CENTRAL BANK OF NIGERIA

# MONETARY POLICY REVIEW

FEBRUARY 2019

Monetary Policy Department

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# Central Bank of Nigeria

## Mandate

▪Ensure monetary and price stability

▪Issue legal tender currency in Nigeria

▪Maintain external reserves to safeguard the international value of the legal tender currency

▪Promote a sound financial system in Nigeria

▪Act as banker and provide economic and financial advice to the Federal Government

## Vision

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

## Mission Statement

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

## Core Values

- Meritocracy
- Leadership
- Learning
- Customer - Focus

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## STATEMENT BY THE GOVERNOR

Monetary policy design and implementation during the second half of 2018 was confronted with global uncertainties arising from rising trade tensions, build-up of financial vulnerabilities and policy uncertainties arising from continuing monetary policy normalisation by the Federal Reserve; resurgence of global inflationary pressures, continuous capital flow reversal and moderate currency depreciations, especially in the emerging market and developing economies. Also, the strengthening of the US dollar, subdued global growth outlook and fiscal fragilities were additional challenges. These were compounded on the domestic front by fragile economic recovery; resurgence of inflationary pressures, disruptions to the food supply chain in major food producing states from terrorist activities; high cost of energy; pre-election spending and concerns about the liquidity impact of the 2018 expansionary Federal Government budget, amongst others. Nevertheless, the economy sustained its growth path, growing by 2.4 per cent in the fourth quarter of 2018 up from 1.81 per cent in the preceding quarter, and driven largely by the performance of the non-oil sector. Headline inflation rate resurged, rising from 11.14 per cent in July to 11.44 per cent in December 2018.

The perennial incidence of banking system liquidity surfeit in the presence of weak flow of credit to the real economy persisted in the review period. The money market remained active, with market rates fluctuating, in response to liquidity conditions in the banking system. The Nigerian stock market witnessed a decline, as the All-Share Index (ASI) decreasd by 18.0 per cent in the review period, showing the possibility of continued weaknesses in the real economy. Capital outflow intensified but was somewhat contained towards the end of the review period as the Bank maintained a steady pace of intervention in the market to strengthen the value of the naira. This was complemented with increased foreign exchange sales to BDCs to improve supply and rein-in speculative activities in the foreign exchange market. The Bank further encouraged more direct transactions between the naira and the yuan, under the bilateral currency swap between the Bank and People's Bank of China.

In view of the foregoing and based on careful considerations of the need to further support growth and investment in the economy within the limits of its price stability mandate, the Bank maintained its tight monetary policy stance throughout the review period. Thus, the Monetary Policy Rate (MPR) was retained at 14.0 per cent along with the asymmetric corridor of +200/-500 basis points, Cash Reserve Ratio (CRR) of 22.5 and Liquidity Ratio (LR) of 30.0 per cent. These were complemented with additional measures in the foreign exchange market to sustain stability and confidence in the market.

Outlook for the domestic economy over the short-to-medium-term indicates that inflation would maintain a moderate uptick. The moderate rise would be due to the liquidity impact of the 2019 election spending, disruption of supply and distribution chains by insecurity in major parts of food producing belts of the country, as well as moderate exchange rate pass-through to inflation due to weakening oil prices. Nonetheless, monetary policy will continue to remain proactive, dynamic and supportive of financial stability in the pursuit of price stability conducive to sustainable economic growth in the coming year.

**GODWIN I. EMEFIELE**
**Governor, Central Bank of Nigeria**
**February 2019**

# CHAPTER ONE

## 1.0 OVERVIEW

In the second half of 2018, monetary policy continued to be shaped by key developments in the global and domestic economic and financial environments. On the global front, the key challenges included: rising trade tensions and policy uncertainties, difficult BREXIT negotiations, build-up of financial vulnerabilities and currency depreciations. These were accentuated by rising cost of borrowing, continued capital flow reversals, fiscal fragilities and increased debt burden especially in the emerging market and developing economies. Other considerations were: the recent episodes of large-scale flooding in major areas across the globe, resurgence of global inflationary pressures, continued geo-political tensions as well as increasingly depressed aggregate demand in some countries. Notwithstanding the Bank's effort to stabilize the exchange rate, the combination of factors including disruptions to the food supply chain from insurgency and herder-farmers crisis in some parts of the country; impact of flooding on agricultural output and other economic activities as well as the appreciation of the US dollar against other major currencies exerted some pressure on domestic prices. Consequently, headline inflation rose from 11.14 per cent in July to 11.44 per cent in December 2018, driven largely by food inflation.

The recovery of the Nigerian economy strengthened despite the modest slowdown in the first half. The improved performance was due largely to sustained policy stability, reflected in the continued supply of foreign exchange to the various segments of the market. Other factors were: the sustained peace in the Niger Delta region which enabled improved oil production and exports; relatively higher crude oil prices; the continued implementation of the 2018 Federal Government budget; improved energy supply; enhanced transportation infrastructure as shown in the reactivation of the railway system; as well as intensified implementation of the Economic Recovery and Growth Plan (ERGP). Consequently, data from the National Bureau of Statistics (NBS) showed that real Gross Domestic Product (GDP) strengthened further to 2.38 per cent (year-on-year) in the fourth quarter of 2018 from 1.81 and 2.11 per cent in the preceding quarter and the corresponding period of 2017, respectively. The growth was mainly attributed to the non-oil sector, which rose by 2.70 per cent in the fourth quarter representing an increase of 0.38 percentage point compared with 2.32 per cent in the preceding quarter. The performance was also higher by 1.25 percentage points compared with the growth of 1.45 per cent in the corresponding quarter of 2017. Growth of the non-oil sector was driven by the performance of Services (3.71%), Industry (2.60%), Agriculture (2.46%), Construction (2.05%) and Trade (1.02%). The performance of the non-oil sector indicated further strengthening of all the sub-sectors, with construction sub-sector being the most significant; partly attributable to capital releases by the Federal Government during the period.

During the review period also, stability in the foreign exchange market was sustained by activities in the various segments, particularly the Investors and Exporters foreign exchange window. The success recorded by the restriction of 41 items from access to official foreign exchange sources became increasingly apparent in the real economy, following increased domestic production of those items. In order to further strengthen the outcome, the policy was expanded to include fertilizer in the list of excluded items. In addition, special foreign exchange intervention sales to BDCs were introduced to address demand pressure in the segment. The Bank also continued its heterodox approach to monetary policy in place of adjusting the monetary policy rate. These included: the bilateral currency swap between the Central Bank of Nigeria and the People's Bank of China; intensification of the policy on repatriation of export proceeds and the return of unutilized foreign exchange sourced from CBN auctions. Others were: the use of Bank Verification Number (BVN) in BDC transactions; sale of foreign exchange by the Bank and International Money Transfer Operators (IMTOs) to BDCs; as well as special foreign exchange auctions to targeted sectors and small scale importers. These measures were able to calm the market and guard against the re-emergence of speculative pressures.

The Nigerian financial markets experienced episodes of large capital outflows, reflecting developments in the global and domestic financial and economic environments. Primary among the global developments were: the continued trade tensions between the US and its key trading partners, particularly, China; progressive normalization of monetary policy by the US and the beginning of normalization in the euro area; as well as the increasingly difficult negotiations over BREXIT between the United Kingdom and the European Union. In addition, the weakening of oil prices threatened to reverse the tepid recovery amongst major oil exporters as the rapid outflow of capital to US dollar denominated assets re-introduced exchange rate pressures.

Accordingly, the Bank in the second half of 2018, continued to conduct monetary policy by deploying various instruments in order to achieve its objectives of price and macroeconomic stability. These instruments were: the Monetary Policy Rate (MPR), the Cash Reserve Ratio (CRR), Liquidity Ratio, Open Market Operations (OMO) and Discount Window Operations. These instruments were complemented by periodic interventions in the foreign exchange market to address shortages and speculative activities. The MPR was maintained at 14.0 per cent in the review period, along with the asymmetric corridor of +200 and -500 basis points around the policy rate. The Liquidity Ratio and the Cash Reserve Ratio (CRR) were also retained at 30.00

and 22.50 per cent, respectively, over the period.

The primary tool used for liquidity management in the second half of 2018 remained Open Market Operations (OMO). There was an increase in OMO sales in the period under review, amounting to ₦12,709.91 billion compared with ₦9,743.76 billion and ₦7,472.21 billion recorded in the first half of 2018 and the corresponding period of 2017, respectively. This represented an increase of 30.44 per cent and 70.10 per cent in the preceding and the corresponding periods of 2018 and 2017, respectively. The increased OMO sales was attributed to higher frequency of OMO auctions and the introduction of special OMO auctions, as well as roll-over of maturing bills. As in the preceding half year, the increase was also due to incidences of DMBs discounting OMO bills before maturity in the secondary market, thus expanding the monetary base and leading to growth in money supply. In the review period, the major monetary aggregates performed above their indicative targets.

The money market remained active during the review period, with rates fluctuating in response to liquidity conditions in the banking system. The fluctuations in market rates were traceable to: Federation Account Allocation Committee (FAAC) disbursements; maturing CBN bills and other government securities; and OMO auctions. Consequently, the MPC maintained its tight monetary policy stance throughout the period.

Activities in the Nigerian capital market were mostly bearish in the second half of 2018. The development reflected the flight to safety and quality by investors as yields on US dollar-denominated assets improved coupled with rising domestic sovereign risk arising from the February 2019 general elections, which resulted in persistent sell-off and profit taking activities. The dwindling price of crude oil, slowing accretion to external reserves, and increasing domestic and foreign debt stock, amongst others, contributed significantly to dampen investor sentiments in the review period. As a result, the All-Share Index (ASI) decreased by 17.89 per cent to 31,430.50 at end-December 2018 from 38,278.55 at end-June 2018. It also decreased by 17.81 per cent compared with 38,243.19 at end-December 2017.

Activities in the bonds market in the second half of 2018 was dominated by Federal Government of Nigeria (FGN) securities. Some minor activity was recorded in the sub-national government and corporate bonds segments of the market, with the latter recording the least share by market volume. The 10-year dollar-denominated bond yields for Nigeria increased by 21 basis points to 6.11 per cent at end-December 2018, from 5.90 per cent at end-June 2018. When compared with 4.47 per cent at end-December 2017, it increased by 164 basis points. The increase reflected the perception of rising sovereign risk by foreign investors.

Headline inflation trended moderately upwards in the second half of 2018, remaining above the Bank's 6-9 per cent indicative band. The uptick was largely attributed to: increase in food prices, mainly from adverse weather conditions in some parts of the country; increased spending towards the 2019 general elections and capital flow reversals. Staff estimates suggest that headline inflation (year-on-year) is projected to increase to between 11.60 and 12.11 per cent during the first half of 2019. Upside risks to these estimates are the residual impact of the 2018 flooding on agricultural output, insecurity in parts of the food producing belt of the country, pass-through of exchange rate depreciation to domestic prices due to likely weakening of oil prices, increased spending towards the 2019 general elections and infrastructure-related challenges.

The outlook for growth is premised on the performance of the economy thus far. According to the National Bureau of Statistics (NBS), real GDP in the fourth quarter of 2018 strengthened to 2.38 per cent (year-on-year) from 1.81 and 2.11 per cent in the preceding quarter and the corresponding period of 2017, respectively. The development was mainly traceable to the non-oil sector, which grew by 2.70 per cent in the fourth quarter compared with 2.32 and 1.45 per cent in the preceding quarter and the corresponding period of 2017. Overall, the economy expanded by 1.93 per cent in 2018 from 0.82 per cent in 2017. The outlook for 2019 remains broadly positive. With output growth estimated at 1.9 per cent in 2018, the IMF and the World Bank projected the Nigerian economy to grow in 2019 by 2.0 and 2.2 per cent, respectively. Similarly, the CBN has projected 2019 output growth at 2.28 per cent. The outlook is anchored on expected improvements in oil production and prices, continuing reforms in the foreign exchange market and prospects of improved agricultural output. In addition, increased non-oil revenue anchored on the ongoing diversification of the economy is expected to improve the fiscal space, and support the implementation of the Economic Recovery and Growth Plan (ERGP).

The thrust of monetary policy in 2019 will be dictated by the need to support the fragile economic recovery, and manage expectations to ensure that the downside risks to growth and upside risks to inflation are well contained.

# CHAPTER 2

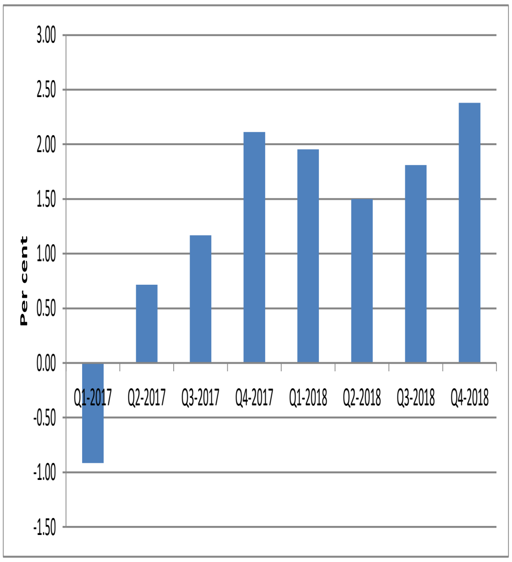
## 2.0 OUTPUT IN THE DOMESTIC ECONOMY

In the second half of 2018, the recovery of the Nigerian economy strengthened despite the modest slowdown in the first half. The improved performance was due largely to sustained policy and political stability, reflected in the continued supply of foreign exchange to the various segments of the market. Other factors were: the sustained peace in the Niger Delta region which enabled improved oil production and exports; relatively higher crude oil prices; the continued implementation of the 2018 Federal Government budget; improved energy supply; enhanced transportation infrastructure as shown in the reactivation of the railway system; as well as intensified implementation of the Economic Recovery and Growth Plan (ERGP).

