In attendance were 8 out of 12 members of the Committee. The Committee examined the global and domestic economic and financial environments in the first half of 2017 and the outlook for the rest of the year.

External Developments

The momentum witnessed in the global economy in Q1 2017 continued through the second quarter, driven by a generally accommodative monetary policy stance in most advanced economies, moderation in energy prices and improved global demand. The emerging markets and developing economies, are experiencing positive spillovers from somewhat improved commodity prices and developments in the advanced economies. The growth prospects for this group of countries in 2017 are expected to rise to about 4.6 per cent from 4.3 per cent in 2016.

Complemented by the momentum in other blocks and a potential positive prospect for expansion in world trade, the IMF in its July edition of the World Economic Outlook (WEO) projected global output growth in 2017 at 3.5 per cent from 3.1 per cent in 2016.

The MPC, however, noted some headwinds confronting the optimistic outlook to global growth arising mainly from receding market expectations of expansionary U.S. fiscal policy, weaker than expected growth in the U.K due to difficult BREXIT negotiations and geo-political risks associated with the forthcoming German general elections. In addition, the Committee noted the downward trend in global inflation after earlier indications of an uptick as the U.S. continues to build up inventories in shale oil, while emerging economies such as Brazil, Russia and South Africa witness strong economic headwinds leading to sharp downturn in output.

Domestic Output Developments

Data from the National Bureau of Statistics (NBS) showed that the contraction in the economy moderated to 0.52 per cent in Q1 2017 from 1.30 per cent in Q4 2016. The data further revealed that fifteen economic activities recorded positive growth in Q1 2017, showing strong signs of recovery. The Purchasing Managers Index (PMI) for manufacturing and non-manufacturing activities stood at 52.9 and 54.2 index points in May and June 2017, respectively from 52.7 and 52.5 index points in May 2017, indicating an expansion for the third consecutive month. Similarly, the Composite Index of Economic Activities (CIEA) rose from 55.85 to 59.50 index points between April and June 2017. The Committee noted the continuous positive effects of improved foreign exchange management on the performance of manufacturing and other economic activities. Non-oil real GDP grew by 0.72 per cent in Q1 2017, reflecting growth in the agricultural sector by 0.77 per cent in the same period. Provisional data also showed that the external sector remained resilient in Q2 2017, as the overall Balance of Payments (BOP) position recorded a surplus of US$0.65 billion, equivalent to 0.8 per cent of GDP. The Committee hopes that the implementation of the 2017 budget and the

Economic Recovery & Growth Plan (ERGP) will further strengthen growth and stimulate employment.

Developments in Money and Prices

The Committee noted that money supply (M2) contracted by 7.33 per cent in June 2017, annualized to a contraction of 14.66 per cent, in contrast to the provisional growth benchmark of 10.29 per cent expansion for 2017. The development in M2 reflected a contraction of 7.45 per cent in net foreign assets (NFA) in June 2017. Similarly, M1 contracted by 7.98 and 10.70 per cent in May and June 2017, respectively, consistent with the directive of the MPC that expansion in narrow money should be controlled. On the other hand, net domestic credit (NDC) grew modestly by 1.02 per cent in June 2017, (annualized at 2.04 per cent), driven mainly by net credit to government, which grew by 5.91 per cent. Credit to the private sector, however, declined relative to end-December 2016 by 0.02 per cent. The MPC noted the widening fiscal deficit of N2.51 trillion in the first half of 2017 and the growing level of government indebtedness and expressed concern about the likely crowding out effect on private sector investment. The constrained growth in the monetary aggregates provides evidence of weak financial intermediation in the banking system arising from the constraints imposed by developments in the macroeconomy.

