



CENTRAL BANK OF NIGERIA COMMUNIQUÉ NO 120 OF THE MONETARY POLICY COMMITTEE MEETING OF SEPTEMBER 24 AND 25, 2018, WITH PERSONAL STATEMENTS OF MEMBERS

Background

The Monetary Policy Committee (MPC) met on the 24th and 25th of September, 2018 and evaluated developments in the global and domestic economic and financial environments in the first eight months of 2018, as well as the outlook for the rest of the year. Ten members of the Committee were in attendance.

Global Economic Developments

The Committee noted the uneven expansion in global output amidst growing trade tension, rising oil prices and debt levels as well as currency depreciation in most of the notable emerging markets and developing economies. These developments notwithstanding, there was evidence of resilient financial markets and output growth in the advanced economies led by the United States, which experienced sharp improvements in output growth. In the Euro area, United

Kingdom and Japan, the pace of growth was moderate but steady, while in the Emerging Markets and Developing Economies (EMDEs), growth was sluggish and relatively uneven.

Growth in the advanced economies was projected to remain at 2.4 per cent in 2018, same as in 2017, led by the US which grew by 4.1 per cent in Q2 2018 and is projected to grow by 2.9 per cent in 2018. The Euro area and Japan, grew by 0.4 and 0.7 per cent, respectively, in Q2 and are projected to grow by 2.2 and 1.0 per cent, respectively, in 2018. In the EMDEs and Developing Economies, growth is expected to remain strong at 4.9 per cent in 2018 compared with 4.7 per cent in 2017. Growth in the EMDEs is expected to be led by India and China, which are projected to grow by 7.3 and 6.6 per cent, respectively, in 2018.

On average, the momentum of the global economy remained on track towards achieving the 2018 growth projections of 3.9 per cent as financial conditions remain broadly favourable with limited spillover of trade tensions amongst the general political sentiments. However, the recent episodes of large-scale flooding in major areas across the globe could pose some threat to growth.

Accordingly, the MPC believes that rising oil prices, tighter financial conditions, higher yields in the advanced economies and capital flow reversal from the EMDEs, resulting in pressure on currencies of some countries with fragile

conditions, as well as growing trade tensions between the US and China, would continue to shape developments in the EMDEs in the medium term.

Domestic Output Developments

Available data from the National Bureau of Statistics (NBS) showed that real GDP growth declined by 45 basis points as the economy grew by 1.50 per cent in the second quarter of 2018, down from 1.95 per cent in the preceding quarter, but higher than 0.72 per cent in the corresponding quarter of 2017. The growth slowdown was traceable to contraction in the oil sector in the second quarter of 2018, compared with the previous quarter. The Committee noted that non-oil real GDP grew by 2.05 per cent, reflecting the strong performance of construction, services and agriculture, which grew, by 7.66, 4.19 and 1.19 per cent, respectively. Furthermore, the non-oil sector was similarly supported by the stability in the foreign exchange market, continued implementation of the 2017 capital budget and the on-going interventions of the Bank in the real sector of the economy.

The MPC was of the view that even though growth remained weak, the effective implementation of the 2018 FGN capital budget and policies that would encourage credit delivery to the real sector of the economy would boost aggregate demand, stimulate economic activity and reduce unemployment in the country.

Developments in Money and Prices

The Committee noted that relative to the level at end-December 2017, Broad Money (M2) grew by 2.98 per cent in August 2018, annualised to 4.47 per cent, but below the provisional benchmark of 10.48 per cent for 2018. The growth in M2 was largely driven by growth in Net Foreign Assets (NFA) of 18.63 per cent in August 2018, annualised to 27.94 per cent and above the provisional growth benchmark of 18.15 per cent for the year. Net Domestic Credit (NDC), however, contracted by 4.18 per cent, annualized to 6.27 per cent, in contrast to the growth benchmark of 12.45 per cent for 2018. The contraction in NDC was attributed to the 34.68 per cent contraction in net credit to the Government in August 2018. Conversely, credit to the private sector grew marginally by 0.81 per cent in August 2018 from a contraction of 0.13 per cent in July 2018, annualized to 1.21 per cent, against the annual benchmark of 5.64 per cent.

The MPC observed that despite the under-performance of key monetary aggregates, headline inflation (year-on-year) inched up to 11.23 per cent in August 2018, from 11.14 per cent in July 2018. The rise in headline inflation was from food, while core inflation declined, indicating that supply side factors were driving the price increase. The near-term upside risks to inflation remained the dissipation of the base effect, expected 2019 election-related spending, continued herdsmen attack on farmers and the current episodes of flooding which has destroyed crops and would affect food supply and prices. In this regard, the Committee urged the fiscal authorities to ensure sustained

implementation of the 2018 budget to relieve the supply side growth constraints, as well as address the flooding incidence which has become perennial, on a permanent basis.

The average inter-bank call rate declined from 9.0 per cent in July 2018, to 4.0 per cent on September 20, 2018. Similarly, the average Open Buy Back (OBB) rate declined from 11.44 to 4.72 per cent over the same period. The relative decline in market rates reflected the increased statutory allocations to states and local governments and maturing securities. The development did not significantly transmit to retail interest rates as average maximum lending rates marginally declined to 30.93 per cent in August from 31.09 per in July 2018. Similarly, average prime lending rate decreased to 16.65 per cent in August from 16.83 per cent in July 2018. The weighted average deposit rate also declined to 4.57 per cent in August from 4.79 per cent in July 2018, widening the spread between the average lending rate and weighted average deposit rate to 26.36 per cent in August 2018 from 26.30 per cent in July 2018.

The Committee noted the decrease in external reserves to US\$44 billion on September 20, 2018 from US\$45 billion at the end-July 2018. Total foreign exchange inflow through the economy fell by 38.34 per cent to US\$6.00 billion in July from US\$9.73 billion in June 2018. The Committee believes that accretion to external reserves should strengthen in the last quarter of 2018, with crude oil

price remaining above the budget benchmark price of US\$51.00 per barrel and oil production increasing to 2.3 million barrels per day.

The Committee, noted the relative stability in both the Investors' and Exporters' (I&E) window of the foreign exchange market, which was sustained by autonomous inflows and measures taken by the Bank to deepen the foreign exchange market and curb speculative practices.

The MPC expressed concern at the decline in major capital market indices. The All-Share Index (ASI) decreased by 14.99 per cent to 32,540.17 on September 21, 2018 from 38,278.55 at end-June 2018. Similarly, Market Capitalization (MC) decreased by 14.33 per cent to N11.38 trillion on September 21, 2018 from N13.87 trillion at end-June 2018. The development was due largely to sustained profit-taking by portfolio investors and capital reversals as foreign yields become increasingly more attractive.

The Overall Outlook and Risks

Available data and forecast of key macroeconomic indicators show a positive outlook for the economy in the third quarter of 2018. The Committee expects that sustained implementation of the 2018 budget, improvements in the security situation and sustained stability in the foreign exchange market will stabilize prices and strengthen economic growth. Growth in the non-oil sector, especially agriculture, manufacturing, services and light industries are expected to drive output growth over the medium term. The Committee, however, identified the

downside risks to the outlook to include: the impact of increased monetary policy normalization in the advanced economies and the strengthening US dollar. Others are: the late implementation of the 2018 budget, weakening demand and consumer spending, build-up in contractor debt, low minimum wage, impact of flooding on agricultural output and other economic activities, continuing security challenges across the North-East and North-Central zones, and growing level of sovereign debt.

The outlook for the year, however, remains positive as the economy is projected to grow by 1.75 per cent in 2018, anchored on continued stability in the foreign exchange market, sustained high price and production of oil and improved electricity supply.

Inflation outlook suggests a mild resurgence of inflationary pressure in the economy, traceable largely to cost-push factors, election related spending, amongst other domestic factors. The moderating factors to the outlook would include; improved power supply, increased expenditure on capital projects and improved security conditions, all of which may exert downward pressure on consumer prices in the near-term.

The Considerations of the Committee

The Committee appraised the macroeconomic environment and noted that at its July meeting, modest stability had been achieved in key indicators, including inflation, exchange rate and external reserves. In particular, relative stability had

returned to the foreign exchange market, buoyed by a robust level of external reserves with inflation trending downwards for the 18th consecutive month. These gains so far achieved appear to be under threat of reversal, following new data which provides evidence of weakening fundamentals. The Committee identified rising inflation and pressure on external reserves created by capital flow reversal as the current challenges to growth. It noted that inflationary pressures have started rebuilding and capital flow reversals have intensified as shown by the bearish trend in the equities market even though the exchange rate remains very stable.

The Committee was concerned that the exit from recession may be under threat as the economy slowed to 1.95 and 1.50 per cent in Q1 and Q2 2018, respectively. The Committee noted that the slowdown emanated from the oil sector, with strong linkages to employment and growth in other key sectors of the economy. In this regard, the Committee urged government to take advantage of the current rising oil prices to rebuild fiscal buffers, strengthen government finances in the medium term and reverse the current trend of decline in output growth. The MPC also called on the fiscal authorities to intensify the implementation of the Economic Recovery and Growth Plan (ERGP) to stimulate economic activity, bridge the output gap and create employment.