Consequently, real Gross Domestic Product (GDP) grew by 1.81 per cent (year-on-year) in the third quarter of 2018 up from 1.17 and 1.50 per cent in the corresponding period of 2017 and the preceding quarter, respectively. The growth was mainly attributed to the non-oil sector, which grew by 2.32 per cent in real terms during the review period, representing an increase of 0.27 percentage point compared with 2.05 per cent in the preceding quarter. The performance was also higher by 3.08 percentage points compared with the contraction of 0.76 per cent in the corresponding quarter of 2017. Growth of the non-oil sector was driven by the performance of Services (3.60%), Industry (1.95%), Agriculture (1.91%), Trade (0.98%) and Construction (0.54%). The performance of the non-oil sector indicated the sustained recovery of all its sub-sectors, following the recovery of the trade sub-sector from negative growth in the preceding period. In contrast to this performance, the oil sector contracted in the third quarter of 2018 by 2.91 per cent, a moderation from the contraction of 3.95 per cent in the preceding quarter. When compared with the growth of 23.03 per cent in the corresponding period of 2017, the sector contracted significantly by 25.94 percentage points, reflecting the production challenges during the period.

In the fourth quarter of 2018, real Gross Domestic Product (GDP) strengthened further by 2.38 per cent (year-on-year) from 1.81 and 2.11 per cent in the preceding quarter and the corresponding period of 2017, respectively. The growth was mainly attributed to the non-oil sector, which expanded by 2.70 per cent, representing an increase of 0.38 percentage point compared with 2.32 per cent in the preceding quarter. The performance was also higher by 1.25 percentage points compared with the growth of 1.45 per cent in the corresponding quarter of 2017. The major drivers of the growth were traceable to the performance of Services (3.71%), Industry (2.60%), Agriculture (2.46%), Construction (2.05%) and Trade (1.02%). During the quarter, the performance of the non-oil sector indicated further strengthening of all its sub-sectors, with the construction sub-sector being the most significant. The sub-sector's performance was partly attributable to improved capital releases by the Federal Government during the period. However, the contraction of the oil sector continued in the fourth quarter of 2018 by 1.62 per cent compared with 2.91 per cent in the preceding quarter. When compared with the growth of 11.20 per cent in the corresponding period of 2017, the sector contracted by 12.82 percentage points.

**Figure 2.1**
**Real GDP Growth (%) 2017 Q1 – 2018 Q4**




**Source: NBS**

## 2.1 DOMESTIC ECONOMIC ACTIVITIES

*I*n the second half of 2018, real GDP growth was driven mainly by the activities in the non-oil sector, complimented by the oil sector. The non-oil real GDP in the third quarter grew by 2.32 per cent, an increase of 3.08 percentage points over the contraction of 0.76 per cent in the corresponding quarter of 2017. It was also 0.28 percentage point higher than the growth of 2.05 per cent in the preceding quarter of 2018. The activities of the non-oil sector that drove this performance were: utilities (13.44%), Information and Communication (12.09%) and transportation (11.95%). Other drivers were Forestry (3.72%), Solid minerals (3.58%), other services (2.86%), Arts, Entertainment & Recreation (2.83%) and Livestock (2.56%). These compare with their growth rates of 7.84, -4.48, -6.23, 3.95, 0.92, 1.72, 0.44 and 2.52 per cent, respectively, in the corresponding period of 2017. Thus, the performance of most activities in the sector was robust during the review period.

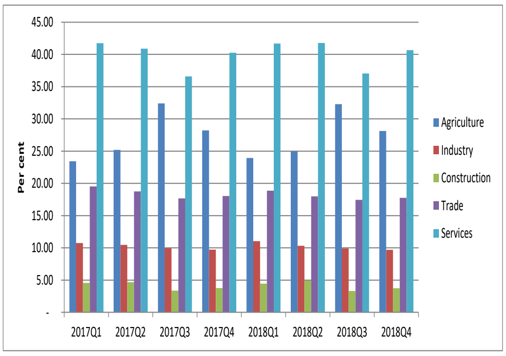
The oil sector, on the other hand, contracted by 2.91 per cent in the third quarter of 2018, indicating a moderation of the sector's contraction from 3.95 per cent in the preceding quarter. Compared with the growth of 23.03 per cent in the corresponding period of 2017, the sector contracted substantially by 25.94 percentage points. This trend was reflected in the performance of oil production during the period. Crude oil production in the third quarter was estimated at an average of 1.94 million barrels per day (mbpd), an improvement of 0.10 mbpd over 1.84 mbpd in the preceding quarter. This was 0.1 mbpd lower than the daily production average of 2.02 mbpd recorded in the third quarter of

2017. The trend towards oil production recovery largely moderated the contraction witnessed in the oil sector.

In the fourth quarter of 2018, non-oil real GDP grew further by 2.70 per cent, an increase of 0.38 percentage point from 2.32 per cent growth in the third quarter. The performance was also 1.25 percentage point higher than the growth of 1.45 per cent in the corresponding quarter of 2017. The activities of the non-oil sector that drove this performance were: solid minerals (17.68%); Information and Communications (13.20%) and transportation (9.48%). Other drivers were: Arts, Entertainment & Recreation (4.18%); Crop Production (2.48%); Livestock (2.35%); and Manufacturing (2.35%). These compare with their growth rates of -9.18, -1.46, 16.57, 3.54, 4.58, 0.19 and 0.14 per cent, respectively, in the corresponding period of 2017. Thus, the performance of most activities in the sector continued to be robust during the fourth quarter.

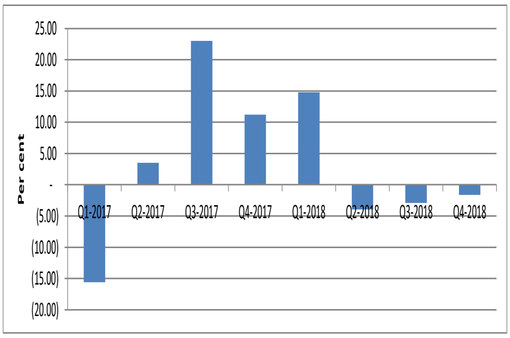
The oil sector, however, contracted by 1.62 per cent, indicating a moderation from 2.91 per cent in the third quarter of 2018. Compared with the growth of 11.20 per cent in the corresponding period of 2017, the sector contracted by 12.82 percentage points. In the fourth quarter of 2018, oil production moderated to an average of 1.91 mbpd compared with 1.95 mbpd and 1.94 mbpd in the corresponding period of 2017 and the preceding quarter, respectively. The trend towards oil production recovery largely moderated the contraction witnessed in the oil sector.

**Figure 2.2:**
**Non-oil Sector Performance 2017Q1-2018Q4**




Source: NBS

**Figure 2.3**
**Performance of the Oil Sector 2017Q1-2018Q4**




Source: NBS

## 2.2 Sectoral Analysis

This section reviews sectoral performance of the economy taking into consideration key policy and institutional factors that contributed to domestic output in the review period.

### 2.2.1 Agriculture

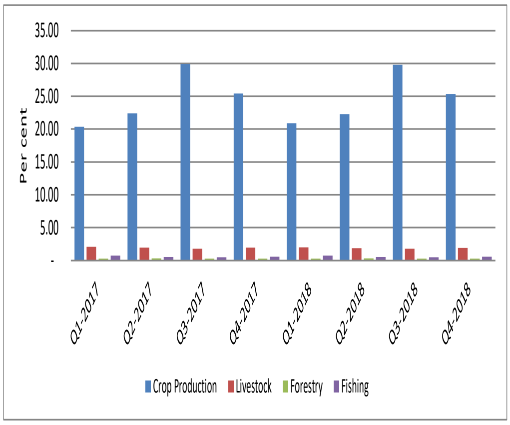
Real agricultural GDP grew by 1.91 per cent in the third quarter of 2018, representing a decrease compared with 3.06 per cent in the corresponding period of 2017. The outcome was, however, higher than the growth of 1.19 per cent in the preceding quarter. The decrease in agricultural output was traceable to moderation in activities in forestry and crop production which grew by 3.72 and 1.87 per cent, respectively, compared with 3.95 and 3.19 per cent in the corresponding period of 2017. Conversely, activities in livestock and fishing increased by 2.56 and 0.84 per cent compared with their respective growth rates of 2.52 and -2.84 per cent, in the corresponding quarter.

In spite of the decline in agricultural output in the third quarter, the overall contribution of the sector to real GDP increased marginally to 29.25 per cent, compared with 29.22 per cent in the corresponding period of 2017 and 22.86 per cent in the preceding quarter of 2018 (Figure2.2).

In the fourth quarter, real agricultural output expanded by 2.46 per cent, representing an increase compared with 1.91 per cent in the third quarter of 2018. The outcome was, however, lower compared with the growth of 4.23 per cent in the corresponding quarter of 2017. The decrease in agricultural output was traceable to moderation in activities in crop production, fishing and forestry which grew by 2.48, 1.73 and 1.97 per cent, respectively, compared with 4.58, 2.83 and 4.05 per cent in the corresponding period of 2017. Conversely, activities in livestock increased by 2.35 per cent compared with 0.19 per cent, in the corresponding quarter of 2017.

The overall contribution of the sector to real GDP increased marginally to 26.15 per cent, compared with 26.13 per cent in the corresponding period of 2017 but a decline compared with 29.25 per cent in the preceding quarter of 2018 (Figure2.2).

**Figure 2.4**
**Agricultural Sector Contribution by Activity, 2017Q1-2018Q4**




Source: NBS

## 2.2.1.2 Agricultural Policies and Institutional Support

The agricultural sector continued to be supported by a number of policies and institutional reforms in the second half of 2018. These included:

### The Agricultural Credit Guarantee Scheme (ACGS)

In the second half of 2018, a total of 20,192 loans valued at ₦2.62 billion were guaranteed under the scheme compared with 10,420 loans valued at ₦1.75 billion in the first half. This indicated decreases of 93.8 and 49.7 per cent, respectively, in the number and value of loans guaranteed. Also, 12,395 loans valued at ₦2.43 billion were repaid, representing declines of

31.1 and 20.3 per cent, respectively, from 17,977 loans valued at ₦3.05 billion repaid in the first half of 2018. This showed that the patronage of the scheme waned in the review period.

### N200 Billion Commercial Agriculture Credit Scheme (CACS)

Under the scheme, the sum of ₦40.36 billion was disbursed to 24 projects in the second half of 2018 compared with ₦39.34 billion disbursed to 16 projects in the first half of the year. A total of ₦37.72 billion was repaid in the review period, compared with ₦17.01 billion in the first half of 2018.

### Agri-Business/Small and Medium Enterprises Investment Scheme (AGSMEIS)

This scheme was introduced to ensure access to finance for Small and Medium Enterprises (SMEs) leveraging the equity contribution of commercial banks. It has both debt and equity components. A total of 162 projects accessed ₦343.23 million from the Scheme during the second half of 2018. The cumulative disbursement as at end-December 2018 was ₦414.92 million. No repayments have been made to date as the loans are yet to fall due.

### Micro, Small and Medium Enterprises Development Fund (MSMEDF)

In the second half of 2018, the disbursement under the scheme fell by 66.2 per cent to ₦1.61 billion compared with ₦4.77 billion disbursed to 14,492 projects in the first half of the year. Repayments during the period, however, rose by 7.2 per cent to ₦3.73 billion compared with ₦3.48 billion in the first half of 2018.

### Anchor Borrowers' Programme (ABP)

During the review period, ₦82.59 billion was disbursed to 490,481 farmers in all 36 states of the Federation and the Federal Capital Territory (FCT), compared with ₦36.37 billion disbursed to 155,732 farmers in the first half of the year. The scheme supported the cultivation of cassava, cotton, maize, rice, soya beans, wheat, sesame, sorghum, tomato, cocoa, castor seed and the production of fish and poultry. Repayments in the review period stood at ₦3.39 billion.

### Paddy Aggregation Scheme (PAS)

Disbursements under the scheme amounted to ₦5.0 billion for one (1) project in the second half of 2018. This disbursement was 17.1 per cent higher than ₦4.25 billion released to three (3) projects in the first half of the year. In the review period, ₦18.63 billion was repaid compared with ₦13.37 billion in the first half of 2018.

### Non-oil Export Stimulation Facility (NESF)

Under this facility, two (2) projects were financed with ₦6.45 billion in the review period, compared with ₦19.04 billion for the same number of projects in the first half of 2018. There were no repayments in the review period.

### Federal Government of Nigeria (FGN) Special Presidential Fertilizer Initiative (PFI)

In the review period, ₦10.0 billion was released under the initiative to one (1) project. There have been no repayments under the initiative as payments had not fallen due.

**Export Development Facility (EDF)**

The EDF was introduced in 2018 with the aim of improving exporters' access to finance for the expansion and diversification of non-oil exports. The facility is managed by the Nigerian Export-Import Bank (NEXIM). In the review period, ₦10.17 billion was extended to 18 projects. Repayments under the facility were yet to commence.

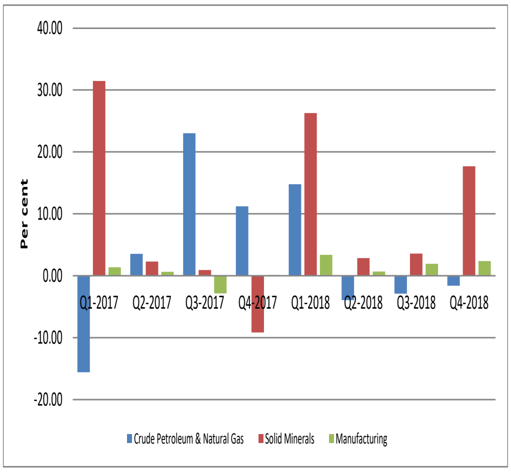
### 2.2.2 Industry

#### 2.2.2.1 Industrial Production

The industrial sector returned to growth during the review period. In the third quarter of 2018, the contraction of the industrial sector moderated to 0.59 per cent from 1.56 per cent in the preceding quarter, in contrast to the growth of 9.19 per cent in the corresponding period of 2017. The contraction of the sector was driven by crude petroleum and natural gas which fell by 2.91 per cent compared with 23.03 and -3.95 per cent in the corresponding period of 2017 and the preceding quarter, respectively. The contraction of the sector was, however, moderated by Solid minerals and manufacturing which grew by 3.58 and 1.92 per cent during the period. This compares with their respective growth rates of 0.92 and -2.85 per cent in the corresponding period of 2017, and 2.86 and 0.68 in the preceding quarter. As a result, the share of industry in overall GDP fell to 18.38 per cent from 18.82 per cent in the corresponding period of 2017.

