Central Bank Of Nigeria Communique No 118 Of The Monetary Policy Committee Meeting Of Monday 21ST And Tuesday 22ND May, 2018

Background

The Monetary Policy Committee (MPC) met on the 21st and 22nd of May, 2018 against the backdrop of optimistic global growth outlook and sustained recovery in the domestic economy. The Committee examined the performance, risks, vulnerabilities in the global and domestic economies up to May 2018, and the outlook for the rest of the year. In attendance were nine members of the Committee.

Global Economic Developments

The momentum of global economic activities remained broadly sustained, with outcomes likely to be shaped by emerging geo-political issues including: easing geo-political tensions on the Korean Peninsula; reduced trade tensions between China and the United States; United States withdrawal from the 2015 Iranian Nuclear Deal; easy financing conditions in the Euro Area, the UK and Japan; as well as difficulties associated with the Brexit negotiations. Accordingly, global output is projected to grow at 3.9 per cent in 2018, up from 3.8 per cent in 2017. Growth in the advanced economies is projected to strengthen to 2.5 per cent in 2018 from 2.3 per cent in 2017 premised on improved investments and consumption spending. Similarly, output growth in the emerging markets and developing economies (EMDEs) is projected to rise marginally at 4.9 per cent in 2018 reflecting improvements from 4.8 per cent in 2017, led by oil exporters, such as Russia, Brazil, and Nigeria. The Committee noted that despite these optimistic developments, the downside risks to global growth include: the geo-political tensions in the Middle-East; lingering uncertainties from BREXIT negotiations; and growing trend towards trade protectionism.

Inflation in the advanced economies is projected to rise by 2.0 per cent and would remain subdued relative to the long term trend. In the emerging markets and developing economies, price developments could surge by 4.6 per cent in 2018. The International Monetary Fund (IMF) forecasts that inflation may rise modestly over the medium to long-term, due to rising asset prices and long-term yields in the major financial markets.

Domestic Output Developments

The Committee noted improvements in the domestic economy, attributable to the steady decline in inflation, rebound in oil prices and increase in production level, as well as the continued stability in the foreign exchange market. According to data from the National Bureau of Statistics (NBS), real Gross Domestic Product (GDP) for Q4 2017 was revised upwards from 1.92 per cent to 2.11 per cent, while a growth of 1.95 per cent was recorded in the first quarter of 2018, up from a contraction of 0.91 per cent in the corresponding period of 2017. The development was due to growth in the oil and non-oil sectors by 14.77 and 0.76 per cent, respectively. The Monetary Policy Committee also noted the sustained positive outlook based on the Manufacturing, and Non-manufacturing Purchasing Managers' Indices (PMI), which rose for thirteenth and twelfth consecutive months to 56.9 and 57.5 index points, respectively, in April 2018. The Committee welcomed this development but believes that growth remains largely fragile and could benefit from further reforms and stimulus. In this regard, the MPC urged the various levels of government to accelerate the settlement of contractor debt and salary arrears as well as facilitate the quick implementation of the 2018 Federal Government budget.

Developments in Money and Prices

The Committee noted that broad money supply (M2) grew by 2.16 per cent in April 2018 from 1.26 per cent in March 2018, annualised to 6.48 per cent. This was in contrast to the provisional growth benchmark of 10.48 per cent for 2018. The performance of M2 was mainly driven by the growth in Net Domestic Credit (NDC) of 6.24 per cent (annualised to 18.72%), owing largely to net credit to government, which grew by 46.13 per cent (annualised to 138.39%) against the provisional benchmark of 54.97 per cent. Credit to the private sector, however, contracted by 0.16 per cent (annualised to -0.47%) in April 2018, in contrast to the provisional annual benchmark of 5.64 per cent. Net Foreign Assets (NFA) grew by 7.38 per cent in April 2018, annualized to 22.13 per cent, compared with the provisional benchmark of 18.15 per cent. Narrow money (M1), however, contracted by 3.31 per cent (annualised to -9.94%), compared with the provisional benchmark of 8.04 per cent.

Inflationary pressures continued to moderate with headline inflation (year-on-year) declining for the fifteenth consecutive month to 12.48 per cent in April 2018 from 13.34 per cent in March 2018. Food and Core inflation also decelerated to 14.80 and 10.92 per cent from 16.08 and 11.18 per cent, respectively, during the same period.

The average inter-bank call rate decreased to 3.34 per cent in April 2018 from 9.49 per cent in December 2017. Similarly, the average Open Buy Back (OBB) rate fell to 2.96 per cent in April 2018 from 8.46 per cent in December 2017. The movement in the net liquidity position and interest rates reflected the combined effects of Open Market Operations (OMO) auctions, foreign exchange interventions and statutory allocation to state and local governments.

The Committee welcomed the sustained improvement in the level of external reserves, which stood at US$47.79 billion on May 18, 2018, compared with US$46.73 billion at the end of March 2018. The Committee urged the Bank to sustain this momentum and continue to boost investor confidence in the economy. The Committee also welcomed the continued rise in the price of crude and called on the Federal Government to seize the opportunity to build fiscal buffers against future oil price shocks.