The Committee noted that disruptions to the food supply chain in major food producing states due to the combined effects of poor infrastructure, flooding

and the on-going security challenges resulted in a rise in food prices, contributing to the uptick in headline inflation. The Committee was, however, optimistic that as harvests progress in the coming months, pressure on food prices would gradually recede, while growth enhancing measures would over the medium term have some moderating impact on food prices.

The MPC expressed concern over the potential impact of liquidity injections from election related spending and increase in FAAC distributions which is rising in tandem with increase in oil receipts.

The Committee was concerned with the rising level of non-performing loans in the banking system, traced mainly to the oil sector and urged the Bank to closely monitor and address the situation. It also expressed concern over the weak intermediation by Deposit Money Banks and its adverse impact on credit expansion and investment growth by the private sector.

In view of the above developments, the MPC noted that the economy was still confronted with growth headwinds and inflationary pressures. It reiterated the need for synergy between monetary and fiscal policies as a viable option for macroeconomic stability. The Committee, therefore, identified two likely policy options as tightening or maintaining the status quo ante. Tightening would tame inflationary pressures, stem the reversal in portfolio capital, improve the external reserves position and maintain stability in the foreign exchange market. Conversely, the MPC felt that raising rates would further weaken growth as

credit would become more expensive, NPLs would increase further, leading to a deceleration in output. In the Committee's opinion, the upward adjustment would not only signal the Bank's commitment to price stability but also its desire to maintain positive real interest rates.

A decision to hold all policy parameters constant would sustain gradual improvements in output growth, maintain the current monetary policy stance and await a clearer understanding of the quantum and timing of liquidity injections into the economy before deciding on possible adjustments. The MPC, however, called on the government to fast track the implementation of the 2018 budget to help jumpstart the process of sustainable economic recovery, and to facilitate passage of the Petroleum Industry Bill in order to increase the contribution of the sector to overall GDP.

The Committee's Decision

In light of the above, the MPC decided by a vote of seven (7) members to retain the MPR at 14 per cent. However, three (3) out of these seven (7) members voted to raise the Cash Reserve Requirement (CRR) by 150 basis points, an indication that left to them, we should have tightened. The other three (3) members voted to tighten by raising the MPR by 25 basis points.

In summary, the MPC voted to:

- I. Retain the MPR at 14 per cent;
- II. Retain the asymmetric corridor of +200/-500 basis points around the MPR;
- III. Retain the CRR at 22.5 per cent; and
- IV. Retain the Liquidity Ratio at 30 per cent.

Thank you.

Godwin I. Emefiele
Governor, Central Bank of Nigeria

25th September 2018

PERSONAL STATEMENTS BY THE MONETARY POLICY COMMITTEE MEMBERS

1. ADAMU, EDWARD LAMETEK

The September 2018 meeting of the Monetary Policy Committee (MPC) held against the backdrop of increased uncertainty in the global economic and financial environment. In Europe, Brexit is proving much harder to negotiate than envisaged, while the trade tension between the U.S. and China continues to degenerate, apparently progressing towards a trade war. In emerging markets and developing economies (EMDEs), local currencies and capital markets have come under severe pressure due to sustained dollar appreciation and the attendant capital reversals. On the domestic front, there appears to be a resurgence of inflation pressures accompanied by slowing output recovery. The overall medium-term outlook remains unclear owing to uncertainties around liquidity, capital flows and economic growth.

From the available data and forecasts, I figured that some of the macro vulnerabilities and threats were already weighing negatively on the financial system. Banking industry resilience appears to be receding with the rising non-performing loans (NPLs) ratio, driven essentially by oil sector exposures. Equally concerning is the decline in capital market indices. Both the All-Share Index (ASI) and Market Capitalization (MC) decreased by about 14.0 per cent between June and September 2018 owing in part to capital flow reversals as foreign yields become increasingly more attractive.

There is no gain saying that monetary policy cannot mitigate all of the current risks to economic stability. However, it remains the proximate tool for achieving price stability. The deceleration in inflation and stability in the naira exchange rate in over a year have been mainly as a result of the tight monetary policy stance. This is why the urge to further tighten the policy stance given the extant risks to price stability continues to be strong. As I stated in my July 2018 statement, the option of tightening further remains relevant even as I voted at the September 2018 meeting to once more hold all the policy parameters. I did so owing to the following considerations:

First, the pressure on consumer prices which led to the increase in headline inflation in August came mainly from food as core inflation continued to moderate. In line with past trends, we expect some moderation in food prices during the next two months (September and October) as harvests kick-in fully. The major risks to this expectation are coming from the recent floods and distribution bottlenecks which cannot be addressed using monetary policy tools.

Second, although the outlook for liquidity remains inclement due to election (campaign) spending and the likely expansive fiscal orientation in the rest of the year, growth in key monetary aggregates up to end-August, remained moderated. Effectively, the sterilization actions of the Bank have prevented money supply from growing unabated, thereby providing some control on the demand side. Besides, the slow pace of fiscal injections up to September has

meant that the much anticipated surge in federal government expenditure may not happen so soon, if at all.

Third, output recovery has remained sluggish. In Q2, 2018, real GDP grew by 1.50 per cent from 1.95 per cent in Q1. Growth can be better than currently seen if credit to the real sector improves and some of the constraints on agricultural production are alleviated. Further tightening at this time could depress credit and undermine the weak recovery. It could also narrow the space for the much needed fiscal actions aimed at stimulating growth and employment in the short-to medium-term.

Finally, the financial system has come under increased pressure in recent months owing to a combination of adverse external and domestic conditions, manifesting in divestments in the equities market and rising NPLs. Further tightening of the monetary policy stance may not be helpful at this time to the system. In the banking sub-sector especially, it could lead to asset re-pricing, increased operating cost and higher risk to asset quality.

I believe that although demand management measures will continue to be useful in curbing price pressures, they cannot be depended upon alone to achieve overall economic stability. It is in this light that complementary policies in other sectors are indispensable in addressing the supply issues that tend to hold down economic growth and stoke price increases. Government investment in

key infrastructure and sustained effort in the area of security will continue to be fundamental to the recovery process.

Therefore, I voted to retain all the monetary policy parameters at the levels prior to the September 2018 meeting, primarily in consideration of growth and employment concerns while hoping that routine sterilization actions of the Bank will continue to have their desired effect on inflation and exchange rate pressures. Specifically, I voted to retain:

- MPR at 14.0 per cent;
- CRR at 22.5 per cent;
- Liquidity Ratio at 30.0 per cent; and
- Asymmetric corridor at +200 and -500 basis points around the MPR.

2. ADENIKINJU, ADEOLA FESTUS

Introduction

The reports presented by the staff on the performance of the Nigerian economy as well as global economies at the September meeting of the MPC painted a very mixed picture. However, while there are several positive developments, especially with the high price of oil, and the positive output growth in countries like the U.S., the economic slowdown in China, and some major and emerging economies, combine with geopolitical tensions will continue to cast a shadow on overall global economic growth. The IMF projects global output growth to reduce from 2.4 per cent in 2018 to 2.2 per cent in 2019. It is also not clear how long the high oil price will subsist, with veiled American threat on OPEC to lower price and rising oil output from the U.S. Agriculture and commodities prices are declining. The growth of the U.S. economy continues to accelerate and unemployment rates continue to fall to record low. The Inflation rates in the OECD are already trending above targets signaling potential rise of interest rates with negative consequences on the economies of emerging countries. Continued U.S. Policy normalization and appreciation of the dollar are further casting shadows on the fortunes of economies of emerging countries. Several of these countries have experienced exchange rate depreciation, significant contraction in stock market indices as portfolio investors continue to flee to safer

havens. Nigeria must calibrate its economic projections taking account of these global developments both in the short and medium term.

Recent statistics released by the National Bureau of Statistics (NBS) are indicative that Nigeria economy may not be immune from the effects of global and domestic factors that have weighed negatively on the economy. National Bureau of Statistics data showed that the Nigerian economy growth rate slowed down in the second quarter from 1.95 per cent in the first quarter when compared to 1.50 per cent in the second quarter. Furthermore, headline inflation which had become sticky in its deceleration in the first quarter actually turned the corner to inch up to 11.23 in September from 11.14 per cent in August. While the increase in inflation rate was attributed to seasonal effects and cost push factors, especially in food prices, the rising trend in broad money, M3, signifies an underlying monetary impulse.

The threat of inflation weighed heavily on my mind as I cast my vote at this meeting. There is no doubt that I am concerned about slowing economic growth rate and high unemployment rate, however, as I indicated in my July personal statement, a turning point on inflation rate in upward direction will tilt my decision for a tightening of the monetary policy. Inflation poses a long term threat to both economic growth and indeed welfare of Nigerians and Central Bank must do all within its power to moderate its effects.

The MPC in its previous meeting has agreed on a number of non-conventional measures to boost credit to the real sector and therefore stimulate growth. These measures include a dynamic CRR to encourage deposit banks that lend to the private sector and the encouragement of operators in the agricultural and industrial sector to raise commercial papers that CBN may also subscribe at a single digit interest rates. These measures adopted at the July meeting should be given time to work their effects through the economy.