In the fourth quarter of 2018, output of the industrial sector returned to growth by 0.71 per cent from a contraction of 0.59 per cent in the preceding quarter. The development represented a decline compared with the growth of 4.72 per cent in the corresponding period of 2017. The growth of the sector was driven largely by Solid minerals which grew significantly by 17.68 per cent compared with 3.58 and -9.18 per cent in the preceding quarter and the corresponding period of 2017, respectively. This was followed by manufacturing which grew by 2.35 per cent from 1.92 and 0.14 per cent in the preceding quarter and corresponding the period of 2017, respectively. Crude petroleum and natural gas, however, contracted by 1.62 per cent, a moderation compared with -2.91 per cent in the preceding quarter, but a decline compared with the growth of 11.20 per cent in the corresponding period of 2017. As a result, the share of industry in overall GDP increased marginally to 16.09 per cent from 16.05 per cent in the corresponding period of 2017.

**Figure 2.5**
**Industrial Sector's Contribution by Activity, 2017Q1-2018Q4**




Source: NBS

### 2.2.2.2 Industrial Policy and Institutional Support

The performance of the sector during the period was supported by the continuation of a number of reforms and incentives. These included:

**N300 Billion Power and Airline Intervention Fund (PAIF)**

During the review period, ₦3.25 billion was disbursed to Ashaka Cement Limited, while ₦13.35 billion was repaid.

**Nigerian Electricity Market Stabilization Facility (N213 billion)**

In the second half of 2018, the sum of ₦24.34 billion was disbursed to 31 market participants comprising 1 (one) distribution company (DisCo), 18 (eighteen) generating companies (GenCos), 6 (six) gas companies (GasCos) and 6 (six) service providers. Within the same period, ₦8.68 billion was repaid.

**Real Sector Support Facility (RSSF)**

In the review period, the Bank introduced two additional windows under the Real Sector Support Facility (RSSF). These were: the Differentiated Cash Reserves Requirement (DCRR), and the Corporate Bonds (CP) windows, aimed at increasing access to long-term credit to the real sector. The facilities target manufacturing, agriculture and other sectors considered employment and growth stimulating. Emphasis was on projects with high backward integration and import substitution prospects.

Under the RSSF, total disbursement in the review period was ₦44.24 billion, comprising ₦6.15 billion for the DCRR projects and ₦38.09 billion for projects under the regular window. This represents an 85.03 per cent increase over the disbursement of ₦23.91 billion in the first half of the year. Repayment under the facility stood at ₦4.95 billion in the review period.

**Textile Sector Intervention Facility (TSIF)**

Under the facility, ₦10.29 billion was disbursed to 2 projects in the review period compared with ₦19.1 billion in the first half of 2018. Repayments in the review period totalled ₦178.45 million.

**Nigeria Bulk Electricity Trading Payment Assurance Facility (NBET-PAF)**

During the review period, ₦176.78 billion was disbursed to NBET Plc. Cumulatively, the amount disbursed under the programme stood at ₦534.10

billion as at end-December, 2018 with no repayments due under the intervention.

**Small and Medium Enterprises Restructuring and Refinancing Facility (SMERRF)**

Disbursement under the scheme was discontinued following its replacement with the Real Sector Support Facility in December 2014. However, repayments during the review period amounted to ₦12.60 billion.

### 2.2.3 Construction

In the third quarter of 2018, growth in the construction sector moderated to 0.54 per cent from 7.66 per cent in the preceding quarter. It was, however, an improvement compared with a contraction of 0.46 per cent in the corresponding period of 2017. The share of construction in overall GDP fell to 3.01 per cent from 3.05 per cent in the corresponding period of 2017.

During the fourth quarter of 2018, growth of the construction sector strengthened to 2.05 per cent from 0.54 per cent in the preceding quarter. It was, however, a moderation when compared with the growth of 4.14 per cent in the corresponding period of 2017. The share of construction in overall GDP fell marginally to 3.48 per cent from 3.49 per cent in the corresponding period of 2017.

### 2.2.4 Trade

The trade sector grew by 0.98 per cent in the third quarter of 2018, up from contractions of 1.74 and 2.14 per cent in the corresponding period of 2017 and the preceding quarter, respectively. The share of trade in overall GDP fell to 15.80 per cent from 15.93 per cent in the corresponding period of 2017.

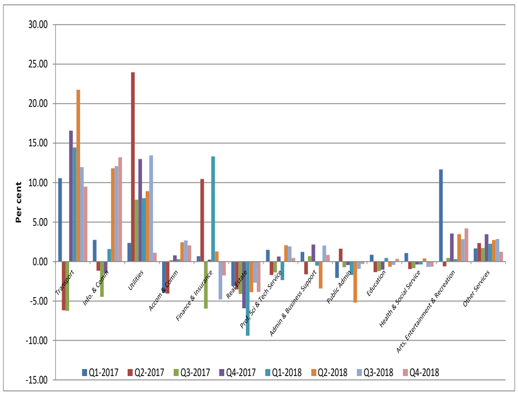
In the fourth quarter of 2018, the trade sector grew further by 1.02 per cent from 0.98 per cent in the preceding quarter and the growth of 2.07 per cent in the corresponding period of 2017, respectively. The share of trade in overall GDP fell to 16.50 per cent from 16.72 per cent in the corresponding period of 2017.

### 2.2.5 Services Sector

The Service sector grew by 3.60 per cent compared with a growth of 4.19 per cent in the preceding quarter of 2018 and a contraction of 2.95 per cent in the corresponding period of 2017. The expansion in the sector was driven by utilities (13.44%), information and communication (12.09%), transport (11.95%), other services (2.86%), arts, entertainment & recreation (2.83%), accommodation and food services (2.66%) and administrative and support services (2.02%). The growth of the Services sector was, however, moderated by activities in Finance & Insurance, and Real Estate sub-sectors, which contracted by 4.81 and 2.68 per cent, respectively. The share of the sector in overall GDP rose to 33.56 per cent in the third quarter compared with 32.98 per cent in the corresponding period of 2017.

During the fourth quarter of 2018, the Services sector expanded further by 3.71 per cent from 3.60 and -0.55 per cent in the preceding quarter and corresponding period of 2017, respectively. The expansion in the sector was driven by information and communications (13.20%), transport (9.48%), arts, entertainment & recreation (4.18%), and accommodation and food services (2.05%). The growth of the Services sector was, however, still moderated by activities in Real Estate sub-sectors, which contracted by 3.85 per cent. The share of the sector in overall GDP rose to 37.79 per cent in the fourth quarter compared with 37.31 per cent in the corresponding period of 2017.

**Figure 2.6**
**Services Sub-Sector Contribution, 2017Q1-2018Q4**




**Source: NBS**

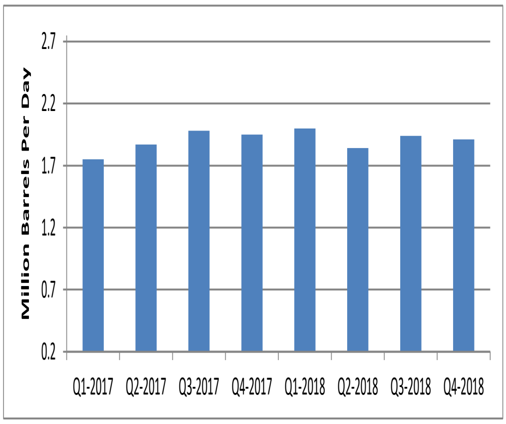
## 2.2.6 Oil Sector

The performance of the oil sector was largely sustained during the review period. This was attributable to relatively stable prices of crude oil and continued peace in the Niger Delta region. As a result, crude oil production was estimated at an average of 1.94 mbpd in the third quarter of 2018, which was 0.10 million barrels higher than the revised daily average production of 1.84 mbpd recorded in the second quarter of 2018 ((NBS, 2017). The outcome was; however, lower by 0.08 mbpd compared with 2.02 mbpd in the corresponding quarter of 2017. In the fourth quarter of 2018, oil production moderated to an average of 1.91 mbpd compared with 1.95 mbpd and 1.94 mbpd in the corresponding period of 2017 and in the preceding quarter, respectively.

During the review period, crude oil prices fluctuated due mainly to ongoing policy uncertainties especially the re-imposition of sanction on Iranian oil export by the US government and Saudi Arabia's stance on increased supply. These were moderated by the Organization of the Petroleum Exporting Countries (OPEC)'s assurance of a continued production ceiling beyond December 2018. Accordingly, the price of Nigeria's reference crude, the Bonny Light 37$^{0}$API, fell from US$75.68/barrel in July 2018 to US$73.64/barrel in August 2018, before rising steadily to US$80.50/barrel and US$82.50/barrel in September and October 2018, respectively. However, the price of Bonny Light declined steadily to US$66.01/barrel and US$58.16/barrel in November and December, 2018. Overall, the average price of Bonny Light of US$72.74/barrel during the review period was an increase over US$71.45/barrel in the first half of 2018, and still above the Federal

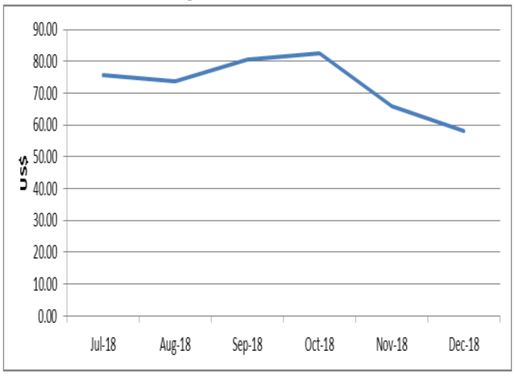
Government's 2018 budget benchmark price of US$51.0/barrel.

**Figure 2.7**
**Quarterly Oil Production (2017Q1-2018Q4)**




**Source: NBS**

**Figure 2.8**
**Monthly Bonny Light Price, July – December 2018**




**Source: CBN**

# CHAPTER 3

## 3.0 PRICE DEVELOPMENTS

Following the moderation in the first half of the year, inflationary pressures resurfaced during the review period despite the sustained tight monetary policy stance of the Bank. All measures of inflation, except core inflation, maintained an upward trend throughout the review period, with headline inflation remaining above the upper limit of the Bank's 6 - 9 per cent benchmark. In general, domestic price development reflected the effects of supply and demand factors.

Supply side factors included structural constraints and the flow of liquidity to the economy. The structural factors include: poor weather conditions which led to the flooding of farmlands; and continued insecurity across most of the farming communities fuelled by insurgency, armed banditry and farmer-herders conflicts which constrained supply of agricultural products, leading to higher prices. These were, however, moderated by stability in the naira exchange rate. The stability of the exchange rate was sustained by existing and new measures to boost capital inflow and improve liquidity in the market. The existing measures included activities at the Investors' & Exporters' window, the use of Bank Verification Number (BVN) for BDC transactions, and sale of foreign exchange to BDCs by the Bank and inflow through International Money Transfer Operators (IMTOs) by banks. The additional measures were: introduction of special foreign exchange intervention sales to BDCs and inclusion of fertilizer to the list of 41 items excluded from accessing foreign exchange at the interbank window. The robust level of external reserves, following the recovery of crude oil prices further supported the stability in the foreign exchange market in the review period. In addition, the Bank also sustained the repatriation of export proceeds as well as return of unutilized foreign exchange sourced from CBN auctions.

The demand-side factors were the primary drivers of price resurgence in the review period. The increased demand for money market securities led to expansion in money supply, which fed into domestic prices. On account of this and coupled with prevailing uncertainties in the market, the Inter-Bank Call and Open Buy Back (OBB) rates fluctuated widely for most of the period and below the benchmark policy rate. The major sources of liquidity in the review period were: CBN interventions, the implementation of 2018 budget, maturing CBN and Open Market Operations (OMO) bills, Joint Ventures Cash (JVC) calls, and increased FAAC distribution.

## 3.1 Trend in Inflation

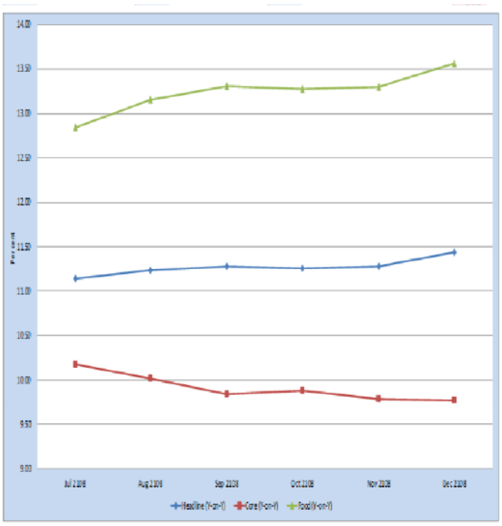
The Consumer Price Indices (CPI) for headline, core and food measures rose from 263.4, 248.2 and 282.2 in July 2018, respectively, to 274.6, 256.7 and 296.4, in December 2018. Accordingly, food inflation (year-on-year) rose by 0.71 percentage point from 12.85 per cent in July to 13.56 per cent in December 2018. However, core inflation declined by 0.41 percentage point from 10.18 per cent in July 2018 to 9.77 per cent in December 2018. As a result, headline inflation increased by 0.30 percentage point from 11.14 per cent in July to 11.44 per cent at end-December 2018.

**Table 3.1:**
**Inflation Rates, July – Dec 2018**

| | Headline Inflation | | | Core Inflation | | | Food Inflation | | |
|---|---|---|---|---|---|---|---|---|---|
| | CPI | Y-on-Y | 12MMA | CPI | Y-on-Y | 12MMA | CPI | Y-on-Y | 12MMA |
| Jul 2018 | 263.42 | 11.14 | 13.95 | 248.12 | 10.18 | 11.48 | 282.16 | 12.85 | 17.10 |
| Aug 2018 | 266.18 | 11.23 | 13.55 | 250.05 | 10.02 | 11.28 | 286.17 | 13.16 | 16.50 |
| Sep 2018 | 268.41 | 11.28 | 13.16 | 251.65 | 9.84 | 11.09 | 289.03 | 13.31 | 15.92 |
| Oct 2018 | 270.39 | 11.26 | 12.78 | 253.67 | 9.88 | 10.90 | 291.39 | 13.28 | 15.36 |
| Nov 2018 | 272.56 | 11.28 | 12.41 | 255.41 | 9.79 | 10.70 | 294.02 | 13.30 | 14.80 |
| Dec 2018 | 274.57 | 11.44 | 12.10 | 256.68 | 9.77 | 10.51 | 296.40 | 13.56 | 14.35 |

***Source:*** *Nigerian National Bureau of Statistics data base*

**Figure 3.1:**
**Headline, Core and Food Inflation Rates (July–Dec 2018) in per cent**



***Source:*** *NBS*

### 3.1.1 Headline Inflation

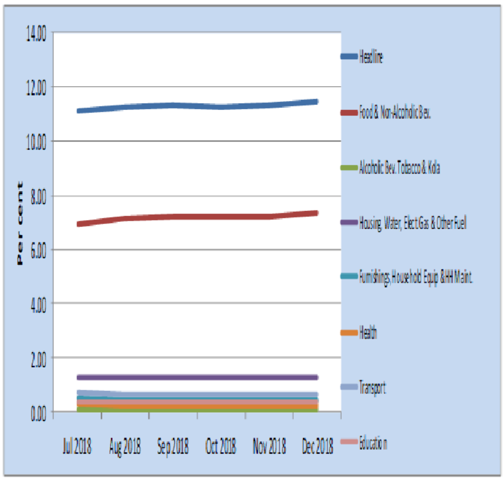
The major components of headline inflation during the second half of the year reflected an upward movement in domestic prices. Food and non-alcoholic beverages remained the major driver, rising from 6.97 per cent in July to 7.38 per cent in December 2018. This was followed by housing, water, electricity, gas and other fuels, which increased from 1.28 per cent to 1.29 per cent over the same period. Overall, headline inflation rose from 11.14 per cent in July to 11.44 per cent in December 2018.