The All-Share Index (ASI) decreased by 6.6 per cent from 43,330.54 on February 28, 2018 to 40,472.45 on May 18, 2018, owing largely to profit taking activities of investors, and capital reversals in response to monetary policy normalization in some advanced economies particularly, the United States. Similarly, Market Capitalization (MC) fell by 5.7 per cent from N15.55 trillion on February 28, 2018 to N14.66 trillion on May 18, 2018. The Committee noted the need to maintain remunerative domestic rates to stem the trend towards huge capital outflow.

The MPC welcomed the continued stability in the foreign exchange market, promoted by improved dollar liquidity in the market due to the high level of activity at the Investors' and Exporters' (I&E) window, that is equally driving rates towards convergence at all segments of the market. Total foreign exchange inflow through the economy from January to March 2018 stood at US$24.719 billion, of which funding from the CBN was US$8.81 billion or 28.5 per cent, while autonomous sources accounted for the larger balance of US$15.91 billion or 71.5 per cent of the total. In addition, the Committee welcomed the US$2.5 billion or RMB 15 billion Currency Swap between the Central Bank of Nigeria (CBN) and the People's Bank of China (PBoC). This swap, the Committee noted, will ease pressure in the foreign exchange market by the reduction in reliance on a third currency for trade settlement between Nigeria and China. They further noted that this swap arrangement could be the basis for an expanded and mutually beneficial economic relationship between Nigeria and China.

2.0. The Overall Outlook and Risks

The macroeconomic environment that propelled the economy's exit from recession has remained positive and is likely to continue in the near-term. The expectation was premised on speedy implementation of the 2018 budget, improved security, continued stability in the foreign exchange market as well as increase in crude oil production and prices. The Committee noted the downside risks to the outlook to include: the late approval and implementation of the 2018 budget; farmers-herdsmen conflict; weak demand and consumer spending associated with outstanding salaries and contractor debt; and the growing level of sovereign debt.

The outlook for inflation indicates continued moderation in the price level, even though the risks include huge liquidity injections that is expected to arise from the implementation of the proposed N9.12 trillion 2018 FGN budget; expenditure towards the 2019 elections; monthly FAAC injections, approval and implementation of the proposed new national minimum wage, possibly finance by a supplementary budget. These could impact aggregate demand and put pressure on domestic prices in the remaining months of 2018 and may dampen the gains already made by the Bank in stabilizing prices.

Staff forecasts, given the anticipated liquidity injections into the economy, indicates upward trending pressure on domestic prices from the second half of fiscal 2018. Consequently, the Committee advocates an orderly injection of the anticipated liquidity by the fiscal authorities to prevent a negative shock to prices that would derail the positive but fragile recovery so far achieved.

Given the CBN's interventions, the current level of oil prices and developments in the global economy, we expect rates to remain stable in the foreign exchange market in the near-term. However, the bearish signs in the capital market associated with profit taking activities of investors, call for a careful calibration of policy so as to moderate the trend of capital outflows in an era of monetary policy normalization in the United States. This is given that there are already indications of severe attacks on the foreign exchange markets of some emerging economies.

Nevertheless, there is significant high level of uncertainties that could arise from the fiscal operations of government in the near term. Amongst these are: when the implementation of the 2017 budget will end; dwindling revenue projections; as well as the possibilities of full implementation of the 2018 Federal budget. Consequently, we expect a likely bunching of government spending in view of the late passage of the budget and government's commitment to honour prior obligations. This could pose a serious challenge to the Bank's price stability mandate.

Revenue is expected to increase in view of the favourable prices of crude oil and improvements in non-oil revenue, particularly taxes. In addition, production levels have also increased in recent times and this is expected to be maintained. However, the implications of a China-US trade deal on China's oil imports from Nigeria remain unclear, especially as the US has included energy imports on the list of items for negotiation with China.

3.0. The Considerations of the Committee

The Committee expressed satisfaction on the positive outlook in the domestic economic environment as the real GDP grew for the fourth consecutive quarter by the first quarter of 2018 and the positive trend in the Manufacturing and Non-manufacturing Purchasing Managers' Indices in the first quarter of 2018. It noted the continued deceleration in headline inflation as well as stability in the foreign exchange market and therefore, called on the Bank to sustain the momentum in order to further subdue inflation and ensure growth. The Committee expressed satisfaction with the level of activities in the Investors' and Exporters' (I&E) window of the foreign exchange market.

The Committee further noted the overall upward growth momentum of the economy with key activity sectors returning positive growth. Despite the improving macroeconomic environment, the Committee noted that disruptions to the supply chains in major food producing states of the country remains a concern as food prices remained sticky downwards. It also noted the potential adverse effect of the rising global inflation on domestic prices and therefore, urged the Government not to relent on curtailing the security challenges to advance controlling inflation to its historical path.