I am concerned about the lack of fiscal buffer in the midst of high oil price, the high debt service revenue ratio, unpredictability in the release of capital votes, the continuous fall in the NSE share index value as portfolio investors' move out of the economy. Furthermore, the reducing level of foreign reserves, due partly to efforts aimed at stabilizing the naira exchange rate, may affect the opportunity to maintain robust foreign reserves at a time of high oil price. It is not by coincidence that external reserves declined from a height of US\$47.43 billion end- April 2108 to US\$43.91 billion on September 20, 2018.

I am also not unmindful of cloud of uncertainties that continues to hang over the economy which would require careful maneuvering of the fiscal authorities. These include, the persistent farmers-herders clashes, effects of flooding on agriculture, trade and services, clamour by labour for increase in minimum wage rate, anticipated election spending, release of capital budget in a

manner that may affect liquidity in the economy and significant cash grants currently being injected into the economy for economic empowerment.

I am of the opinion that a marginal adjustment in the monetary policy rates will serve a strong signal to stakeholders that CBN will not condone any resurgence of inflation. Waiting for any of the upticks to inflationary pressures to manifest would require stronger monetary policy adjustments. A tightening will protect our currency and mitigate current rate of capital outflow. Comparator countries like Indonesia, Russia and Turkey have already raised interest rates in a bid to curb inflation and support their currencies.

Hence on the balance of probabilities, I strongly feel that the measures already put in place by the CBN to support economic growth, which ordinarily should be led by the fiscal authorities, should be monitored and continue to be fine-tuned to pressure deposit banks to increase credits to the real sectors. However, the Central Bank should focus on its primary mandates of ensuring price and exchange rate stability and protecting foreign reserves at a time of oil boom, which from lessons of experience is highly volatile, and easily reversible.

Decision

Given the aforementioned reasons, I believe when situations are right, marginal step to tame inflationary build up and manage sensitive economic decisions is a better option than a delay that may necessitate stronger countervailing measures that may pose a major shock to the economy, I cast my vote to:

- i. Increase MPR by 25 basis points to 14.25%**
- ii. maintain CRR at 22.5%**
- iii. Maintain existing asymmetric corridor around the MPR**

3. AHMAD, AISHAH

Introduction

Recent domestic and international economic developments shaped discussions at the September 2018 MPC meetings. Fragile domestic growth and rising inflation was tempered by a relatively stable exchange rate, whilst external reserve buffers appeared to show signs of some strain in the light of foreign portfolio investor exits. The monetary policy 'trilema' came sharply into focus as the committee was confronted with the multiple challenges of driving growth and stemming rising inflation amidst increasing exchange rate pressures.

International economic headwinds are manifest. Trade tensions continued to build as the US renegotiated a number of bilateral trade agreements and introduced a wide range of tariff hikes, stocking considerable uncertainty in the global trade arena.

In addition, the US GDP growth of 4.1 per cent in Q2 2018 and inflation above its long run target at 2.7 per cent in August 2018 (year on year), presents a convincing case for further monetary policy rate hikes. This has been repeatedly signaled by the Federal Open Market Committee, with attendant implications for capital outflows from the rest of the world, particularly, emerging market economies which have recorded significant currency depreciation.

However, some analysts have suggested that these emerging market currency weaknesses in response to a stronger dollar are largely idiosyncratic and isolated to each individual country's balance of payments, with no theoretical justifications for contagion. Arguably, some of these countries have huge current account deficits and high inflation rates, which is challenging for countries with significant dollar exposures particularly in a rising interest rate environment.

Thankfully, Nigeria has maintained a healthy balance of payment surplus boosted by rising oil prices and robust external reserves. Although reserve levels are declining, from \$47.1b as at end July 2018 to \$45.1bn as at September 17th 2018, it remains at levels that can sustain significant months (estimated at about seventeen months) of imports and further portfolio investment withdrawals.

Domestic growth remains fragile

GDP growth slowed to 1.50 per cent in Q2 2018 from 1.95 per cent in Q1 2018, tempering the optimism from the positive trajectory from the last two quarters of 2017, following the exit from recession. According to the National Bureau of Statistics, this lower growth was driven by lower than expected oil production and relatively weak agricultural output. Notwithstanding, it is good to note that Q2 output growth was driven by the non-oil sector, which grew by 2.05 per cent, representing the strongest growth in non-oil GDP since the fourth quarter of 2015. These are indications that some structural reforms are beginning to yield

results and require sustained efforts to forestall any reversals. Near term growth projections also remain positive on account of rising crude oil prices, expected agricultural harvest and anticipated fiscal stimulus from the implementation of the 2018 federal budget.

This sluggish growth was reflected as both a cause and consequence on financial system soundness indicators. CBN staff reports indicate that Non-Performing Loans (NPLs) ratio which had earlier declined in June 2018 rose marginally in August 2018, amidst moderated return on assets and equity. Whilst Bank Staff offered further insights into the rise in NPLs due to the implementation of the new IFRS 9 provisions, which requires significant increases in expected loss provisions, there is clearly a need to further incentivize the banking system to support the required boost in economic activities.

The rise in NPLs partly reflected in the observed decline in new credit - a concern the CBN has continuously highlighted in view of its implications for real sector growth. Hence, as part of the CBN's efforts to expand credit to critical real sectors, at the July 2018 MPC meetings, the Committee announced a dynamic Cash Reserve Ratio regime and encouraged the issuance of Commercial Papers by large corporates. Guidelines for these policies have been issued and there is optimism that the initiatives will yield the desired results. On the whole, the banking system remains resilient and the

CBN is committed to providing the needed impetus to drive the sector's contribution to overall economic performance.

Inflationary headwinds in sight, but still far in distance

In earlier statements, I cautioned about rising price levels due to a number of inflationary headwinds and the eventual dissipation of the base effect momentum. These appear to have surfaced with headline inflation increasing, for the first time in eighteen months, to 11.23 per cent in August from 11.14 per cent in July. Food inflation rose to 13.16 per cent from 12.85 per cent over the same period resulting from increases in prices of food due to seasonality from the Sallah celebrations, distribution constraints, farmers/herdsmen conflicts in food producing areas and reduced supply from off-season effect.

However, the early signs of rising headline inflation may be isolated and largely driven by cost-push factors; especially as core inflation continued to decline, reducing to 10.02 per cent in August 2018 from 10.18 per cent in the previous month on account of improved supply of petroleum products and stable energy prices. Besides, the much anticipated expansionary fiscal activities have not manifested, given muted fiscal budget spending thus far, whilst there appears to be no recognizable inflationary effect from election spending despite two concluded state elections amidst preparations for the general elections which is also well underway.

In the short term, these considerations justify some optimism where inflationary headwinds and the inflation forecast are concerned, two key factors in determining the monetary policy response. However, it is prudent to remain vigilant regarding price developments in the medium term, particularly as budget implementation picks up steam and party primaries are concluded amidst the increasing clamour for a rise in the minimum wage.

Crude oil prices look set to remain strong for the rest of 2018 in view of ongoing supply concerns over US sanctions on Iran that come into force November this year. Current price of Bonny Light crude at \$80p/b (21st September, 2018) remains higher than the 2018 budget bench mark (\$51p/b) which provides an opportunity for re-building fiscal and external reserve buffers. This gives the CBN the leverage to manage the exchange rate and respond to capital flow reversals which may be sustained over the medium term on account of normalization of interest rates in the US and short-term political and economic uncertainties.

Although high and rising crude oil prices are good for the economy, the attendant increase in the price of imported refined crude oil may heighten subsidy payments by the federal government if petrol pump prices are to remain within regulated levels. This underscores the importance of the ongoing efforts of the federal government at revenue and economic diversification in

view of the vulnerability associated with heavy reliance on crude oil export proceeds for economic management.

More importantly, intensified implementation of the Economic Recovery and Growth Plan which recognizes the all-important need to diversify the productive and export base of the economy is critical to support a more robust and resilient economic recovery.

Decision

Based on the foregoing developments, the balance of risks to overall economic outlook in Nigeria, particularly with respect to growth and inflation has shifted further to the downside in the short term. In particular, i) Nigeria's economic rebound observed since Q2 2017 remains fragile and could be derailed in the near-term if imminent shocks are misjudged; ii) Inflation which had maintained a downward trajectory is reversing and may persist in the near term – thus remaining above the acceptable band with adverse implications; iii) the relative stability in the exchange rate is gratifying, however, observed decline in the external reserves position raises concerns in view of policy directions in the US; iv) the expected budgetary injections and election spending could expand aggregate demand beyond acceptable levels thus intensifying the inflationary trend.

In this circumstance, further tightening of the monetary policy stance, which is ideal to curb rising inflationary trends and capital flow reversals may further

exacerbate the already slow growth momentum. Thus, juxtaposing the objective of price stability with the benefits of sustained growth, there is a compelling case for keeping policy rates at current levels to support gradual improvements in output growth as the direction of liquidity injections become clearer.

Therefore, I vote to retain the current monetary policy stance, by keeping MPR at 14%; Cash Reserve Ratio at 22.5%; Liquidity Ratio at 30% and Asymmetric corridor at +200 and -500 basis points around the MPR.