The upward trend in headline inflation was mainly due to supply-side factors notably: poor weather conditions leading to flooding of farmlands; and the continued insecurity across most of the farming communities fuelled by insurgency, armed banditry and farmer-herders conflicts. Other contributory factors were the increase in fiscal activities resulting from increased FAAC disbursements to the three tiers of government. The developments in prices were, however, moderated by the stability in the foreign exchange market in response to the Bank's sustained policy intervention.

**Table 3.2:**
**Major Components of Headline Inflation (Y-on-Y), July–December 2018**

| | Headline | Food & Non-Alcoholic Bev. | Alcoholic Bev. Tobacco & Kola | Clothing & footwear | Housing, Water, Elect.Gas & Other Fuel | Furnishings, Household Equip &HH Maint. | Health | Transport | Education |
|---|---|---|---|---|---|---|---|---|---|
| Jul 2018 | 11.14 | 6.97 | 0.08 | 0.78 | 1.28 | 0.47 | 0.25 | 0.67 | 0.34 |
| Aug 2018 | 11.23 | 7.15 | 0.08 | 0.76 | 1.27 | 0.44 | 0.24 | 0.65 | 0.34 |
| Sep 2018 | 11.28 | 7.23 | 0.08 | 0.75 | 1.27 | 0.43 | 0.24 | 0.64 | 0.34 |
| Oct 2018 | 11.26 | 7.22 | 0.08 | 0.74 | 1.26 | 0.43 | 0.24 | 0.63 | 0.34 |
| Nov 2018 | 11.28 | 7.24 | 0.09 | 0.74 | 1.27 | 0.43 | 0.24 | 0.63 | 0.34 |
| Dec 2018 | 11.44 | 7.38 | 0.09 | 0.75 | 1.29 | 0.43 | 0.25 | 0.62 | 0.34 |
| Change btw Jul & Dec. 2018 | 0.30 | 0.41 | 0.01 | -0.03 | 0.01 | -0.04 | 0.00 | -0.05 | 0.00 |

**Figure 3.2:**
**Major Components of Headline Inflation (Y-on-Y), Jul – Dec 2018.**



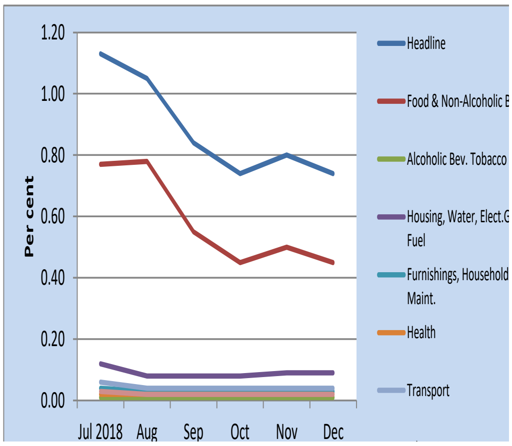

On a month-on-month basis, headline inflation declined from 1.13 per cent in July to 0.74 per cent in December 2018. This decline was traceable to the fall in the prices of food and non-alcoholic beverages, from 0.77 per cent in July 2018 to 0.45 per cent in December 2018. Similarly, housing, water, electricity, gas & other fuel fell from 0.12 per cent in July to 0.09 per cent in December 2018 (Table 3.3 and Figure 3.5). The decline in the month-on-month headline inflation as opposed to the rising year-on-year measure, suggests that year-on-year headline inflation may moderate in the short to medium term.

**Table 3.3:**
**Major Components of Headline Inflation (M-on-M), July - December 2018**

| | Headline | Food & Non-Alcoholic Bev. | Alcoholic Bev. Tobacco & Kola | Clothing & footwear | Housing, Water, Elect.Gas & Other Fuel | Furnishings, Household Equip &HH Maint. | Health | Transport | Education |
|---|---|---|---|---|---|---|---|---|---|
| Jul 2018 | 1.13 | 0.77 | 0.01 | 0.06 | 0.12 | 0.04 | 0.02 | 0.06 | 0.03 |
| Aug 2018 | 1.05 | 0.78 | 0.01 | 0.06 | 0.08 | 0.03 | 0.02 | 0.04 | 0.02 |
| Sep 2018 | 0.84 | 0.55 | 0.01 | 0.06 | 0.08 | 0.03 | 0.02 | 0.04 | 0.02 |
| Oct 2018 | 0.74 | 0.45 | 0.01 | 0.06 | 0.08 | 0.03 | 0.02 | 0.04 | 0.02 |
| Nov 2018 | 0.80 | 0.50 | 0.01 | 0.06 | 0.09 | 0.03 | 0.02 | 0.04 | 0.02 |
| Dec 2018 | 0.74 | 0.45 | 0.01 | 0.06 | 0.09 | 0.03 | 0.02 | 0.04 | 0.02 |
| Change btw Jul & Dec. 2018 | -0.39 | -0.32 | 0.00 | 0.00 | -0.03 | -0.01 | -0.01 | -0.01 | -0.01 |

**Source: NBS**

**Figure 3.3:**
**Major Components of Headline Inflation (M-on-M), July – December 2018**




**Source: NBS**

### 3.1.2 Food Inflation

Food inflation (year-on-year) trended upwards from 12.85 per cent in July to 13.56 per cent in December 2018, an increase of 0.71 percentage point. The major source of the increase was the

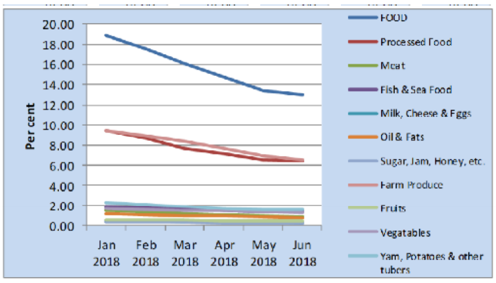
0.76 percentage point rise in the price of farm produce from 6.53 to 7.29 per cent. Processed food, however, declined by 0.05 percentage point from 6.32 per cent in July to 6.27 per cent in December 2018. The higher price of farm produce was accounted for by the increase of 0.15, 0.14 and 0.04 percentage point in the prices of potatoes & other tubers, vegetables, and fruits, respectively. The unfavourable weather conditions and festive period spending towards the end of the year also contributed to the uptick in food inflation.

**Table 3.4:**
**Major Components of Food Inflation (Y-on-Y), July - December 2018**

| | FOOD | Processed Food | Meat | Fish & Sea Food | Milk,Cheese & Eggs | Oil & Fats | Farm Produce | Fruits | Vegatables | Yam Potatoes & other tubers |
|---|---|---|---|---|---|---|---|---|---|---|
| Jul'18 | 12.85 | 6.32 | 0.95 | 1.29 | 0.25 | 0.75 | 6.53 | 0.45 | 1.29 | 1.56 |
| Aug'18 | 13.16 | 6.59 | 1.02 | 1.28 | 0.24 | 0.77 | 6.57 | 0.46 | 1.35 | 1.56 |
| Sep'18 | 13.31 | 6.67 | 1.05 | 1.29 | 0.24 | 0.78 | 6.64 | 0.48 | 1.38 | 1.60 |
| Oct'18 | 13.28 | 6.44 | 1.07 | 1.29 | 0.24 | 0.79 | 6.84 | 0.48 | 1.39 | 1.63 |
| Nov'18 | 13.30 | 6.60 | 1.10 | 1.30 | 0.24 | 0.79 | 6.70 | 0.49 | 1.41 | 1.68 |
| Dec'18 | 13.56 | 6.27 | 1.14 | 1.34 | 0.24 | 0.80 | 7.29 | 0.49 | 1.43 | 1.71 |
| change btw Jul & Dec 2018 | 0.71 | -0.05 | 0.19 | 0.05 | 0.01 | 0.05 | 0.76 | 0.04 | 0.14 | 0.15 |

**Source: NBS**

**Figure 3.4**
**Major Components of Food Inflation (Y-on-Y), January – June 2018**




**Source: NBS**

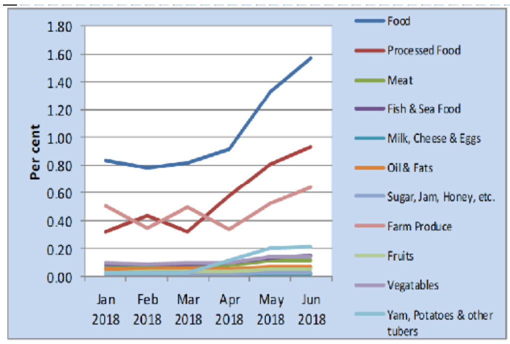
In contrast to the year-on-year trend, food inflation, declined on a month-on-month basis by 0.59 percentage point from 1.40 per cent in July to 0.81 per cent in December 2018. This was driven by the processed food component which declined by 0.69 percentage point from 0.64 per cent in July 2018 to -0.05 per cent in December 2018. On the other hand, the price of farm produce rose by 0.10 percentage point from 0.77 per cent in July to 0.86 per cent in December 2018. The key drivers of the latter were rice agric sold loose and rice local sold loose which rose by 0.11 and 0.09 percentage point, respectively.

**Table 3.5**
**Major Components of Food Inflation (M-on-M), July- December 2018**

| | FOOD | Processed Food | Meat | Fish & Sea Food | Milk,Cheese & Eggs | Oil & Fats | Farm Produce | Fruits | Vegatables | Yam Potatoes & other tubers |
|---|---|---|---|---|---|---|---|---|---|---|
| Jul'18 | 1.40 | 0.64 | 0.11 | 0.14 | 0.02 | 0.07 | 0.77 | 0.05 | 0.15 | 0.20 |
| Aug'18 | 1.42 | 0.76 | 0.12 | 0.13 | 0.02 | 0.08 | 0.66 | 0.05 | 0.15 | 0.17 |
| Sep'18 | 1.00 | 0.39 | 0.09 | 0.09 | 0.02 | 0.06 | 0.61 | 0.04 | 0.11 | 0.12 |
| Oct'18 | 0.82 | 0.24 | 0.08 | 0.08 | 0.02 | 0.06 | 0.58 | 0.03 | 0.09 | 0.10 |
| Nov'18 | 0.91 | 0.61 | 0.07 | 0.09 | 0.02 | 0.05 | 0.29 | 0.03 | 0.09 | 0.10 |
| Dec'18 | 0.81 | -0.05 | 0.07 | 0.09 | 0.02 | 0.05 | 0.86 | 0.03 | 0.08 | 0.09 |
| change btw Jul & Dec 2018 | -0.59 | -0.69 | -0.03 | -0.05 | 0.00 | -0.02 | 0.10 | -0.02 | -0.07 | -0.11 |

**Source: NBS**

**Figure 3.5**
**Major Components of Food Inflation (M-on-M), July - December 2018**




**Source: NBS**

### 3.1.3 Core Inflation

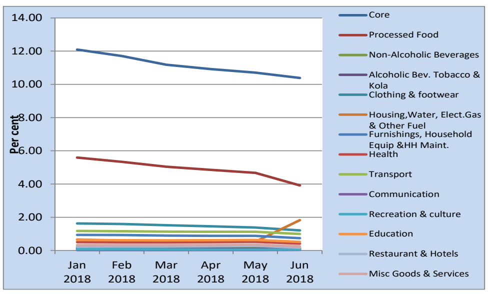
Core inflation (year-on-year) trended downwards from 10.98 per cent in July 2018 to 9.77 per cent in December 2018, a decline of 0.14 percentage point. The development reflected decreases in: clothing and footwear (0.21 percentage point), furnishing, household equipment and maintenance (0.18 percentage point), transportation (0.09 percentage point), and restaurant and hotels (0.02 percentage point). The drop in the prices of clothing & footwear and household equipment and maintenance was attributable to the continued stability in energy prices as well as weak aggregate demand.