Headline inflation (year-on-year) declined for the fifth consecutive month in June 2017, to 16.10 per cent from 16.25 per cent in May, and 18.72 per cent in January 2017. Core inflation moderated to 12.50 per cent in June from 13.00 per cent in May 2017 while the food index rose marginally to 19.91 per cent in June from 19.27 per cent in May 2017. This development was traced to intermittent attacks by herdsmen on farming communities, sporadic terrorist attacks in the North-East and other seasonal farming effects. The Committee was particularly concerned about the unabating pressure from food inflation but hopeful that the situation will dampen in the third quarter as harvests begin to manifest.

The Committee also attributed the moderation in inflation to be partly due to the effects of the relative stability in the foreign exchange market, stemming from improved management, which promoted increased inflows. Against this backdrop, the Committee reiterated its commitment to sustain and deepen flexibility in the foreign exchange market to further enhance foreign exchange flow in the economy. The Committee, however, noted the protracted effects of high energy and transportation costs as well as other infrastructural constraints on consumer price developments and expressed hope that government will fast-track its reform agenda to address these legacy issues. The Committee noted that while responding to the current tight monetary policy stance, inflation still had a strong base effect which is expected to wane by August 2017.

Money market interest rates moved in tandem with the high level of liquidity in the banking system. The interbank call rate opened at 16.13 per cent on May 25, 2017 and closed at 4.43 per cent on June 29, 2017. However, the average inter-bank call rate during the period stood at 12.49 per cent. The movement in the net liquidity position reflected the effects of OMO, foreign exchange interventions, statutory allocation to state and local governments, and maturity of CBN Bills.

The Committee noted the improvements in the equities segment of the capital market as the All-Share Index (ASI) rose by 33.33 per cent from 25,516.34 on March 31, 2017, to 34,020.37 on July 21, 2017. Similarly, Market Capitalization (MC) rose by 32.84 per cent from N8.83 trillion to N11.73 trillion during the same period. Relative to end-December 2016, capital market indices rose by 26.59 and 26.81 per cent, respectively, reflecting growing investor confidence due to improvements in foreign exchange management. The Committee however, noted the seeming bubble in the capital market and cautioned on the utilization of the inflows.

Total foreign exchange inflows through the Central Bank of Nigeria (CBN) increased by 35.41 per cent in June 2017 compared with the previous month. Total outflows, on the other hand, decreased by 12.73 per cent during the same period, as a result of reduced CBN intervention in the interbank foreign exchange market, which also reduced TSA (dollar) payments balances by 61.4 per cent in the period under review. The positive net flows resulted in an improvement of gross external reserves to $30.30 billion at end-June 2017, compared with $29.81 billion at end-May 2017.

The Committee noted the emerging convergence between the bureau-de-change (BDC) and Nigeria Autonomous Foreign Exchange (NAFEX) segment rates and the stability of the average naira exchange rate at the inter-bank segment of the foreign exchange market during the review period.

2.0. Overall Outlook and Risks

Available forecasts of key macroeconomic indicators point to a fragile economic recovery in the second quarter of the year. The Committee cautioned that this recovery could relapse in a more protracted recession if strong and bold monetary and fiscal policies are not activated immediately to sustain it. Thus, the expected fiscal stimulus and non-oil federal receipts, as well as improvements in economy-wide non-oil exports, especially agriculture, manufacturing, services and light industries, all expected to drive the growth impetus for the rest of the year must be pursued relentlessly. The Committee expects that timely implementation of the 2017 Budget, improved management of foreign exchange, as well as security gains across the country, especially, in the Niger Delta and

North Eastern axis, should be firmly anchored, to enhance confidence and sustainability of economic recovery.

The Committee identified the downside risks to this outlook to include weak financial intermediation, poorly targeted fiscal stimulus and absence of structural programme implementation.

3.0. The Considerations of the Committee

Notwithstanding the improved outlook for growth, the Committee assessed the implications of the uncertainties arising from the continued normalization of monetary policy by the US Fed and the implications of a strong dollar, the weak recovery of commodity prices, and the uncertainty of US fiscal policy. The Committee similarly evaluated other challenges confronting the domestic economy and the opportunities for achieving economic growth and price stability in 2017.