4. ASOGWA, ROBERT CHIKWENDU

Background:

The September 2018 MPC meeting took place against the backdrop of changing and unexpected developments in the domestic economic projections especially the 2018 quarter 2 GDP growth and the recent year-on-year Inflation figures for August 2018. These worrisome trends accompanied by the yet unabated uncertainties at the domestic front such as the expected impact of the 2018 budget and other pre-election spending as well as the increasing turbulence in the stock market continue to limit policy choices. At the international levels, key downside risks relating to the ongoing trade tensions between major economies and the gradual pace and pattern of monetary policy normalization process in some advanced economies also continue to create considerable uncertainty in global financial market conditions. As such, choice of policy rate at this MPC meeting will rest on two key approaches; either to strongly respond to these emerging domestic concerns and scenarios even though deemed temporary or to maintain the existing status quo so as to enable for more time to monitor developments in the near-term.

International Economic Outlook:

On the international economic outlook, the monetary policy normalization in some advanced economies which appears to be proceeding in a well communicated manner thus generating financial market uncertainties and

turbulence remains a growing policy challenge for developing and emerging economies. In September, the US Federal Reserve raised its key interest rate for the third time in 2018 by 25 basis points to a range of 2-2.25% and has signalled one more hike in 2018, most likely in December. While the Bank of England retained policy rates in September after it was raised to 0.75 in August which is similar to the ECB and several other economies the rise on US Treasury yields alone continue to trigger adjustments in global financial market conditions. For instance, the US Dollar has continued to strengthen over the past six months, while the Euro, Yen and British Pounds remain almost unchanged. In contrast, most emerging and developing market currencies have depreciated sharply. CBN staff report for September 2018, show significant depreciation in the currencies of South Africa, Brazil, Argentina, Russia, India while there are moderate depreciations in the currencies of Ghana, Egypt, Canada, Columbia, UK, the Euro Area and China. Similarly, the equity indices for most of these economies declined but modestly. CBN staff report also show stock market indices declined in Nigeria, Kenya, Egypt, Ghana, UK, Columbia and China between June and August 2018.

Most of these negative trend (in currencies and equity index) reflects largely the weakening capital flows and a general uptick in non-resident sales of portfolio debt and equity securities in many emerging and developing economies and the corresponding higher yields in the US. Moreover, the rising trade tensions which has seen the US impose tariffs on a variety of imports thereby prompting

retaliatory measures from trading partners have also clouded the earlier projected positive macroeconomic outlook for so many countries.

In terms of recent global output, CBN Staff data show that the dip in output in the first quarter of 2018 for several developed economies was indeed only temporary, with momentum recovering in the second quarter of 2018 despite the forecasts which have lately been revised downwards. There were improvements in second quarter growth in the US, Germany, UK, Japan, China and India but marginal slowdown in South Africa, Ghana and Nigeria compared to the first quarter of 2018. The positive growth outlook in these major economies is quite encouraging inspite of the considerable uncertainty in the global trade area and the rising geopolitical tensions. Eventhough South Africa had a slip in the negative growth territory in the first quarter of 2018, there are somewhat huge expectations of positive recovery over the remainder of 2018 and 2019.

Similar to the global output data, the updated Inflation data based on the CBN Staff Report show mixed trends in the near term outlook for several economies. While there were mild increases in the August inflation data for the UK, Japan, China, Ghana, Egypt and Russia, there were decreases in the August inflation rates for the US, the Euro Area, India, South Africa and Brazil. These marginal changes in the inflation rates did not however alter the policy rates decisions in most of the countries either in August or September. Interestingly, such countries

as India, Indonesia, and the US where the policy rates were raised in August/September, their inflation rates had dropped marginally in the preceding months before the hike.

Domestic Economic Outlook:

On the domestic front, the economic outlook especially the August Inflation Report and the 2018 second quarter GDP changed on the negative side against projections relative to the position at the last MPC meeting in July. The factors shaping the recent outcomes do not however warrant panicky policy adjustments. While the year-on-year headline Inflation increased marginally to 11.23% in August from 11.14% in July, the core inflation however declined from 10.20% in July to 10.02% in August. The food inflation increased from 12.85% in July to 13.16% in August. While the marginal uptick in headline inflation (year-on-year) raises some concern, its cost push nature arising mainly from scarcity of farm produce due to temporary underlying factors provides optimism for reversal in the coming months especially if potential threats of huge elections spending is minimised in the remaining months of 2018.

The dip in 2018 quarter 2 output to 1.50 % from the 1st quarter level of 1.95% which although is considered to be temporary, however raises considerable concern especially with the slowing performance of the Industrial sector (manufacturing and mining). The manufacturing index in the second quarter of 2018 remained at about 175.9 points which is a decrease of 3.5% when

compared to the levels of the first quarter of 2018. The manufacturing PMI in September also stood at 56.2 index points which although indicated expansion in the sector for the 18th consecutive months, but grew at a slower rate when compared to the month of August. Similarly, the PMI for the non-manufacturing sector was 56.5 points in September also an indication of expansion for the 17th consecutive month but also at a slower rate when compared to August level. Given the expected temporary nature of the swings in these two key domestic variables; inflation and GDP, an appropriate policy stance at this time would be to stay on the side of caution while monitoring developments in the future.

Mixed Performance of the domestic financial soundness and external sector indicators:

Besides the domestic headline inflation and the Q2 GDP data which are deemed temporary to warrant any strong policy changes at this time, the emerging signal of mixed performance in both the financial soundness and external sector indicators appear also to be clouding the positive outlook which is expected in the coming months.

Two financial soundness indicators which evoke new concerns based on the recent CBN staff report are the Non-Performing Loans (NPLs) ratio and the Capital Adequacy Ratio (CAR). The NPL ratio which is a measure of the industry's asset quality increased from 12.45% in June to 14.70% in August, while the Capital Adequacy Ratio (CAR) declined from 12.0% in June to 10.79% in

August. This trend is worrisome given the expectation that loan losses by the banking industry should be declining at this time, with the exit from recession. Other financial soundness indicators such as total assets and total credit growth however recorded some modest improvements. Whilst the total banking industry assets grew from 33.7 trillion Naira in July to 34.05 trillion Naira in August, the total Industry credit moved slightly from 15.53 trillion Naira to 15.76 trillion Naira. Given that the banking sector as a whole has continued to be liquid, fairly profitable and solvent despite the recent asset quality deterioration, cautious monetary policy options will be ideal at this time to avoid provoking any further distress in the banking sector.

Similarly, the mixed performance in the external reserves/foreign capital inflow and the exchange rate which to some extent reflect the monetary policy normalization process in some advanced economies would require more policy patience than a hasty approach to policy changes. For instance, the partial but consistent decline in the external reserves since July 2018 inspite of the increase in the crude oil revenue receipts is linked to the decline in foreign capital inflows from July and the increased capital outflows as from August. While the sudden appreciation of the dollar against major currencies has not affected the relative stability in the Nigerian foreign exchange market largely because of the sustained interventions by the Central Bank, managing the uncertainties very cautiously remains critical. The prospects of tighter monetary policy at this time may also expose the country to higher borrowing costs and heavy debt

servicing schedule given the growing foreign debt component in the national debt management strategy.

Decision:

It is critical for monetary policy to remain supportive of growth amid the emerging inflationary pressures which look temporary and the heightened uncertainty in the capital inflow environments arising from increasing domestic political risk and the monetary normalization process in advanced economies. A cautionary approach which I am disposed to at this Monetary Policy Committee meeting will require keeping policy parameters as they are while monitoring developments in the near-term. I will thus vote to:

- Retain the MPR at 14.0 %
- Retain the CRR at 22.5%
- Retain the Asymmetric Corridor at +200/-500 basis points
- Retain the Liquidity Ratio at 30.0%.

5. BALAMI, DAHIRU HASSAN

Financial Soundness of the Banking Sector

In the Nigerian banking sector, the trend of financial soundness indicators show that Capital Adequacy Ratio (CAR) fell from 12.08% to 10.79% in August 2018. This was below the prudential requirement of 10% and 15% for banks with national authorisation and international authorisation, respectively. The Nigerian banking sector registered a low CAR when compared with her pairs like Turkey, South Africa and Malaysia. On the other hand, the asset based soundness indicators showed that the Non-Performing Loans (NPLs) ratio had risen from 12.45% in June 2018 to a high of 14.70% higher than the maximum 5% prudential requirement, compared to Turkey, South Africa and Malaysia with 2.8%, 3.1%, and 1.6%, respectively.

The high NPL ratio may not be unconnected with poor credit administration of the Deposit Money Banks (DMBs) as well as high interest rate in the economy. Again macroeconomic challenges affecting the obligor's cash flow particularly in the oil sector where credit concentration is high may also have been responsible for the high NPLs ratio. The good news is that about 82% loan loss provision has been made in the books as at August 2018. The liquidity ratio on the other hand has marginally increased from 46.09% in June to a high of 46.68% in August as against a minimum of 30% as required by the prudential requirement.

The income and expense based result shows that both return on equity and return on asset decelerated from 22.22% to 2.15% in June to 20.84% and 1.97% in August 2018, respectively. The ratio of interest margin to total operating income decreased from 70.15% in June to 69.01% August 2018, while the ratio of total operating cost to total operating income rose from 70.90% in June to 72.75% in August 2018.