**Table 3.6**
**Major Components of Core Inflation (Y-on-Y) July - December 2018**

| | core | Processed Food | Non-Alcoholic Beverages | Alcoholic Bev. Tobacco & Kola | Clothing & footwear | Housing,Water, Elect.Gas & Other Fuel | Furnishings, Household Equip &HH Maint. | Health | Transport | Communication | Recreation & culture | Education | Restaurant & Hotels | Miscellaneous Goods & Services |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Jul'18 | 10.18 | 3.87 | 0.14 | 0.11 | 1.15 | 1.86 | 0.69 | 0.38 | 0.98 | 0.03 | 0.06 | 0.52 | 0.15 | 0.23 |
| Aug'18 | 10.02 | 3.90 | 0.14 | 0.11 | 1.10 | 1.84 | 0.65 | 0.36 | 0.95 | 0.04 | 0.06 | 0.50 | 0.14 | 0.22 |
| Sep'18 | 9.84 | 3.87 | 0.14 | 0.12 | 1.07 | 1.82 | 0.62 | 0.35 | 0.92 | 0.04 | 0.06 | 0.49 | 0.12 | 0.20 |
| Oct'18 | 9.88 | 5.96 | 0.14 | 0.12 | 0.96 | -2.36 | -0.27 | 0.70 | 1.56 | 0.50 | 0.38 | 1.45 | 0.75 | -0.02 |
| Nov'18 | 9.79 | 5.91 | 0.14 | 0.12 | 0.93 | -2.31 | -0.28 | 0.69 | 1.55 | 0.50 | 0.38 | 1.45 | 0.74 | -0.03 |
| Dec'18 | 9.77 | 3.89 | 0.14 | 0.13 | 0.94 | 1.91 | 0.51 | 0.35 | 0.89 | 0.10 | 0.11 | 0.56 | 0.13 | 0.12 |
| change btw Jul & Dec 2018 | -0.14 | 0.02 | 0.00 | 0.02 | -0.21 | 0.05 | -0.18 | -0.03 | -0.09 | 0.07 | 0.04 | 0.04 | -0.02 | -0.11 |

**Source: NBS**

**Figure 3.6**
**Major Components of Core Inflation (Y-on-Y) July - December 2018**




**Source: NBS**

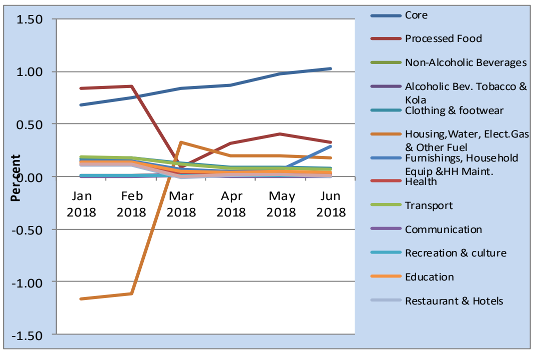
On a month-on-month basis, core inflation, also decreased by 0.31 percentage point from 0.81 per cent in July to 0.50 per cent in December 2018. Housing, water, electricity, gas & other fuel remained the major driver of the fall in core inflation, from 0.17 per cent in July to 0.13 per cent in December 2018. This was followed by furnishing, household equipment & maintenance which fell by 0.02 percentage point.

**Table 3.7**
**Major Components of Core Inflation (M-on-M) July - December. 2018**

| | core | Processed Food | Non-Alcoholic Beverages | Alcoholic Bev. Tobacco & Kola | Clothing & footwear | Housing,Water, Elect.Gas & Other Fuel | Furnishings, Household Equip &HH Maint. | Health | Transport | Communication | Recreation & culture | Education | Restaurant & Hotels | Miscellaneous Goods & Services |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Jul'18 | 0.81 | 0.35 | 0.01 | 0.01 | 0.08 | 0.17 | 0.04 | 0.03 | 0.07 | 0.00 | 0.01 | 0.04 | 0.00 | 0.01 |
| Aug'18 | 0.78 | 0.39 | 0.01 | 0.01 | 0.09 | 0.11 | 0.04 | 0.02 | 0.05 | 0.00 | 0.00 | 0.03 | 0.01 | 0.01 |
| Sep'18 | 0.64 | 0.27 | 0.01 | 0.01 | 0.08 | 0.12 | 0.04 | 0.02 | 0.05 | 0.00 | 0.00 | 0.03 | 0.00 | 0.01 |
| Oct'18 | 0.81 | 2.19 | 0.01 | 0.01 | -0.01 | -3.71 | -0.76 | 0.35 | 0.66 | 0.43 | 0.30 | 0.92 | 0.59 | -0.18 |
| Nov'18 | 0.68 | 2.09 | 0.01 | 0.01 | -0.03 | -3.66 | -0.77 | 0.34 | 0.66 | 0.43 | 0.30 | 0.92 | 0.58 | -0.19 |
| Dec'18 | 0.50 | 0.17 | 0.01 | 0.01 | 0.06 | 0.13 | 0.02 | 0.01 | 0.05 | 0.01 | 0.01 | 0.03 | -0.01 | -0.01 |
| change btw Jul & Dec 2018 | -0.31 | -0.18 | 0.00 | 0.00 | -0.02 | -0.04 | -0.02 | -0.02 | -0.02 | 0.01 | 0.00 | -0.01 | -0.01 | -0.01 |

**Source: NBS**

**Figure 3.7**
**Major Components of Core Inflation (M-on-M) January – June 2018**




**Source: NBS**

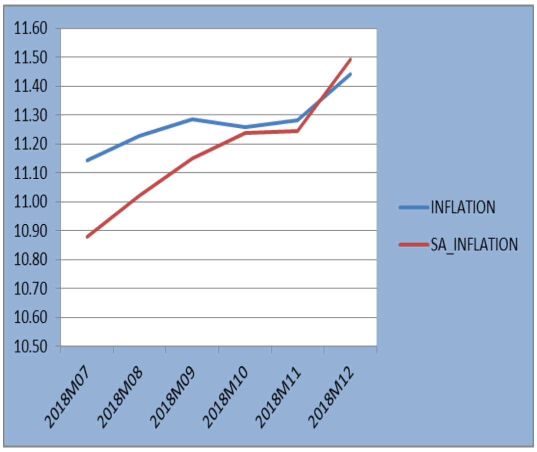
### 3.1.4 Seasonally-Adjusted Inflation

In the review period, actual and seasonally-adjusted headline inflation trended upwards, reversing the downward trend witnessed in the first half of 2018 (Table 3.8 and Figure 3.10). Actual headline inflation trended generally above the seasonally-adjusted measure during the second half of 2018. The overall upward trend in headline inflation and its seasonally-adjusted measure can be attributed to the increased spending associated with end-of-year festivities and the forthcoming general elections, rising food prices due to unfavourable weather conditions in some parts of the country as well as the disruptive impact of insecurity on the production and distribution systems of the economy, despite the tight monetary policy stance of the Bank.

**Table 3.8**
**Actual and Seasonally Adjusted Headline Inflation July – December 2018**

| Date | Inflation | Seasonally Adjusted Inflation |
|---|---|---|
| Jul-18 | **11.14** | 10.88 |
| Aug-18 | **11.23** | 11.02 |
| Sep-28 | **11.28** | 11.15 |
| Oct-18 | **11.26** | 11.24 |
| Nov-18 | **11.28** | 11.25 |
| Dec-18 | **11.44** | 11.49 |

**Figure 3.8**
**Actual and Seasonally Adjusted Headline Inflation July – December 2018**




**Source: NBS**

### 3.2 Key Factors that Influenced Domestic Prices

Inflationary trend during the period was primarily driven by cost-push, demand-pull and some moderating factors. Inflation rose slightly during the period owing to the net effect of these forces. The key factors included: unfavourable weather conditions in some parts of the country leading to poor harvests; continued liquidity surfeit in the banking system; and increased FAAC disbursements arising from improved foreign exchange receipts. Others were: the repayment of outstanding contractors debts and salary arrears by governments; the impact of festive and other seasonal activities; persistent clashes between herdsmen and farmers in some parts of the country; and production and distribution challenges due to insurgency in the North-east. The moderating factors were: stability in the exchange rate, energy prices, and sustained tight monetary policy stance of the Bank.

### 3.2.1 Demand-side Factors

On the demand side, the increase in headline inflation was traceable to sustained liquidity surfeit in the banking system as well as liquidity in the wider economy. The major sources of liquidity in the review period were: CBN interventions, the implementation of the 2018 Federal Government budget, maturing CBN and OMO bills, Joint Ventures Cash (JVC) calls, the repayment of outstanding contractor debts and salary arrears by governments; and increased FAAC disbursements owing to higher oil receipts. Overall, these factors drove domestic price developments during the review period.

### 3.2.2. Supply-side Factors

In the review period, a number of supply side factors drove inflationary pressure. These were: unfavourable weather conditions leading to poor harvests; persistent clashes between herdsmen and farmers in some parts of the country; armed banditry; and production and distribution challenges due to insurgency in the North-east. The increased political and policy uncertainties in the run-up to the 2019 general election affected investment and production decisions thereby influencing expectations. The net effect of these factors was to constrain output and supply, thereby putting upward pressure on domestic prices.

### 3.2.3 Moderating Factors

The moderating factors were the supply and demand forces during the period that calmed the upward pressure on prices. These were: sustained stability in the exchange rate, stable energy prices, and the continued tight monetary policy stance of the Bank.

**BOX 3.1 MINIMUM WAGE AND INFLATION IN NIGERIA: IMPLICATIONS FOR MONETARY POLICY**

Historically, wages in Nigeria are bargained between Government and labour but are not regularly reviewed. Consequently, workers continue to clamour for review of wages in line with domestic economic developments, working conditions and global trends. This is usually premised on welfare considerations taking cognisance of the erosion in the purchasing power of money and currency depreciation. These forces are even more severe in an import dependent economy, which is more susceptible to the adverse effects of imported inflation.

The clamour for a minimum wage is to ensure that the welfare consideration of the least paid worker in an economy is not undermined. The argument is that with inflation, fixed wages buy less goods and services over time. As such, since those on minimum wage are the least paid, they are the most hit by inflation. Consequently, there is a need to always update the wages of the least paid to ensure that they maintain a minimum level of welfare, commensurate with the welfare and developmental agenda of the government as well as those of the international community. Additionally, increasing the minimum wage, would lead to productivity and efficiency gains, in essence advancing the efficiency wage argument. It is against this background that there has been persistent clamour for the review of the national minimum wage in Nigeria.

The minimum wage in Nigeria, is determined by the government and is guided by the National Minimum Wage (Amendment) Act 2011 which is binding on the both the private and public sectors at the Local, State and Federal Government levels. The minimum wage is typically negotiated with workers' representatives/unions and by the employers of labour in the economy, notably the government and the private sector. The first structured monthly minimum wage in Nigeria was set in 1981 at ₦125.00; it was later increased to ₦250.00 in 1989/90. The administration of Gen. Abdulsalami Abubakar approved an increase of the monthly minimum wage to ₦3,000.00 in 1998. In 2000/01, there was an increase to ₦5,500.00 for state workers and ₦7,500.00 for federal and oil sector workers. In 2010, the monthly minimum wage was increased again to ₦18,000.00 through a tripartite structure that was signed into law; with part of the provisions being that the minimum wage should be reviewed every 5 years. A tripartite committee was set up again in 2017 for the review of the national minimum wage which according to the provisions of the law had been due for a review since 2015. On November 6, 2018, the Federal Government approved a monthly minimum wage of ₦30, 000.00.

The Table below summarises the relationship between inflation rate and the national minimum wage in Nigeria.

Although the welfare argument has been proffered as a justifiable reason for the implementation of successive reviews of the minimum wage, contrary views have also been advanced that in general, minimum wages may reduce rather than enhance the welfare of citizens.

| **Year** | **Minimum Wage (₦)** | **Inflation Rate (%)** |
|---|---|---|
| 1981 | 125 | 17.40 |
| 1990 | 250 | 3.6 |
| 1998 | 3,000 | 11.9 |
| 2001 | 5,500 and 7,500 | 16.49 |
| 2010 | 18,000 | 11.82 |
| 2018 | 30000 | 11.44 |

The proponents of this view argue that increase in the minimum wage initially increases the wages of the beneficiaries; which then triggers wage comparison across board, resulting in comparative reviews in general wage levels. This practice generates a shift across board in unit labour cost, and adjustment in factor mix, in line with the productive sector's cost minimisation objective. The resultant factor substitution (i.e. labour/capital substitution) may or may not result in increased productivity as the net substitution effect is dependent on the stage of the business cycle, the existing policy environment as well as inflation expectations. The spill-over effect of the minimum wage increases affects the unemployment rate, productivity and inflation. If increases in minimum wage results in higher unemployment, this reduces the bargaining power of unions and becomes deflationary, which may mitigate inflation and inflationary expectations. Alternatively, if the increased minimum wage induces a significant improvement in productivity, it will lead to increased capacity utilisation and aggregate production and a fall in prices and inflation expectations, particularly when an economy is operating far from its full employment capacity. However, if the economy is operating near its full employment capacity, an increase in minimum wage will result in higher unemployment and inflation, as well as decreased output. The significant increase in production costs will outweigh the productivity gain from increased wages and deflationary impact of higher unemployment, resulting in a new equilibrium characterised by lower output and higher prices.

The implication of minimum wage adjustments for monetary policy would significantly depend on the stage of the economy on the business cycle and the output gap. A negative output gap in an economy that is slowly emerging from recession indicates that the economy could still absorb the effect of moderate increases in the minimum wage without adverse inflationary consequences. This was clearly the case with Nigeria during the 2018 national minimum wage review. However, the demand for minimum wage review in an economy with a positive output gap, would likely generate inflationary pressures. In addition, the inflationary effects of minimum wage reviews would depend on how it is funded as some funding sources are potentially inflationary.

# CHAPTER 4

## 4.0 MONETARY POLICY AND LIQUIDITY MANAGEMENT

The design and implementation of monetary policy in the second half of 2018 was shaped by developments in global and domestic economic and financial environments. On the global front, rising trade tensions and policy uncertainties, difficult BREXIT negotiations, build-up in financial vulnerabilities and currency depreciations, remained the key developments in the review period. These were accentuated by rising cost of borrowing, continuous capital flow reversal, fiscal fragilities and increased debt burden especially in the emerging market and developing economies. Others included: the recent episodes of large-scale flooding in major areas across the globe, resurgence of global inflationary pressures, continued geo-political tensions as well as increasingly depressed aggregate demand in some countries.

On the domestic front, key developments that shaped monetary policy in the review period were: the fragile economic recovery; disruptions to the food supply chain due to insurgency and herdsmen-farmers crisis in some parts of the country; impact of flooding on agricultural output and other economic activities; rebuilding of inflationary pressures; liquidity surfeit in the banking system; pre-election spending; and the liquidity impact of the 2018 expansionary Federal Government budget. Others included: low fiscal buffers; rising public debt; the high level of non-performing loans in the banking system; reduced portfolio inflows; low domestic credit and weak intermediation by Deposit Money Banks. The Bank's goal to support the fragile economic recovery without compromising its primary mandate of ensuring price and financial system stability, informed the direction of monetary policy in the review period.

## 4.1 Decisions of The Monetary Policy Committee (MPC)

During the second half of 2018, decisions of the Monetary Policy Committee (MPC) were influenced by key developments in the global and domestic economic and financial environments. The global factors were: rising trade tensions, uncertainties in BREXIT negotiations, and concerns over North Korea's commitment to the denuclearisation of the Korean Peninsula. Others were: the build-up of financial vulnerabilities and policy uncertainties; rising energy prices and costs of borrowing in the Emerging Markets and Developing Economies; sustained recovery in global commodity prices, as well as recent episodes of large-scale flooding in major areas across the globe which could pose some threat to growth. Furthermore, other considerations included: the resurgence of global inflationary pressures, continuous capital flow reversal and moderate currency depreciations, especially in the emerging markets as well as a strengthening US dollar and subdued global economic growth outlook. Also, the gradual erosion of rule-based multilateral trading system, fiscal fragilities and increased debt burden, continued geo-political tensions as well as increasingly depressed aggregate demand in some countries, helped to shape the nature of policy choices.