The Committee expressed satisfaction with the gradual but consistent decline in inflationary pressures in the domestic economy, noting its substantial base effect, continuous improvements in the naira exchange rate across all segments of the foreign exchange market, and considerable signs of improved investments inflows. The Committee welcomed the move by the fiscal authorities to engage the services of asset-tracing experts to investigate the tax payment status of 150 firms and individuals in an effort to close some of the loopholes in tax collection, towards improving government revenue. However, the Committee expressed concern about the slow implementation of the 2017 Budget and called on the relevant authorities to ensure timely implementation, especially, of the capital portion in order to realize the objectives of the Economic Recovery and Growth Plan.

The MPC believes that at this point, developments in the macroeconomy suggest two policy options for the Committee: to hold or to ease the stance of monetary policy.

Against the backdrop of the outlook for the domestic and global economy; the enthusiasm around the base-effect which reduced inflationary pressures and the continuous relative stability in the naira exchange rate, there is need to maintain cautious optimism, given the potential ramification of a major deviation from the existing policy path. The Committee is not unmindful of the high cost of capital and its implications on the still ailing economy, which arguably necessitates an accommodating monetary policy stance. The MPC also noted the liquidity surfeit in the banking system and the continuous weakness in financial intermediation, but agreed on the need to support growth without jeopardizing price stability or upsetting other recovering macroeconomic indicators, particularly the relative stability in the foreign exchange market.

The MPC thinks that easing at this point would signal the Committee's sensitivity to growth and employment concerns by encouraging the flow of credit to the real economy. It would also promote policy consistency and credibility of its decisions. Also, the Committee observed that easing at this time would reduce the cost of debt service, which is actually crowding out government expenditure. The risks to easing however, would show in terms of upstaging the modest stability achieved in the foreign exchange market, the possible exit of foreign portfolio investors as well as a resurgence of inflation following the intensified implementation of the 2017 budget in the course of the year. The Committee also reasoned that easing would further pull the real interest rate down into negative territory.

The argument for holding is largely premised on the need to safeguard the stability achieved in the foreign exchange market, and to allow time for past policies to work through the economy. Specifically, the MPC considered the high banking system liquidity level; the need to continue to attract foreign investment inflow to support the foreign exchange market and economic activity; the expansive outlook for fiscal policy in the rest of the year; the prospective election related spending which could cause a jump in system liquidity, etc.

The MPC expressed concern over the increasing fiscal deficit estimated at N2.51 trillion in the first half of 2017 and the crowding out effect of high government borrowing. While urging fiscal restraint to check the growing deficit, the Committee welcomed the proposal by government to issue sovereign-backed promissory notes of about N3.4 trillion for the settlement of accumulated local debt and contractors arrears. The Committee, however, advised the Management of the Bank to monitor the release process of the promissory notes to avoid an excessive injection of liquidity into the system thereby offsetting the gains so far achieved in inflation and exchange rate stability.

On the outlook for financial system stability, the Committee noted that, in spite of the resilience of the banking sector, the prolonged weak macroeconomic environment has continued to impact negatively on the sector's stability. The MPC reiterated its call on the Bank to sustain its intensive surveillance of deposit money banks' activities for the purpose of promptly identifying and addressing vulnerabilities. The Committee also called on the DMBs to support economic recovery and growth by extending reasonably priced credit to the private sector.

4.0. The Committee's Decisions

In consideration of the headwinds confronting the domestic economy and the uncertainties in the global environment, the Committee decided by a vote of 6 to 2 to retain the Monetary Policy Rate (MPR) at 14.0 per cent alongside all other policy parameters. Consequently, 6 members voted to retain the MPR and all other parameters at their current levels while two members voted to ease the stance of monetary policy. In summary, the MPC decided 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 corridor at +200 and -500 basis points around the MPR.

Thank you for listening.

Godwin I. Emefiele

Governor, Central Bank of Nigeria

25th July, 2017