The banking industry financial soundness indicators shows a more robust banking industry if the four outlier banks are removed. The capital adequacy ratio of 17.88% is higher than the prudential requirement. However NPLs at 8.17% is still higher than the maximum of 5% required. The liquidity ratio improved from 48.58% to a high of 49.44% in August 2018 but still lower than that of Malaysia (152.8%) and Turkey (71.5%), although higher than that of South Africa (31.9%). The CBN intervention and regulatory policies should be intensified to address the problems of the four outlier banks. It should be noted that the average CAR for banks with international authorisation at end-August 2018 stood at 11.68% while banks with national authorisation is 8.36% both fall below the prudential requirement. This was due to increase in risk weighted assets as well as payment of interim dividend.

Credit Portfolio Distribution and NPLs

Sectoral credit allocation showed that the share of the five major sectors were; oil and gas (30.81%), manufacturing (12.95%), Government (9.58%), general

commerce (7.36%), and general (6.34%). Credit availability and good administration is supposed to be a good driver of growth in the economy. However, evidence-based analysis shows that the sector that enjoys the most credit is not an important employment generation sector of the economy because oil and gas is capital intensive. Ordinarily, the areas which more credit should flow to are sectors such as agriculture, manufacturing, transport and storage, service, mining and quarrying as well as real estate activities. It should be noted that eight sectors recorded increases in credit between August 2017 and August 2018, while 18 sectors recorded decreases in credit. The critical question to ask is what credit appetite do banks have for giving more credit to the gas and oil sector?

In Nigeria, the sectors with highest credit concentration are also sectors with high impact on the NPLs. For example, between August 2017 and August 2018, the Oil and Gas (44.67%), General Commerce (8.31%), General (8.85%), Power and Energy (6.95%), and Manufacturing (6.13%) and so on. As highlighted in July statement, there is need for CBN to employ the use of unconventional and innovative monetary policy instrument such as discriminated CRR and introduction of corporate bonds to encourage the advancement of credit to the real sectors of the economy. The low CAR and rising level of NPLs increases caution by Nigerian banks in lending to the real sector which is supposed to be the prime driver of the economy.

Challenges in the Nigerian Economy and CBN's Mandate

The Nigerian economy has a number of challenges. At the global level, the normalisation of US economy and interest rate is triggering capital flows out of Nigeria leading to a drop in the foreign reserve. There is also threat on crude oil price from US - China trade war. At the domestic level, the challenges include issues related to growth, employment, inflation, issue related to accretion to reserve, debt service, and downturn in the capital market. If there are mandates that affects the CBN, then multiples of unconventional polices should be adopted. It should be noted that through credit creation and innovative ideas, such as the introduction of dynamic CRR and corporate bonds to support credit, the Bank can play a supportive role while also monitoring the administration of the policies to ensure their effectiveness. The credibility of the CBN is of paramount importance and therefore the Bank must remain proactive. The adoption of heterodox policies and methods should be adopted.

Policy Choice

In my view, specific targets should have specific instruments, although certain policy instrument can conflict with others. For example policy put in place to promote growth may be inflationary. The two policy options for current challenges will either be tightening or to hold. Given the five challenges highlighted earlier, tightening should be the more appropriate policy to be taken. The challenges of growth will be tackled through the policy recommended at last MPC as well as the fiscal side. Tightening would assist in

taming inflation. It will assist in attracting more inflow both in terms of FDI and FPIs into the economy as well as discouraging outflow which is important for the economy. This would assist in stabilizing the exchange rate as well as the external reserves. In view of the above, I vote to tighten. I, therefore, recommend the following:

i. Raise the MPR by 25 basis point to be 14.25percent;

ii. Retain the CRR at the 22.5 percent;

iii. Retain the Liquidity Ratio at 30.00 percent; and

iv. Retain the Asymmetric Corridor at +200 and -500 basis points around the MPR.

6. ISA-DUTSE, MAHMOUD

A. EXTERNAL ECONOMIC CONDITIONS

Global growth indices are being threatened by geo-political tensions and a renewed wave of trade protectionist policies since the beginning of 2018. Against this backdrop, global growth forecast for 2018 is put at 3.9 per cent based on expected modest growth outcomes in some advanced economies as well as significant recovery in emerging and developing economies.

The normalization of policy rates in some advanced economies, especially in the US, continued to exert negative effects on capital market performance and portfolio investment flows especially in developing countries. The strengthening of the US dollar has contributed significantly to currency depreciation in many countries. The world economy is, however, witnessing upward movements in the price of oil which is expected to be sustained given the recent abrogation of the US-Iranian nuclear agreement coupled with the impending formalization of harsh sanctions against Iran. This development should raise fiscal buffers and promote a relatively stable exchange rate regime in Nigeria and other major oil exporting nations.

B. DOMESTIC ECONOMIC CONDITIONS

Domestic output performance remains subdued as real GDP grew by 1.50 per cent in the second quarter of 2018 compared with 1.95 per cent in the first

quarter. It is noteworthy that while the growth drivers exclude the manufacturing and oil sectors, which contracted by 0.29 per cent and 0.36 per cent respectively in Q2 2018, the growth propellers (services, construction and agricultural sectors) in the review period are weak. The growth in the economy is therefore quite fragile. Consequently, it is important that in the choice of policy options, this reality should be taken into consideration.

Headline inflation increased marginally from 11.15 per cent in July 2018 to 11.23 per cent in August 2018. A further breakdown shows that, while the food component of inflation rose from 12.85 to 13.16 per cent between July and August 2018, core inflation decreased from 10.20 to 10.18 per cent in the same period. The slight uptick in the price level could be attributed to structural problems, massive flooding that destroyed farmlands, herdsmen/farmers clashes, among others. The expected rise in spending towards 2019 general elections and review of wages/salaries could further cause inflation to rise in the near to medium-term. The fact that the growth rates of monetary aggregates were largely below the benchmarks is a reflection of the effects of sustained non-accommodative monetary policy stance.

Moreover, the credit developments in the economy indicate that credit to the private sector grew by a meager 0.81 per cent as compared to the provisional benchmark of 5.64 per cent in August 2018. In addition, the retail lending rates

of deposit money banks remain high and interest spreads widened during the review period. This has serious implications for small and medium enterprises which constitute veritable engines of growth.

The foreign exchange market has been characterized by a fairly stable naira-dollar exchange rate due to the sustained supply of foreign exchange from both official and autonomous sources against the backdrop of rising oil price. Consequently, the normalization of policy rates in the US and other advanced economies may not have an over-bearing impact on the market. Also of note is the investors' and exporters' (I & E) window in the foreign exchange market that has boosted liquidity and contributed to the accretion in foreign reserves.

The level of non-performing loans (NPL) is still high but the expected improvements in key macroeconomic fundamentals following improved oil prices would continue to exert a moderating influence. Banks patronized the standing deposit facility window more than the standing lending facility which is an indication that the system was awash with liquidity in the review period. This liquidity overhang could be addressed through Open Market Operations and other tools available to the CBN without resort to a hike in MPR.

C. VOTING DECISION

The implications from global and domestic economic conditions, call for tightening of monetary policy to reverse portfolio outflows, improve capital market performance and rein-in inflationary pressures. However, increasing the policy rate at this time is not advisable in view of the need to prop up weak domestic growth and avoid slipping back into recession. Increasing the policy rate will also worsen the heavy burden of government debt service, reduce available fiscal space and constrain public infrastructure investment and aggregate demand, further compounding the growth dilemma. The rising trend in the international price of crude oil is anticipated to continue well into 2019 and this should facilitate accretion in foreign reserves and thus reduce the need to employ the policy rate as a stabilizing tool. Against this background, I voted as follows:

- MPR should remain at 14% per annum;
- The asymmetric corridor at +200/-500 basis points should be maintained;
- Liquidity ratio to remain at 30% per annum;
- Dynamic differentiated CRR to encourage banks to lend to the real sector.

7. NNANNA, OKWU JOSEPH

Growth was lower than projected, reflecting weak domestic demand on account of weak purchasing power and lagged implementation of the capital budget. Available data showed that Real GDP moderated to 1.50 per cent in the second quarter relative to 1.95 per cent in the first quarter of 2018 (NBS, 2018). The change was attributed to the 2.05 per cent growth in the non-oil sector. Specifically, construction, services and agriculture sectors grew by 7.66, 4.19 and 1.19 per cent, respectively. The oil sector fell by 3.95 per cent during the period, in contrast to a growth rate of 14.77 per cent in the first quarter. Key PMI indicators showed that manufacturing and non-manufacturing stood at 56.2 and 56.5 index points in September, respectively, indicating a gradual momentum in the sector. At the backdrop of the subdued growth, the high rate of unemployment has remained protracted.