The key developments in the domestic economy were: the still fragile economic recovery; worsening farmer-herdsmen conflicts in some parts of the country; disruptions to the food supply chain in major food producing States due to the combined effects of poor infrastructure and high cost of energy; and uncertainties surrounding the external demand for Nigeria's oil. Other concerns were: the rebuilding of inflationary pressures; pre-election spending; concerns about the liquidity impact of the 2018 expansionary Federal Government budget as well as increased FAAC distributions. Others included: low fiscal buffers despite rising oil prices; continued non-payment of workers' salaries and pensions in some States; weakening demand and consumer spending, build-up in contractor debt, as well as impact of flooding on agricultural output and other economic activities. In addition, rising sovereign debts, anticipated review of the national minimum wage; the rising levels of non-performing loans in the banking system; reduced portfolio inflows; low domestic credit and weak intermediation by Deposit Money Banks were noticeable. These developments and the need to achieve the Bank's mandate of price stability conducive to sustainable economic growth were the key considerations that informed monetary policy decisions in the review period.

### 4.1.1 July 2018 MPC Meeting

At its 23rd and 24th July, 2018 meeting, the Monetary Policy Committee reviewed developments in the global and domestic economic and financial environments, as well as the outlook for the rest of the year.

The MPC noted that global growth momentum remained promising despite rising trade tensions, uncertainties in BREXIT negotiations and concerns over North Korea's commitment to the denuclearisation of the Korean Peninsula. Other notable challenges were: currency depreciations, rising energy prices and costs of borrowing in the Emerging Markets and Developing Economies. Consequently, global growth was projected at 3.9 per cent in 2018, up from 3.7 per cent in 2017, largely driven by the recovery in oil prices, rising asset prices and long term yields in major financial markets as well as a rebound in investment, manufacturing output and trade.

On the domestic front, data from the National Bureau of Statistics (NBS) showed that real Gross Domestic Product (GDP) grew by 1.95 per cent in the first quarter of 2018, compared with 2.11 per cent in the preceding quarter and a contraction of 0.91 per cent in the corresponding quarter of 2017. The Committee noted that the oil sector was the major source of growth, contributing 1.26 per cent in Q1 2018 up from 0.76 per cent in Q4 2017. The Committee welcomed the positive outlook to growth of the domestic economy as the Purchasing Managers Indices (PMI) for manufacturing, and non-manufacturing activities rose for the fifteenth and fourteenth consecutive months to 57.0 and 57.5 points, respectively, in June 2018.

In terms of prices, the Committee was satisfied with the continued deceleration in domestic prices as headline inflation (year-on-year) trended downwards for the seventeenth consecutive month to 11.23 per cent in June 2018 from 11.61 per cent in May. Food and Core inflation also fell to 12.98 and 10.40 per cent, from 13.45 and 10.71 per cent, respectively, over the period. The Committee, however, observed a rise in the month-on-month inflation rate, to 1.24 per cent in June, from 1.09 per cent in May 2018, suggesting the possibility of a rebuilding of inflationary pressures.

The MPC noted with satisfaction the relative stability in the financial markets as reflected in the marginal increase in the All-Share Index (ASI) by 0.09 per cent to 38,278.55 on June 29, 2018, from 38,243.19 at end-December 2017. Market Capitalisation (MC) also increased by 1.89 per cent to N13.87 trillion on June 29, 2018, from N13.61 trillion at end-December 2017. The Committee, however, observed that ASI and MC fell by 7.24 per cent, apiece, on June 29, 2018 compared with the level at end-April 2018 as a result of the profit taking activities of investors, and the effect of monetary policy normalization in the United States. The MPC noted the continued improvements in the performance of deposit money banks and expressed optimism that the moderation in non-performing loans in the industry will continue. The Committee also noted with satisfaction, the relative stability in the foreign exchange market as well as high level of activities, particularly, at the Investors' and Exporters' (I&E) window. In addition, the commencement of the currency swap deal with the People's Bank of China (PBoC) and improved availability of Renminbi to Nigerian investors will ease pressure in the foreign exchange market.

In its considerations, the Committee noted with satisfaction the fourth consecutive quarter of growth in real GDP and the positive growth outlook in the domestic economy. The MPC commended the approval of the 2018 Federal Government budget and called for its accelerated implementation to further support the fragile growth recovery. The Committee also urged the sustained implementation of the Economic Recovery and Growth Plan (ERGP) to further stimulate output growth. The MPC was, however, concerned about the liquidity impact of the 2018 expansionary fiscal budget and increasing Federation Accounts Allocation Committee (FAAC) disbursements, owing to rising prices of crude oil as well as the build-up in election related spending. The Committee took note of the sustained moderation in inflationary pressures; especially headline inflation, as well as stability in the foreign exchange market. It, however, expressed concern on the threat posed by incessant herdsmen-farmers crisis in some key food producing states particularly the negative impact on food supply chains which could continue to exert upward pressure on food prices. Overall, the Committee considered the sustained positive growth in real GDP over the last quarter, stability in the foreign exchange market and high level of accretion to external reserves.

In arriving at its decision, the MPC reviewed the policy options available at this meeting, notably to raise, ease or hold policy. The Committee strongly considered the option of tightening given that this measure would curtail the threat of a rise in inflation, even as the injection from the fiscal authorities would still provide the economy with substantial liquidity. Also, tightening would help stem the tide of capital flow reversals, rein-in inflationary pressure, increase real interest rate, build investor confidence with positive impact on capital inflows and further stabilize the country's exchange rate. On the other hand, the Committee was not unmindful of the risks of raising rate namely the possibility of weakening consumption, and increasing the cost of borrowing in the domestic economy. In considering the option of loosening, the MPC assessed its potential positive effects in stimulating aggregate demand through lower cost of capital. The Committee also noted the potential risks to loosening in terms of exacerbating inflationary and exchange rate pressures as well as returning the real interest rate into negative territory. The argument for holding was also considered. On this, the MPC believed that the risks to the macroeconomic and financial environment appeared fairly balanced with respect to improvements in output growth and inflation outcomes. Holding policy in the prevailing circumstance will continue to support growth and further moderate inflation.

The MPC recognised the difficult choices before it as each policy option had its strengths and weaknesses. Accordingly, a heterodox approach to reform the market in order to strengthen the flow of credit would be appropriate at this time. Consequently and as part of the decisions, credit constrained businesses, particularly large corporations are encouraged to issue commercial paper to meet their credit needs, as a way of incentivizing deposit money banks to increase lending to manufacturing and agriculture. In addition, a differentiated dynamic cash reserve requirement (CRR) regime would be implemented, to direct cheap long term bank credit at 9 per cent, with a minimum tenor of seven (7) years and two-year moratorium to employment elastic sectors of the economy.

In consideration of the foregoing, therefore, the Committee decided by a vote of Seven (7) members to retain the Monetary Policy Rate (MPR) at 14.00 per cent alongside all other policy parameters. Two (2) members, however, voted to increase the MPR by 50 basis points, while one (1) member voted to increase the MPR by 25 basis points.

### 4.1.2 September 2018 MPC Meeting

The September 24 and 25, 2018 meeting of the MPC evaluated developments in the global and domestic economic environments in the first eight months and the outlook for the rest of the year. The MPC noted the uneven expansion in global output amidst growing trade tensions, rising oil prices and debt levels as well as currency depreciation in most of the notable emerging markets and developing economies (EMDEs). Notwithstanding these developments, there was evidence of resilient financial markets and output growth in the advanced economies. Consequently, growth in the advanced economies was projected 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 was projected to grow by 2.9 per cent in 2018. In the EMDEs, growth was expected to remain strong at 4.9 per cent in 2018 compared with 4.7 per cent in 2017, led by India and China. On average, growth momentum in the global economy was on track as financial conditions were broadly favourable with limited spill-over of trade tensions. However, the episodes of large-scale flooding in major areas across the globe could threaten growth.

On the domestic front, data from the National Bureau of Statistics (NBS) showed that real GDP growth declined to 1.50 per cent in the second quarter of 2018, from 1.95 per cent in the preceding quarter, although higher than 0.72 per cent in the corresponding quarter of 2017. The decline was traceable to the contraction in the oil sector during the second quarter of 2018. The Committee noted, however, 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. The performance of the non-oil sector was 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 Committee was concerned that the economy's exit from recession may be under threat as output slowed in Q2 relative to Q1, 2018. In this regard, the Committee urged the 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 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.

Further analysis of price developments indicated that headline inflation (year-on-year) inched up to 11.23 per cent in

August 2018, from 11.14 per cent in July 2018. The Committee observed that while core inflation declined, the rise in headline inflation was driven by the food component, indicating that supply side factors were driving the increase.

On financial stability parameters, 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 Committee attributed the developments to continued profit-taking by portfolio investors and capital reversals as foreign yields had become increasingly attractive. The Committee was equally concerned about 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 and investment growth in the private sector.

Available data and forecast of key macroeconomic indicators showed 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 continued stability in the foreign exchange market would stabilize prices and strengthen economic growth.

In the Committee's consideration, modest stability had been achieved in key macroeconomic indicators, including inflation, exchange rate and the external reserves. The MPC, however, observed that the gains so far achieved appeared to be under threat of reversal, following new evidence of weakening macroeconomic fundamentals. The Committee noted that inflationary pressures were rebuilding and capital flow reversals had intensified as shown by the bearish trend in the equities market even though the exchange rate remained stable.

Following the above developments, the MPC reasoned that the economy was still confronted with growth headwinds and inflationary pressures. Accordingly, the Committee reiterated the need for synergy between monetary and fiscal policies as a viable strategy to achieve macroeconomic stability.

In this regard, the Committee identified two likely policy options to anchor its decision namely: tightening or maintaining the status quo. The argument for tightening was that it would tame inflationary pressures, stem the reversal in portfolio capital, improve the external reserve position and maintain stability in the foreign exchange market. On the flip side, the MPC felt that raising rates will further weaken growth as credit will become more expensive, NPLs will increase further, leading to a deceleration in output. The other option of holding all policy parameters constant will, according to the MPC, sustain gradual improvements in output growth, while awaiting clearer understanding of the quantum and timing of liquidity injections into the economy before deciding on possible adjustments.

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, indicating their preference for tightening through the instrument. The other three (3) members voted to tighten by raising the MPR by 25 basis points.

In summary, the MPC voted to: Retain the MPR at 14 per cent; Retain the asymmetric corridor of +200/-500 basis points around the MPR; Retain the CRR at 22.5 per cent; and Retain the Liquidity Ratio at 30 per cent.

### 4.1.3 November 2018 MPC Meeting

The November 21 and 22, 2018 meeting of the Monetary Policy Committee appraised recent developments in the global and domestic macroeconomic and financial environments, with near term outlook into the first half of 2019. The MPC observed a contraction in global output, underpinned largely by escalating trade tensions resulting from widespread uncertainty and waning investor confidence. Consequently, global growth in 2018 was downgraded to 3.7 per cent from the earlier estimate of 3.9 per cent. The outcome reflected the softening of growth in the major advanced economies in the third quarter of 2018. Growth in the Emerging Markets and Developing Economies (EMDEs) remained uneven, owing to a combination of country-specific factors. Overall, the downside risks to global economic activity were: elevated financial and fiscal fragilities and policy uncertainties; gradual erosion of the rule-based multilateral trading system; tighter financial conditions with underlying threat of disruptive portfolio adjustments, reflected in increased capital flow reversals and exchange rate volatilities; as well as depressed aggregate demand in some countries. The Committee believed that these factors in addition to geo-political tensions, would chart the course of developments for the rest of 2018 and beyond.

On the domestic scene, the MPC noted the positive outlook for output growth, evidenced by the Manufacturing and Non-manufacturing Purchasing Managers Indices (PMI), which stood at 56.8 and 57.0 points, respectively, in October 2018, indicating expansion for the 19$^{th}$ and 18$^{th}$ consecutive months. The development was attributed to the stability in the foreign exchange market, implementation of the 2018 capital budget and the on-going intervention of the CBN in the real sector of the economy. However, the recent incidence of flooding across the country and the impact of herdsmen attack on farming communities could affect output growth for the rest of the year. In terms of price developments, the Committee welcomed the benign performance of headline inflation of 11.26 per cent in October 2018, representing a decrease from 11.28 per cent in September after two consecutive months of marginal increases. The drop in headline inflation was driven by the food component, which moderated to 13.28 per cent in October 2018 from 13.31 per cent in September. Core inflation, however, inched up marginally to 9.9 per cent in October 2018 from 9.8 per cent in the previous month.

The Committee also assessed the state of financial system stability, being the principal channel for monetary policy transmission. In this regard, the MPC observed a bearish trend in the equities segment of the Nigerian capital market during the period, as the All-Share Index (ASI) decreased by 8.70 per cent from 34,848.45 on August 31, 2018 to 32,058.28 on November 16, 2018. Similarly, Market Capitalization (MC) decreased by 8.72 per cent from N12.72 trillion to N11.70 trillion in the same period. Relative to the end-December 2017, the indices decreased by 19.29 and 16.32 per cent, respectively. These developments largely reflected sustained profit taking activities by portfolio investors as foreign yields become increasingly attractive. The MPC, however, believed that this trend would reverse in the medium term given the current efforts at further improving investor confidence and restoring stability in the foreign exchange market. The MPC also observed improvements in financial stability indicators, including non-performing loans, capital adequacy and liquidity ratios of the Deposit Money Banks (DMBs). It urged the Bank to sustain its surveillance over the Banking industry and take prompt corrective measures to further improve stability in the system.

The MPC in its consideration, assessed the macroeconomic environment in 2018 and noted the modest stability thus far achieved in domestic prices, output growth and in the financial system. The Committee was convinced that the economy was on the right path, but some key sectors continued to experience significant challenges. The MPC also expressed concern about the tepid growth outlook, partly hinged on growing uncertainty in the global financial markets, the poor reception of the BREXIT deal by British politicians, continuing trade war between the US and her major trading partners, as well as the commencement of US sanctions on Iran. While the Committee noted the economy's tepid recovery from recession, it called for further efforts to strengthen aggregate demand.