Members of the Committee were satisfied with the progress made with the implementation of the Economic Recovery and Growth Plan, but were concerned on the effect of delay in the passage of the 2018 Appropriation could derail the programme and urged the Federal Government to sustain its implementation to further accelerate the economic recovery thus far achieved. The Committee urged the Government to set the machinery for the effective implementation of the 2018 budget to further stimulate the economy. It also encouraged the Government to sustain current efforts at boosting tax revenue generation notwithstanding the increase in crude oil and other commodity prices. The MPC, however, noted the potential effects of expansionary fiscal budget of 2018 and the liquidity impact of rising FAAC distribution, following increase in the prices of crude oil as well as the build up in election related spending towards the 2019 general elections.

The Committee took note of the improved performance of deposit money banks and observed that the relatively high levels of non-performing loans in the industry was moderating and urged Government to promptly settle outstanding contractor arrears as earlier promised. The Committee commended the effort of the Bank in achieving the positive outlook for the industry and advice the Bank to intensify efforts to further improve banking sector soundness. It called on the Bank to sustain its monitoring apparatus to ensure compliance with existing prudential regulations and early detection and management of emerging vulnerabilities. Also, it similarly encouraged the Bank not to relent in ensuring that liquidity continues to flow from the banking sector to the real sector to further strengthen economic recovery and employment generation.

4.0. The Committee's Decisions

The Committee critically evaluated the policy options in terms of developments in the international and domestic environments, noting in particular progress made in stimulating output growth, including stability in the foreign exchange market increase in the level of foreign exchange reserves, and sustained deceleration in the rate of inflation.

The Committee considered the forecast of high liquidity injection in the second half of 2018, upward pressure on prices, driven largely by substantial expansionary fiscal policy, which will arise from the late passage of the 2018 appropriation bill, outstanding balance from the 2017 budget and the pre-election expenditures. Thus, tightening would ensure the mop-up of excess liquidity. Mindful that despite the moderation in inflation, the current inflation rate is still above targeted single digit and that real interest rate only turned positive in the review period. The objective of the policy stance therefore, would be to accelerate a reduction in the inflation rate to single digit to promote economic stability, boost investor confidence, and promote foreign capital flows with complementary impact on exchange rate stability.

Conversely, the Committee believes that raising interest rate would, however, depress consumption and increase the cost of borrowing to the real sector. Moreover, such policy would make deposit money banks to re-price their assets.

In reviewing the choice of loosening, the Committee evaluated the potential impact of stimulating aggregate demand through lower cost of credit. Nevertheless, the Committee deliberated on the effectiveness of the choice at a time when liquidity injection had been forecast to rise tangentially in the second half of the year. The outcome therefore, would most likely exacerbate inflationary pressure, cause higher pressure on the exchange rate as demand for forex increases and return real rate into negative territory as nominal interest rate fall lower than the inflation rate. Owing to the poor transmission mechanism as a result of structural rigidities, the reduction in the MPR may not necessarily transmit to lowering market lending rate on account of the high cost of doing business. The Committee further noted that loosening could worsen the current account balance through increase in importation, margin lending, lowering of risk evaluation in accessing loans which will drive up loans and likely increase in NPLs with potential negative consequence on the stability of the banking industry. The cost of liquidity management would also rise considerably.

The Committee, while arguing for a hold, observed that the downside risk to growth and upside risk to inflation appears balanced as growth is improving while inflation is moderating. Maintaining the current policy stance would sustain gradual improvements in both indices. It was noted that there is need to see how all the components of GDP would evolve in the second quarter of 2018 in order to gain greater clarity on the direction of monetary policy. In summary, the predominant argument for a hold at this time is to await more clarity on the evolution of key indicators i.e. the passage and implementation of the budget, economic activities, and traction in fiscal policy in 2018.

Overall, the Committee was convinced that the economy needed a new impetus of increased lending by the banking system and would work with the Bank to adopt innovative ways to encourage the deposit money banks (DMBs) to adopt innovative ways to accelerate credit growth, including a reduction in the policy rate when conditions for such a decision arise. The MPC noted that at single digit inflation and higher reserve levels, the risks associated with a policy rate reduction under conditions of wavering foreign capital inflows and an unstable oil market, including other severe uncertainties, could be better managed to deliver macroeconomic stability in Nigeria. In consideration of the foregoing, therefore, the Committee decided by a vote of 8 members to retain the Monetary Policy Rate (MPR) at 14.0 per cent alongside all other policy parameters. One (1) member, however, voted to increase the MPR by 50 basis points.

Consequently, the MPC voted to retain the:

(i) MPR at 14.0 per cent;

(ii) CRR at 22.5 per cent;

(iii) Liquidity Ratio at 30.0 per cent; and

(iv) Asymmetric corridor at +200 and -500 basis points around the MPR.

Thank you for listening.

Godwin I. Emefiele

Governor, Central Bank of Nigeria

22nd May, 2018