Reversal of the disinflation process reflected base-effect normalisation, incipient inflationary pressures due to cost-push effects associated with insecurity and flooding in farming areas. Headline inflation rose in August to 11.23 per cent compared with 11.14 per cent in the previous month. Similarly, food inflation rose to 13.16 per cent at end-August 2018, from 12.85 per cent in the preceding month. However, core inflation decelerated further to 10.02 per cent relative to 10.18 per cent recorded at end-July 2018. On month-on-month basis, headline and core inflation fell, while food inflation, increased marginally in the month of

August, due, mainly, to increase in the price of staple foods. The anticipated deficit financing of 2018 FGN budget and 2019 election spending, including review of salaries and wages in 2018 constitute upside risks to inflation in the near-term.

Despite the growth in the monetary aggregates, it was not sufficient to conclude on inflationary pressure concerns. Broad money (M2) grew by 2.98 per cent at end-August 2018, and 4.47 per cent on annualized basis. Money market rates reflected liquidity conditions in the banking system, indicating the effects of CBN liquidity management strategy and FAAC distributions to the 3-tiers of governments. The monthly average inter-bank call and OBB rates for June 2018 were 16.32 per cent and 12.26 per cent, respectively.

Risks to financial stability are being intensified by simmering fragility in the banking industry as intermediation remains weak with elevated ratio of non-performing loans (NPLs). Claims on the core private sector grew marginally by 0.43 per cent, annualised to 0.65 per cent at end-August 2018. Net claims on the Federal Government fell by 34.68 per cent in August 2018, representing a decline of 52.01 per cent on annualized basis. While the recovery in oil price offers hope to the banking industry, lending and asset quality in the near term remain sticky. The combination of rising oil price, pending settlement of Federal Government's contractual obligations to the private sector and accelerated

pace of economic growth remain tailwinds to subdue NPLs, improve asset quality and sustain financial system stability in the long-run.

Protracted monetary policy normalisation in some advanced economies has continued to weigh in negatively on the financial markets, resulting in capital reversals. Consequently, as at September 21, the All-Share Index (ASI) fell by 14.99 per cent from 38,278.55 at end-June 2018. Similarly, Market Capitalization (MC) fell by 14.33 per cent to N11.88 trillion at end-June 2018. A reversal of the bearish trend is, however, expected in the medium term, to depend on continued improvements in key macroeconomic fundamentals.

I hold the same view that expectation of expansionary fiscal policy in the near-term remains a concern to macroeconomic stability. I therefore advocate for greater efficiency in government expenditure: better focused and targeted on capex and other infrastructural spending rather than on recurrent and overheads.

The retail spot and forward foreign exchange markets have remained the game changer in achieving exchange rate stability. Consistent with the improved FX liquidity and a healthy external reserve buffers, the foreign exchange market will continue to support a healthy balance of payments position. The current account surplus observed in recent times will be sustained on account of recovery in oil prices and high export revenues. The I&E window exchange rate, which recorded a weighted average of ~~N~~360.86/US\$ at end-June 2018, was

~~₦~~362.38/US\$ in August 2018. The naira exchange rate at the retail SMIS window and the BDC segment remained at an average of ~~₦~~330.00/US\$ and ~~₦~~359.0/US\$, respectively. These rates are consistently aligned with the real effective and relative purchasing power parity rates of the naira.

Against the backdrop of continued stability in the key macroeconomic indicators and concerns about emerging fiscal surprises, I vote to raise the CRR by 150 basis points and to hold the other policy metrics at current levels. Recent empirical study in Nigeria has shown that raising the cash reserve ratio (CRR), is more potent than raising the Monetary Policy Rate (MPR), in curbing time inconsistent growth in monetary aggregates, arising from fiscal surprises.

8. OBADAN, MIKE IDIAH

The implications of developments in the global economy, especially in the areas of global output, trade and trade policies, commodity prices, financial market developments, regional integration policies and issues, among others, have continued to be important for the Nigerian economy. Of specific importance are the following:

- The escalating trade war between the United States on the one hand and China, Europe, Mexico and Canada on the other. Escalating the US-China tariff/trade war is the most recent imposition by the US of 25 percent tariffs on US\$ 200.0 billion worth of Chinese goods and announced plans to issue additional US\$ 267 billion, and the retaliation by China with a tariff hike of US\$ 60.0 billion of US goods effective September, 2018. The new tariffs have brought 'new uncertainties' to China-US negotiations as China has cancelled planned trade talks. Europe, Mexico and Canada have also continued to respond appropriately to US trade policy measures, using retaliatory trade tariffs against the U.S. The various trade policies may slow down investments and trade flows globally.
- The politico-economic conflict between the US and Iran has continued as the US has widened sanctions on Iran to include purchase, subscription or facilitation of issuance of Iranian debt, auto motive sector, etc. This implies

that any persons or firms dealing with Iran, after November 4, 2018, may face sanctions.

- The uncertainties surrounding the BREXIT have not abated. The possibility of a 'no deal' BREXIT looms large and this seemingly chaotic option could adversely affect the British economy with spill-over effects.
- Manifestations of the worrisome implications of Chinese loans to sovereign nations. Defaults on repayments of such loans have resulted in Chinese seizure and control of key national assets in African countries and others outside Africa. While such loans have aimed at developing infrastructure in the countries concerned, the threat of China's recolonization of the debtor countries and their loss of sovereignty can be avoided if the loan beneficiary countries strive to make loan repayments as and when due and the loans are deployed to productive projects. Importantly, before loan agreements are entered into, the conditions must be thoroughly scrutinized and understood.
- Monetary policy normalization in the US and parts of Europe and implications for capital flows to the emerging market economies including Nigeria. There has been reduced capital inflows to emerging markets, particularly those with weaker fundamentals or higher potential risks,

Nigeria included, while inflows to the normalizing countries, for example, US, has increased. Capital flow reversals have threatened exchange rate and price stability.

- Although global inflation is still subdued, pressures are rebuilding such that the inflation rate is projected to rise to 3.2 percent in 2018 from 3.1 percent in 2017 considering rising energy prices, and moderate currency depreciations in some emerging market and developing countries.

Global growth is good for trade flows and improved welfare. But the momentum of global economic activity is mixed while recovery is moderate. Global growth in 2018 is projected to reach 3.9 per cent compared with 3.7 per cent in 2017. The improved growth is hinged on the expectations of continued improvements in some advanced economies and sharp recovery in a number of emerging markets and developing economies. However, in the advanced economies, growth is projected, on average, to remain flat at 2.4 per cent, the same level it attained in 2017 largely due to moderations in the Euro area and Japan.

Growth in the emerging market and developing economies is projected at 4.9 per cent, up from 4.7 per cent in 2017. China and India are currently Nigeria's largest trading partners. China's growth is expected to slow to 6.6 per cent in 2018 compared with 6.9 per cent in 2017 as it continues to pursue its

rebalancing programme which de-emphasizes exports in favor of domestic consumption. India is, however, expected to grow by 7.3 per cent in 2018, a significant improvement, compared with 6.7 per cent recorded in 2017.

The expected improvement in global output in 2018 is expected on the back of improved oil and other commodity prices as well as major trade agreements between the Euro area, Japan and Canada. However, the 2018 global growth forecast could be mitigated by factors such as the renewed wave of trade protectionist policies in the U.S; uncertainties surrounding the BREXIT negotiations in Europe, the continued pace of monetary policy normalization by the US Federal Reserve Bank, and sizeable slack in many advanced economies.

Nigeria is expected to grow at 2.1 percent in 2018 from 0.8 per cent in 2017, largely owing to higher oil production due to improvement in security in the Niger Delta region, rising oil prices and expected increase in public spending. This is in spite of a slowdown to 1.50 per cent at the end of the second quarter of 2018 from 1.95 per cent at the end of the first quarter.

Developments in the world oil market are of particular significance to Nigeria. Although oil accounts for about 10 percent of the nation's gross domestic product (GDP), it remains the driver of economic activities in the country, accounting for over 95 percent of foreign exchange earnings and about 80 percent of government revenue. Consequently, the current regime of high crude oil prices in the world market is good news to the country. The price of

Bonny light on September 14, 2018, stood at US\$ 79.03 per barrel compared with US\$ 78.83 on July 11, 2018 and the opening price of US\$ 67.02 per barrel on January 2, 2018. The improvement in the price of Bonny Light largely reflected the continued impact of the Organization of Petroleum Exporting Countries (OPEC) production freeze as well as likely U.S. sanctions on Iranian oil scheduled to commence from November 04, 2018.

With the recent cancellation of the U.S–Iranian nuclear deal, oil prices are expected to sustain the current upward trajectory well into 2019; signals from the futures market indicate that the price may cross the US\$100 mark by July 2019. While this will enhance the Central Bank's ability to effectively manage the exchange rate with the continued accretion of external reserves, the lesson for Nigeria is the strong need to deliberately build fiscal buffers through saving of part of oil revenue. This is the more pertinent considering the increasing investment in shale oil production coupled with increasing shale oil production by the US which remains a significant threat to future oil price increases.

In the Nigerian economy, significant challenges have remained. Although crude oil prices have improved significantly, oil production has yet to reach the expected target. The budgeted oil production target of 2.3 mbpd has yet to be met as average crude oil production and exports rose to 1.85 mbpd and 1.40 mbpd, respectively, in August 2018 from 1.82 mbpd and 1.37 mbpd in July 2018

owing largely to repairs and re-opening of major oil installations in the Niger Delta region. More efforts are required to shore up oil production and export.