The MPC welcomed the moderation in inflation in October 2018, reflected in declining food prices. It believed that given the negative output gap due to prolonged weak aggregate demand arising from salary arrears and contractor debt, the proposed increase in the national minimum wage will stimulate output growth.

In reaching its decision, the MPC considered the options to loosen, tighten or hold. The Committee continues to hold the view that loosening would encourage the flow of credit to the real sector, help in reducing the cost of credit and spur business and investment spending, thus reinforcing the CBN's support for output growth and economic recovery. It, however, believed that doing so will reverse more rapidly, the gains of price and exchange rate stability so far achieved. On tightening, the MPC held the view that it will strengthen the stability of the foreign exchange market due to the dampening effect on the demand for foreign exchange. The flip side of this option is that it will dampen investment, depress aggregate demand, and widen the output gap. On the option to hold, the MPC recognized that it had held the policy rate and other parameters constant over the last several meetings. It underscored that holding its policy position constant was an expression of confidence in the existing policies and administrative measures deployed by the Bank which have resulted in the moderation in domestic price levels and stability in the foreign exchange market.

In light of the above, the MPC decided by a vote of all eleven (11) members present to retain the MPR at 14 per cent; the asymmetric corridor of +200/-500 basis points around the MPR; the CRR at 22.5 per cent; and the Liquidity Ratio at 30 per cent.

### 4.2.0 Instruments of Liquidity Management

The Bank in the second half of 2018, continued to conduct monetary policy using various instruments in order to achieve its objectives of price and macroeconomic stability. These instruments were: the Monetary Policy Rate (MPR), the Cash Reserve Ratio (CRR), Liquidity Ratio, Open Market Operations (OMO) and Discount Window Operations. These were complemented by periodic interventions in the foreign exchange market.

### 4.2.1 Monetary Policy Rate (MPR)

The MPR remained the key instrument for monetary policy management and was maintained at 14.0 per cent in the review period. The asymmetric corridor around the MPR was also retained at +200 and -500 basis points. The retention of the MPR and its asymmetric corridor signalled confidence in the various policies and administrative measures deployed by the Bank which resulted in the moderation in domestic price levels and stability in the foreign exchange market. It also indicated the Bank's commitment to a tight monetary policy stance.

### 4.2.2 Open Market Operations (OMO)

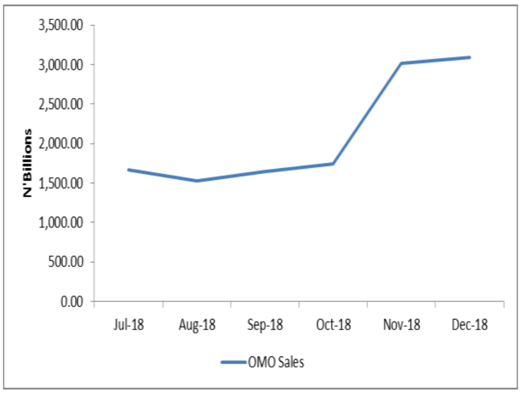
The primary tool used for liquidity management in the second half of 2018 remained the Open Market Operations (OMO). There was an increase in OMO sales in the period under review, amounting to ₦12,709.91 billion compared with ₦9,743.76 billion and ₦7,472.21 billion recorded in the first half of 2018 and the corresponding period of 2017, respectively. This represented an increase of 30.44 per cent and 70.10 per cent in the preceding half year, and the corresponding period of 2017, respectively (Table 4.1). The increase in the volume of OMO sales was attributed to increased frequency of OMO auctions and the introduction of special OMO auctions, as well as roll-over of maturing bills. As in the preceding half year, the increase was also due to incidences of DMBs discounting OMO bills before maturity in the secondary market, thus expanding the monetary base and leading to growth in money supply.

**Table 4.1**
**OMO Bills Auction (July – December, 2018)**
**(₦'billion)**

| Date | 2017 | 2018 | % Change |
|---|---|---|---|
| Jan | 700.52 | 2,132.61 | |
| Feb | 619.14 | 845.28 | |
| Mar | 391.16 | 1,561.38 | |
| Apr | 316.09 | 2,084.46 | |
| May | 580.08 | 2,033.42 | |
| Jun | 1,267.28 | 1,086.61 | |
| **1st Half** | **3,874.27** | **9,743.76** | 151.50 |
| Jul | 1,517.53 | 1,669.13 | |
| Aug | 1,104.57 | 1,529.93 | |
| Sep | 741.85 | 1,651.51 | |
| Oct | 1,179.20 | 1,743.64 | |
| Nov | 1,461.13 | 3,020.28 | |
| Dec | 1,467.93 | 3,095.42 | |
| **2nd Half** | **7,472.21** | **12,709.91** | 70.10 |
| **Cumulative Figure** | **11,346.48** | **22,453.67** | 97.89 |

**Source: Financial Market Department**

**Figure 4.1**
**OMO Bills Auction (July - December, 2018)**




### 4.2.3 Reserve Requirements

To complement the MPR and OMO as instruments of liquidity management, the Bank deployed Reserve Requirements namely: Cash Reserve and Liquidity Ratios as macro-prudential instruments in the second half of 2018. The Monetary Policy Committee maintained the Cash Reserve Ratio (CRR) at 22.5 per cent of total deposits during the period under review, the same as in the preceding half year, to address the persistent liquidity surfeit in the banking system. The liquidity ratio (LR) was also kept unchanged at 30.0 per cent.

### 4.2.4 Standing Facilities

The Bank continued to deploy the standing facilities (lending/deposit) window in the second half of 2018 in order to meet the daily liquidity requirements of Deposit Money Banks (DMBs) and the Discount House (DH). The asymmetric corridor remained unchanged at +200/-500 basis points around the MPR during the period under review.

The request for Standing Lending Facility (SLF), decreased by 33.76 per cent from ₦7,027.46 billion in the first to ₦4,655.06 billion in the second half of 2018. When compared with ₦25,664.35 billion in the corresponding period of 2017, the requests for SLF decreased by 81.86 per cent (Table 4.2).

At the Standing Deposit Facility (SDF) window, the volume of deposits decreased marginally by 4.58 per cent to ₦10,194.71 billion in the second half of 2018 from ₦10,684.38 billion in the first half of 2018. The deposits, however, represented a 138.47 per cent increase relative to N4,275.00 billion in the corresponding period of 2017 (Table 4.3).

Transactions at the two windows resulted in a 51.47 per cent increase in net deposits of ₦5,539.65 billion in the second half of 2018 from ₦3,657.32 billion in the preceding half year. The development reflected continued liquidity surfeit in the banking system as well as increased counter-party risks in the interbank money market.

**Table 4.2**
**CBN Standing Lending Facility (January 2017 – December 2018) (₦'billion)**

| Date | 2017 | 2018 | % Change |
|---|---|---|---|
| Jan | 3,380.57 | 833.09 | |
| Feb | 4,478.50 | 1,020.15 | |
| Mar | 5,052.56 | 952.23 | |
| Apr | 5,746.68 | 1,145.52 | |
| May | 4,596.99 | 1,847.69 | |
| Jun | 4,211.28 | 1,228.78 | |
| **1st Half** | **27,466.58** | **7,027.46** | **-74.41%** |
| Jul | 3,855.13 | 441.10 | |
| Aug | 5,585.51 | 53.04 | |
| Sep | 4,377.89 | 483.40 | |
| Oct | 5,605.30 | 864.80 | |
| Nov | 3,909.09 | 684.70 | |
| Dec | 2,331.43 | 2,128.02 | |
| **2nd Half** | **25,664.35** | **4,655.06** | **-81.86%** |
| **Total** | **53,130.93** | | |

**Source: Financial Market Department**

**Figure 4.2**
**Standing Lending Facility (July - December, 2018)**

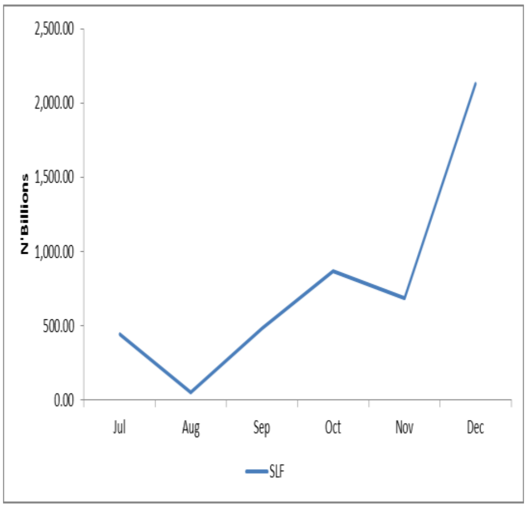
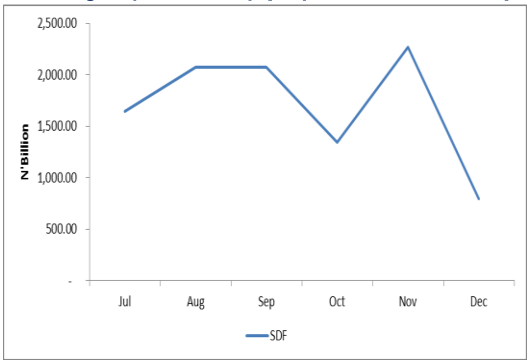


**Table 4.3**
**CBN Standing Deposit Facility (January 2017 – December 2018) (₦'billion)**

| Date | 2017 | 2018 | % Change |
|---|---|---|---|
| Jan | 1,855.98 | 1,919.78 | |
| Feb | 804.07 | 1,144.10 | |
| Mar | 889.35 | 1,508.75 | |
| Apr | 593.79 | 2,952.20 | |
| May | 665.28 | 1,527.04 | |
| Jun | 702.28 | 1,632.51 | |
| **1st Half** | **5,510.75** | **10,684.38** | **93.88%** |
| Jul | 825.1 | 1,643.71 | |
| Aug | 315.24 | 2,073.10 | |
| Sep | 411.43 | 2,070.85 | |
| Oct | 405.21 | 1,345.34 | |
| Nov | 691.97 | 2,267.19 | |
| Dec | 1,626.05 | 794.52 | |
| **2nd Half** | **4,275.00** | **10,194.71** | **138.47%** |
| **Total** | **9,785.75** | **20,879.09** | |

**Source: Financial Market Department**

**Figure 4.3**
**Standing Deposit Facility (July - December, 2018)**




## 4.2.5 Foreign Exchange Intervention

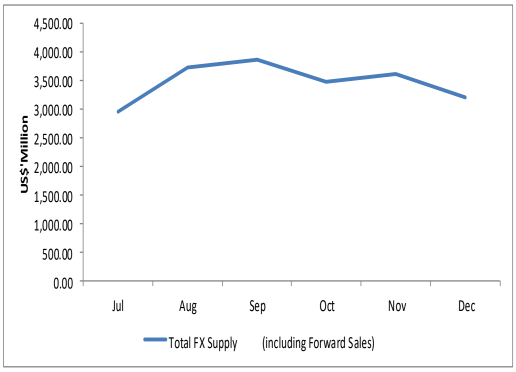
During the second half of 2018, stability in the foreign exchange market was sustained by activities in the various segments, particularly the Investors and Exporters foreign exchange window. The success recorded by the restriction of 41 items from access to official foreign exchange sources became increasingly apparent in the real economy, following increased domestic production of those items. In order to further strengthen the outcome, the policy was expanded to include fertilizer in the list of 41 items. In addition, special foreign exchange intervention sales to BDCs were introduced to address demand pressure in the segment. The Bank also continued its heterodox approach to foreign exchange management by implementing existing and new measures including: the bilateral currency swap between the CBN and the People's Bank of China; intensification of the policy on repatriation of export proceeds and the return of unutilized foreign exchange sourced from CBN auctions. Others were: the use of Bank Verification Number (BVN) in BDC transactions; sale of foreign exchange by the Bank and International Money Transfer Operators (IMTOs) to BDCs; as well as special foreign exchange auctions to targeted sectors and small scale importers. These measures were able to calm the market and guard against the re-emergence of speculative pressures. As a result, total supply of foreign exchange increased substantially by 119.87 per cent to US$20,887.20 million in the second half of 2018 from US$9,499.92 million in the first half of the year. The development represented an increase of 170.89 per cent when compared with US$7,710.49 million in the corresponding period of 2017 (Table 4.4). The increased supply of foreign exchange was also due to improved accretion to foreign reserves occasioned by the rise in oil receipts and the inflow of US$2.8 billion Euro bond proceeds in the second half of 2018. The external reserves position improved significantly from US$39.35 at end-December 2017 to US$42.54 billion at end-December 2018. Notwithstanding the moderate decline in oil prices toward the end of the second half of 2018, private inflows returned to the economy to take advantage of cheaper naira denominated assets thus, helping to support foreign exchange market stability.

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

| Date | 2017 | 2018 | % Change |
|---|---|---|---|
| | Total FX Supply (including Forward Sales) | Total FX Supply (including Forward Sales) | |
| Jan | 768.76 | 1,343.12 | |
| Feb | 876.48 | 1,237.26 | |
| Mar | 1,309.44 | 1,300.93 | |
| Apr | 1,919.30 | 1,422.35 | |
| May | 2,109.93 | 2,039.51 | |
| Jun | 1,121.04 | 2,156.75 | |
| **1st Half** | **8,104.95** | **9,499.92** | **17.21%** |
| Jul | 1,207.00 | 2,966.31 | |
| Aug | 1,449.49 | 3,733.66 | |
| Sep | 1,220.33 | 3,868.67 | |
| Oct | 1,315.99 | 3,481.15 | |
| Nov | 1,210.99 | 3,617.03 | |
| Dec | 1,306.69 | 3,220.38 | |
| **2nd Half** | **7,710.49** | **20,887.20** | **119.87%** |

**Source: Financial Market Department**

**Figure 4.4**
**Total FX Supply (including Forward Sales) (July - December, 2018)**




## 4.3 Developments in the Monetary Aggregates

During the review period, the major monetary aggregates performed above their indicative targets. The development was as a result of the expansion in both Net Foreign Assets (NFA) and Net Domestic Assets (NDA) of the banking system. The increase in NDA was as a result of the substantial growth in credit to government due to increased deficit financing in the face of moderately improving government receipts. The growth in NFA was due to relatively higher global crude oil prices as well as proceeds from issuance of Eurobonds.