The normalization of monetary policy in some advanced countries, particularly, the US, has contributed to capital flows reversal in Nigeria with significant pressure on external reserves which has witnessed notable reductions in recent months. External reserves stood at US\$ 43.91 billion on 20 September, 2018 compared with US\$ 47.43 billion at end-April, 2018. This development is a threat to the gains in exchange rate stability and inflation deceleration witnessed for several months.

In the financial sector, non-performing loans have remained a threat to the stability of the financial system and the macro-economy. The oil and gas sector accounts for the highest proportion (44.67 percent) of non-performing loans. This was understandable during the recession and oil market crash when the fortunes of the oil sector dwindled. But under the current regime of high oil prices and improved oil production, the oil and gas sector obligors should be able to service their loans and consequently, reduce the stress of the financial sector.

Nigeria's real GDP grew by 1.50 per cent in the Q2 2018, a decline of 0.45 percentage point compared with 1.95 per cent in the Q1 2018. It however, recorded an increase of 0.79 percentage point above the 0.72 per cent recorded in Q2 2017. The major drivers of the growth in Q2 2018 were mainly

from the services, construction and agricultural sectors which contributed 1.56, 0.33 and 0.27 per cent, respectively to total. Crude oil and natural gas contracted by 3.95 percent in the second quarter of 2018 compared to an expansion in the first quarter. Growth of the economy thus remains a challenge.

Another incipient challenge is the reversal of the trend of deceleration of inflation witnessed for 17 months. Inflationary pressure in the economy resurfaced, as headline inflation (year-on-year) increased marginally to 11.23 per cent in August 2018 from 11.14 per cent in July 2018. Food inflation also increased to 13.16 per cent in August from 12.85 per cent in July 2018. Core inflation, however, decreased to 10.18 from 10.20 per cent. Thus, two measures of inflation (headline and food) marginally increased in August 2018 thereby ending the downward trend in domestic prices, which commenced in January 2017. The slight upward trend in the headline inflation was largely driven by food component (processed and farm produce). The upward turnaround of inflation may have to do with the base effects which have ended and cost push factors rather than monetary. This is in view of the fact that broad money and other monetary aggregates underperformed (in relation to targets) during the period. However, the behavior of M3 (M2 - broad money supply plus OMO bills discounted by DMBs) elicits concern as it grew by 7.8 percent in August 2018 compared to 9.17 percent in July, annualized to 11.79 percent; this is above the M2 provisional growth benchmark of 10.48 percent for the year.

One thing though is that it is not clear as to the sustainability of the upward trend in inflation, hence the situation would need to be watched for sometime. This is the more so as some of the identified risks to inflation have not yet started to manifest and it is not clear what their impact would be. The risks include the following: sustained implementation of the capital budget; electioneering expenditure towards the 2019 elections; possible implementation of the proposed minimum wage; effects on food supply of continuous clashes between farmers and herdsmen; effects of flooding on agricultural production and distribution in various states in the country.

Opinion

My opinion is predicated on the above considerations and, in particular, the following:

- That the extant indicators portray an already sufficiently tight monetary policy stance and there is a limit on what conventional monetary policy can achieve under the present circumstances
- Growth is fragile and there are concerns that the economy could slip back into recession.
- Most of the possible headwinds to inflation have yet to materialize and there is no evidence that the upturn in inflation will be sustained.
- At this point in time, raising the MPR may result in more damages to the economy than benefits.

Therefore, there is no need to take precipitate monetary policy actions that may achieve some ends but inflict serious damages in other areas, particularly the growth and employment objectives. This suggests that generally the current monetary policy stance should be retained with a careful watch on monetary, price, exchange rate and other macroeconomic developments in the next two months. The expected benefits of this option outweigh the costs.

However, against the backdrop of the extant policy of lower cash reserve requirement (CRR) for banks that are willing to lend to agriculture and manufacturing at single digit interest rates, the CRR for the other banks can be reviewed upwards in order to simultaneously address the issue of growth and employment and concerns about inflationary expectations. This entails using a carrot and stick approach to realise the objective of increased lending to agriculture and manufacturing by the Deposit Money Banks.

Supportive Measures

Meanwhile, the following actions could be considered in support of the monetary and price stability goals.

- CBN to sustain the institution specific prompt corrective actions to address cases of banking sector weaknesses.
- Investigate why the oil and gas sector has not improved in its loan servicing obligations to the banking sector as well as the challenges of redeeming collaterals used to secure loans.

- CBN to continue the monetary policy actions that aid cost reduction by real sector operators with positive effect on inflation reduction. This includes financing support at single digit interest rates.
- Support to relevant agencies aimed at addressing security challenges in the agricultural ones.
- Need to restrict the monetary policy instruments aimed at managing liquidity (CBN bills) from being traded in the open market, as so doing has implications for liquidity build up and inflation. M3 growth is founded on access to the instruments by non-bank public including foreign investors. .
- As oil earnings are still very crucial for external reserves build-up, the government must do the needful to douse any incipient tensions in the Niger Delta region, boost security of oil assets and installations and, hence boost oil production and export.
- CBN could tinker with rates on government securities as incentive for capital inflows.
- Implement prudential capital controls, for example, those that can change the duration and structure of inflows to relatively long-term;
- Efforts geared towards developing and improving confidence in the financial system can reduce the volatility of portfolio and banking flows.
- Explore the possibility of further supporting monetary policy with trade policy as in the case of the 41 import items.

9. SANUSI, ALIYU RAFINDADI

1. Decision:

I have voted to further tighten the monetary policy stance in today's meeting for a number of reasons, key amongst which is the crystallisation of the threat to the disinflationary process and capital flows in the month of August, both of which I have anticipated. Secondly, further tightening is required to sustain the exchange rate stability which, in itself, is a crucial requirement for a sustainable disinflation. In this meeting, I voted to raise the MPR by 25 basis points, a smaller magnitude relative to the 50 basis points I voted in the last meeting, because of the fragility of the output recovery as observed in the realised output growth in the 2nd quarter. Output growth is, however, forecasted to remain positive in the 3rd and 4th quarter of the year. Thirdly, although the rising non-performing loans (NPLs) are a significant constraint in my consideration to voting for a raise, the proactive regulatory intervention by the Bank to recapitalise the defunct Skye Bank has allayed my fret for the banking system's stability amidst of tighter monetary conditions. Finally, my interpretation of the available data, staff forecasts and estimates, strengthens my belief that an optimal forward-looking monetary policy requires further tightening now.

2. Background and Justification

2.1. Global Economic Developments

The global output growth, the escalating trade war between US and China and US sanctions on Iran have important implications for Nigeria's trade, while the sustained monetary policy normalisation in the US continues to threaten capital inflows, reserves, asset prices, exchange rate stability and, consequently, domestic inflation in the medium-term.

The US has imposed tariffs on another set of Chinese goods worth \$200 billion by the US effective from 24th September 2018 at an initial rate of 10 per cent to be increased to 25 per cent in January 2019. China has announced retaliatory tariff of US\$ 60 billion worth of US goods on the 18th September 2018 and has announced, on the 22nd September 2018, the cancellation of planned trade talks ahead of the impending implementation of the US tariffs on US\$ 200 billion worth of Chinese goods. By the 24th September 2018, the third round of tariffs would be implemented, bringing the total amount to US\$ 250 billion worth of Chinese products.

The escalation of the trade war between the US and China continues to threaten global output in the medium to longer term, thus threatening the global demand for oil. However, the US has also sanctioned Iran and is threatening to sanction any firms or persons dealing with Iran after 4th November

2018. In addition to raising price hike in the global oil market, this implies that the demand for Nigeria's crude by India (the second largest importer of Iran's oil after China) may rise in the near term. *These two global developments are likely to raise Nigeria's reserve accretion, especially if Nigeria can sustain the steady increase in crude production observed since June 2018.*

As the US Federal Reserve continues with its monetary policy normalisation, a further rate hike is expected, and capital flow reversals from emerging markets are likely to continue with attendant implications for the stability of their asset prices, reserves, exchange rate stability and price level. This implies that exchange rate and price stability in Nigeria requires a monetary policy stance that raises the yields on Naira-denominated assets are needed to reduce the adverse consequences of the rising US yields.

2.2. Domestic Economic Developments

Domestic economic conditions and outlook suggest that in the medium-term, output recovery would remain positive but fragile, and the uptick in inflation may put a halt to the disinflationary process.

Domestic output grew at a lower rate of 1.5 per cent in the second quarter of 2018 compared with 1.95 per cent growth in the first quarter. The increase was driven by the activities of the non-oil sector, which grew by 2.05 per cent. The oil sector contracted by 3.95 per cent during the quarter. The Purchasing

Managers Index (PMI) indicates expansion of manufacturing and non-manufacturing activities in the month of September 2018, albeit at a slower rate than observed in August 2018. Staff forecasts for the third and fourth quarters show that output growth will continue to be positive, albeit slower than forecasted earlier. Output forecast for 2018 is expected to grow at 1.75 per cent. Key drivers include the effective implementation of the ERGP, diversified government revenue sources, improved production and exports of oil, sustained the stability of the exchange rate, as well as enhanced flows of credit to the private sector. Critical headwinds to output growth include the farmers/herders conflicts and flooding across states, which affects agricultural output and political activities that could affect investor confidence.

Latest data on price developments show that headline inflation has increased from 11.14 per cent in July 2018 to 11.23 per cent in August 2018, mainly due to the rise in prices of food and non-alcoholic beverages. Core inflation, however, declined. The key drivers of the food price movements are distribution constraints, farmers/herders conflict and the off-season effects of some food items which reduced their supply. Availability of petroleum products and stability of energy prices account for the decline in Core Inflation during the period. *Staff forecasts indicate that, in the medium-term, headline inflation is likely to continue to rise, albeit remain within the lower two-digit level, driven mainly by the rise in core inflation.* Critical drivers of prices in short to medium-term include

the electioneering spending, sustained implementation of the 2019 budget, the possible implementation of the proposed new minimum wage, effects of flooding and farmers/herders conflicts on agricultural output and distribution across states.

Development in the monetary sector indicates that while M2 grow at an annualised rate of 4.47 per cent, below the programmed target of 10.48 per cent, the broader definition (M3), which better captures liquidity outside the banking system, grew by an annualised rate of 11.8 per cent in August 2018. Credit flows to the private sector remains positive, but weak at an annualised rate of 1.12 per cent in August 2018, mainly due to the perceived risks that reduce the inflows of credit to the real sector. The foreign exchange market continues to remain stable with Naira remaining stable in the interbank market, but depreciated slightly in the I&E window and appreciating in the BDC segment. Despite the net capital outflows in the month of August, external reserves remain strong at about US\$ 44 billion, enough to finance 17 months of imports. The banking sector remains stable, especially with the proactive regulatory intervention by the Central Bank, which enabled the takeover and recapitalisation of the defunct Skye Bank Plc. This policy has significantly reduced the NPL ratio of the industry.

3. The basis for My Policy Choice

Although the realised data on inflation appear to show that the rise in headline inflation in the month of August 2018 is predominantly supply side, pointing at food and beverages, projections based on staff forecasts suggest that, in the medium term, headline inflation would be driven by rising core inflation. Indeed, the forecasts show that food inflation would moderate in the medium term. The forecasted rise in core inflation implies that there is space for forward-looking monetary policy levers for effective stabilisation of the mounting inflationary pressure. Because of policy lags, an action is required now to dampen the pressures in the medium term and rein in inflation. A rise in the policy rate is also consistent with the need to accommodate international monetary policy spillovers by raising the yields of Naira-denominated assets thereby retaining Nigeria's relative attractiveness amongst its emerging market peers and mitigate capital flow reversals. This, in my opinion, is required not only for exchange rate and price stability but also for output stability in the medium-term, given the role of foreign exchange supply on output. My concern for the fragile output recovery is allayed, in part, by the implementation of the dynamic CRR policy taken at the last MPC, which is expected to have effects during the second half of the year. This policy, along with the other existing credit interventions is expected to improve the flow of credit at low interest rates. This is especially true as we expect the electioneering spending and sustained

implementation of the ERGP and 2019 budget during the fourth quarter would significantly boost aggregate demand.

Consequently, to further tighten I voted to:

- Raise the MPR by 25 basis points to 14.25 per cent;
- Retain the CRR at 22.5 per cent;
- Retain the asymmetric corridor at +200/–500 basis points; and
- Retain liquidity ratio at 30.0 per cent.

10. EMEFIELE, GODWIN I.

GOVERNOR OF THE CENTRAL BANK OF NIGERIA AND CHAIRMAN, MONETARY POLICY COMMITTEE

Since the last MPC meeting, uncertainties have heightened in the global financial markets with increased vulnerabilities especially in emerging market economies. The rising yields in the US and strengthening dollar, reinforced by escalating trade tensions between the US and China, exposed financial fragilities and imbalances in key emerging markets. This has led to huge capital flow volatility in these economies with immense pressures on exchange rates, official reserves and balance of payments. Accordingly, global economic growth remained uneven with tepid short-term outlook. While the pace of growth in advanced economies, especially the US, remained robust (and could reach the 2018 projection of 3.9 percent), growth in emerging markets and developing countries remained fragile with weakening prospects of achieving the 4.9 percent projected for 2018.

Macroeconomic conditions in the domestic economy lost pace in 2018q2 as downside risks threaten short-term outlook. Real GDP growth rate slowed from nearly 2.0 percent in 2018q1 to 1.5 percent in 2018q2. A breakdown indicates that, at -0.4 percent, the oil sector had a negative contribution to overall growth rate. In contrast the non-oil sector recorded a more robust performance and contributed the balance of about 1.9 percent to total growth. Further

analyses show that this was driven by growths in construction, services and agriculture sectors. With improving conditions in the international oil market and the expected surge in political related spending, short-term growth outlook remains somewhat modest. Staff estimates show a slight pick-up in the two remaining quarters of 2018 with an overall growth rate of 1.8 percent projected for the year. But, potential exchange market pressure —due to yield induced capital reversals— implies that this growth outlook is fragile.

On domestic prices, I noted in my July statement that the asymptotic decline in inflation was flattening with an imminent uptick in the near-term. After eighteen consecutive months of disinflation, year-on-year headline rate rose marginally to 11.2 percent in August 2018 from 11.1 percent in July. This reflected the rise in food inflation even as core inflation declined. In the near-term, the upside risks to inflation include; (i) anticipated budgetary and elections spending, (ii) disruptions to food supply networks —due to flooding and farmers-herders clashes— and, (iii) diminished base effects. These need to be sufficiently mitigated so as to contain the anticipated liquidity injections, anchor inflation expectations, and revert expeditiously to a path of disinflation.

Analyses of liquidity conditions show an annualised contraction of 9.8 percent in narrow money supply (M1) in August 2018 accompanied by a less-than-par annualised expansion of 4.5 percent in broad money supply (M2). Net foreign assets exhibited an annualised growth of 27.9 percent relative to the target of

18.2 percent. Though net domestic credit contracted, private sector credit (PSC) increased marginally by 1.2 percent annualised during the review month. I note that whilst the expansion in PSC is welcome, more still needs to be done to ensure that the 2018 target of 5.6 percent is achieved. The marginal growth of PSC reflects, again, the risk aversion of banks in the face of high NPLs. Consequently, I reiterate the need to innovatively de-risk PSC in order to enhance its risk perception, strengthen financial system soundness, accelerate economic diversification and ensure inclusive growth.

Assessment of recent financial systems development in key emerging market economies indicate considerable vulnerabilities reflected in volatile exchange rates, reserves, money market interest rates and the capital markets of those countries. In Nigeria, external reserves declined from US\$45 billion in July to about US\$44 billion as at 20 September 2018. While the exchange rate in the various windows remained largely stable, average interbank interest rate declined from 9.0 percent in July to 4.0 percent as at 20 September 2018. Key capital market indicators also exhibited significant declines as the ASI and market capitalisation, respectively, contracted by over 14 percent between end-June and 21 September 2018.

In my consideration, I note that the prevailing macroeconomic stability and short-term prospects are threatened by global and domestic headwinds. On the global scene, the rising yields in the US and some advanced economies are

triggering capital flows reversals with significant ramifications for our FX reserves, exchange rate, and inflation. This is further exacerbated by the anticipated fiscal and political spending over the next few months and its impact on inflation expectations. While the cyclical recovery of Nigerian economy is still fragile it is important that inflation expectations are adequately anchored. I am of the view that the continued benign outcome of oil prices will cushion the pressure on FX reserves and exchange rate as oil receipts rise. It is important, nonetheless, to ensure that we protect the economy from the uncertainties of the oil price fluctuations. At this time, given the recent uptick in headline inflation and rising expectations, the doctrinal decision is to tighten further. This is envisaged to curb near-term inflation with a tangential benefit for the exchange rate stability. Regardless, I am more inclined towards a more practical and well-balanced decision with considerations for output, unemployment and poverty.

At the last MPC meeting, the policy to strategically release portions of banks' CRR for real sector lending was announced. This was to stimulate productivity in qualifying high-impact sectors (mainly agriculture and manufacturing) so as to diversify economic growth in Nigeria. I am of the opinion that the aggregate supply boost from this policy would considerably moderate inflation and expectations. Since the key mandate of the CBN remains price, monetary and

exchange rate stability, I am committed to driving inflation to single-digit levels and building sufficient reserves buffers to defend the naira.

Today, my immediate predisposition is to further tighten monetary stance in order to rein in inflation and exchange rate expectations. Yet, I recognise the need to allow recent decisions permeate the system. As it is, monetary stance is sufficiently tight. Further tightening would rightly signal our intention; it could inadvertently disrupt on-going transmission of recent decisions. While a rate hike is likely soon, the current level of real policy rate is appropriate to balance the objectives of exchange rate stability, price stability and output stabilisation without introducing disruptive policy shocks. Therefore, I vote to:

1. Retain the MPR at 14.0 percent;
2. Retain the CRR at 22.5 percent;
3. Retain the asymmetric corridor at +200/–500 basis points; and
4. Retain liquidity ratio at 30.0 percent

GODWIN I. EMEFIELE, CON

Governor

September 2018