### 4.3.1 Broad Money (M2)

Broad Money (M2) grew by 9.13 per cent to ₦27,078.83 billion at end-December 2018 from ₦24,814.00 billion at end-June. Compared with the end-December 2017 level of ₦24,140.63 billion, M2 increased by 12.17 per cent, which was above the 2018 indicative growth target of 10.48 per cent.

**Figure 4.5**
**Money Supply (M1), (M2) and (M3) (July – December, 2018)**

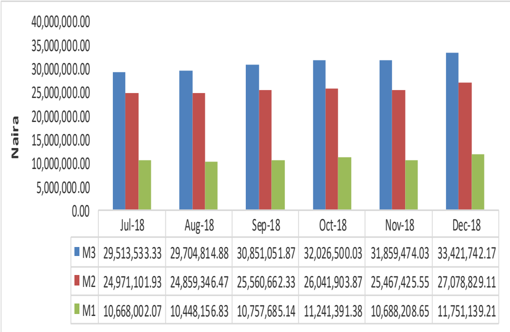
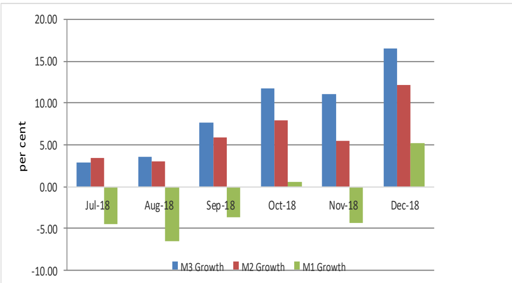



**Figure 4.6**
**Growth in Money Supply (M1), (M2) and (M3) (July - December, 2018)**




### 4.3.2 Narrow Money (M1)

Narrow Money (M1) increased by 9.81 per cent to ₦11,751.14 billion at end-December 2018 from ₦10,701.11 billion at end-June 2018. On a year-on-year basis, M1 grew by 5.15 per cent when compared with ₦11,175.57 billion at the end-December 2017. This was, however, below the indicative growth target of 7.32 per cent for the year, implying that M1 under-performed during the review period (Figures 4.4 and 4.5).

### 4.3.3 Net Foreign Assets (NFA)

Net Foreign Assets (NFA) increased marginally by 0.33 per cent to ₦18,397.82 billion at end-December 2018 from ₦18,337.53 billion at end-June 2018. Compared with the end-December 2017 figure of ₦15,520.76 billion, NFA grew by 18.54 per cent, above the indicative growth target of 14.50 per cent. The observed performance of NFA in the review period was attributed to improved crude oil prices, receipts from Eurobond issuance, as well as improved capital inflows occasioned by the tight monetary policy stance of the Bank.

## 4.4 Net Domestic Assets (NDA)

Net Domestic Assets (NDA) increased by 36.50 per cent to ₦15,023.93 billion at end-December 2018 from ₦11,006.30 billion at end-June 2018. Compared with the end-December 2017 figure of ₦13,148.82 billion, NDA grew by 14.26 per cent, which was marginally above the indicative growth target of 13.09 per cent for the year. This was attributable to the significant growth in credit to the government.

**Figure 4.7**
**Net Domestic Asset (NDA) (July – December, 2018)**

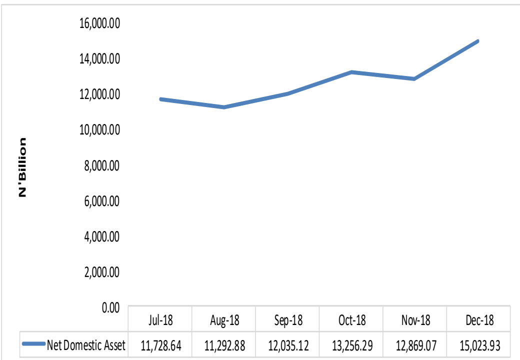
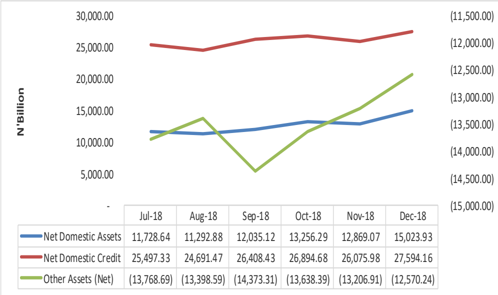


**Figure 4.8**
**NDA, NDC and Other Assets (Net) – (July – December, 2018)**



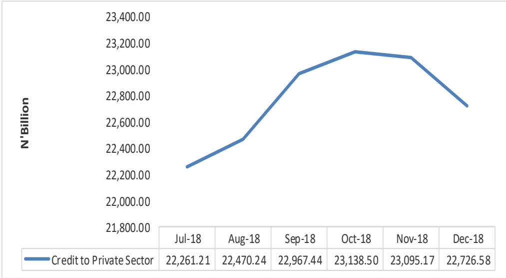

## 4.4.1 Credit to the Government ($C_g$)

Credit to government (Cg) in the second half of 2018 grew by 48.12 per cent to ₦4,867.58 billion at end-December 2018 from ₦3,286.34 billion at end-June 2018. Compared with the end-December 2017 level of ₦3,640.93 billion, Cg grew by 33.69 per cent, significantly above the indicative growth benchmark of 17.38 per cent. The development was attributed to increased deficit spending by the government.

## 4.4.2 Credit to the Private Sector ($C_p$)

Credit to the private sector (Cp) increased marginally by 2.00 per cent to ₦22,726.58 billion at end-December 2018 from ₦22,281.87 billion at end-June 2018. Compared with the end-December 2017 figure of ₦22,290.66 billion, Cp also rose marginally by 1.96 per cent. This was substantially below the indicative growth target of 12.39 per cent for 2018. The weak performance was partly explained by the significant growth in credit to government which crowded out the private sector.

**Figure 4.9**
**Domestic Credit to Private Sector (July – December, 2018)**




## 4.4.3 Reserve Money (RM)

Reserve Money (RM) increased by 12.19 per cent to ₦7,135.73 billion at end-December 2018 from ₦6,360.47 billion at end-June 2018. Compared with its end-December 2017 level of ₦6,484.30 billion, RM increased by 10.05 per cent but was below the indicative growth benchmark of 21.63 per cent. The growth in RM was due to growth in its components, Currency-in-Circulation (CIC) and bank deposits. In the review period, CIC grew by 22.57 per cent from N1,900.67 billion to N2,329.71 billion, while bank deposits expanded by 7.76 per cent from N4,459.79 billion to N4,806.02 billion. A summary of the major monetary aggregates and provisional outcome as at end-December 2018 is presented in Table 4.5.

**Table 4.5**
**Monetary Aggregates Outcomes (Growth in % except otherwise stated)**

| Variables | Actual H2 2017 | Actual H1 2018 | Actual H2 2018 | Benchmark 2018 | H2:2018 Deviation from Benchmark | Change in H2 over H1, 2018 |
|---|---|---|---|---|---|---|
| M3 (N'b) | 31,157.56 | 29,343.83 | 33,421.74 | 35,213.39 | -1,791.65 | 4,077.91 |
| M3 (%) | 10.02% | -5.82% | 16.58% | 13.02% | 0.04 | 0.22 |
| M2 (N'b) | 24,140.63 | 24,814.00 | 27,078.83 | 26,671.62 | 407.21 | 2,264.83 |
| M2 (%) | 9.83% | 2.79% | 9.13% | 10.48% | -0.01 | 6% |
| M1 (N'b) | 11,175.57 | 10,701.11 | 11,751.14 | 11,993.36 | -242.22 | 1,050.03 |
| M1 (%) | 9.67% | -4.25% | 9.81% | 7.32% | 0.02 | 14% |
| RM (N'b) | 6,484.30 | 6,360.47 | 7,135.73 | 7,112.74 | 22.99 | 775.26 |
| RM (%) | 18.32% | -1.91% | 12% | 21.63% | -0.09 | 14% |
| NDA (N'b) | 13,148.82 | 11,006.30 | 15,023.93 | 17,441.94 | -2,418.01 | 4,017.63 |
| NDA (%) | 18.32% | -1.91% | 37% | 21.63% | 0.15 | 38% |
| NDC (N'b) | 25,931.58 | 25,568.21 | 27,594.16 | 29,325.47 | -1,731.31 | 2,025.95 |
| NDC (%) | -4.79% | -1.40% | 7.92% | 13.09% | -0.05 | 9% |
| Cg (N'b) | 3,640.93 | 3,286.34 | 4,867.58 | 4,273.86 | 593.72 | 1,581.24 |
| Cg (%) | -30.66% | -9.74% | 48.12% | 17.38% | 0.31 | 58% |
| Cp (N'b) | 22,290.66 | 22,281.87 | 22,726.58 | 25,051.62 | -2,325.04 | 444.71 |
| Cp (%) | 1.39% | -0.04% | 2.00% | 12.39% | -0.10 | 2% |
| NFA (N'b) | 15,520.76 | 18,337.53 | 18,397.82 | 17,771.45 | 626.37 | 60.29 |
| NFA (%) | 83.29% | 18.15% | 0.33% | 14.50% | -0.14 | -18% |

**BOX 4.1: INTRODUCING THE M3 MONETARY AGGREGATE IN NIGERIA**

**1.0 Introduction**

A money supply aggregate generally refers to a measure of a group of safe assets that can be used to hold financial investments and make payments for goods and services by businesses and households. Such assets are held in savings and checking account balances across the banking system and thus provide information necessary to guide the Central Bank and other institutions in taking vital policy decisions. The economy's monetary base is defined as the sum of total ***Currency-in-Circulation*** plus ***Reserve Balances*** of deposit money banks held by the Central Bank plus ***Currency in bank's vaults***. In adjusting money supply, the Central Bank expands or contracts this monetary base. Since money supply has overtime been recognized to affect the behaviour of some macroeconomic aggregates such as inflation, central banks consistently place reliance on the accurate measure of money supply which guides their monetary policy. The relationship between money supply and some macroeconomic variables has been unstable and the subject of empirical research in many countries.

The concepts of money and money supply have varied as new forms of money evolve; thus existing measures tend to be reviewed constantly. Before the mid-2000s, the standard measures of money supply were Narrow Money M1and Broad Money M2. After 2006, The United States Federal Reserve Bank adopted a more encompassing form of Broad Money M3, following which M4 was also defined.

**2.0 Components of the Various Definitions of Money Supply**

Across the financial system of most jurisdictions, the following measures of money supply exist:

1) **Narrow Money (M0)** = The total of *all Physical Currency Inside & Outside Banking System*.

2) **Narrow Money (M1)** = *Currency held by the Public + Transactional Deposits at Deposit Holding Institutions*.

3) **Broad Money (M2)** = ***M1*** + ***Savings and Time Deposits***

4) **Broad Money (M3)** = ***M2*** + ***Large and Long-Term Deposits***

5) **Broad Money (M4)** =***M3*** + ***Commercial Paper*** + ***Treasury Bills***

Across various central banks, however, these definitions are modified slightly to suit local practices and conveniences.

**3.0 Money as defined by Selected Central Banks**

***The US Federal Reserve Bank (US Fed)***

The US Fed used to publish three measures of money supply (M1, M2 and M3) up to March 2006 when it ceased the publication of M3. The Bank decided to cease publication of this aggregate after observing that developments in M3 did not convey any additional information that could not be gleaned from M2. As such, M3 only had a minor impact on total money supply and thus did not derail monetary policy in any significant manner.

***The Bank of England (BoE)***

The BoE uses only two measures of money supply to conduct monetary policy (**Narrow Money, M0 and Broad Money, M4**). The BoE defines **M0** as cash outside the Bank of England plus Commercial Bank's Operational Deposits with the Bank of England; and **M4** as Cash in Circulation (in the public and non-bank firms) plus private sector retail bank & building society deposits plus private sector wholesale bank and building society deposits and certificates of deposits.

***The European Central Bank (ECB)***

The ECB uses three measures of money supply (**M1, M2 & M3**). The Bank defines **M1** as currency in circulation plus overnight deposits; **M2** as M1 plus deposits with an agreed maturity of up to 2 years plus deposits redeemable at a period of notice of up to three months; and M3 as M2 plus repurchase agreements plus money market funds shares/units plus debt securities up to two years

***The Reserve Bank of India (RBI)***

The RBI uses five measures of money supply (**M0, M1, M2, M3 & M4**). The Bank defines **M0** as currency in circulation plus bankers deposits with RBI plus other deposits with RBI plus net credit to the government plus RBI credit to the commercial sector plus RBIs claims on banks plus RBIs net foreign assets plus government's currency liabilities to the public less RBI's net non-monetary liabilities. **M1** is defined as currency with the public plus deposit of the public (demand deposits with the banking system plus other deposits with RBI. **M2** is defined as M1 plus savings deposits with the post office savings banks. **M3** is defined as M1 plus time deposits with the banking system plus net credit to the government plus Bank credit to the commercial sector plus net foreign exchange assets of the banking sector plus government's currency liabilities to the public less net non-monetary liabilities of the banking sector.

From the above review, it is clear that the type of monetary aggregates utilized depends on the nature and growth of the banking system, the instruments available in the financial market and the money holding behaviour of economic agents.

**4.0 Money Supply at the Central Bank of Nigeria and the Introduction of M3**

For the central banks reviewed, the definition of the various measures of money supply varied, to adequately capture local practices and usage of money. The RBI appears to adopt the broadest coverage of the four central banks reviewed. The US Fed had initially migrated to M3 but reverted back to M2 as it did not see any additional information provided by M3; while the BoE merged M2 and M3 to form a new aggregate called M4. The ECB on the other hand continues to publish data on M1, M2 & M3 as it finds all three provide relevant information for monetary policy.

At the Central Bank of Nigeria, data on M2 in recent times appeared not to be consistent with the behavior of key macroeconomic indicators such as inflation and output growth, thus raising considerable concern as to the continued relevance of M2 as the measure for money supply. There was, therefore the need to migrate to M3 to improve the efficacy of monetary policy.

Over time, the Central Bank observed development in the secondary market where Deposit Money Banks (DMBS) engage in discounting OMO bills in their holdings.

Discounting of these bills to **institutional investors, large corporates and high net worth individuals** summarily constitutes the creation of money under the fractional reserve banking system, and **thus has huge implications for the growth of money supply**.

The Bank's initial reaction was to issue regulatory measures to curb the existence of such a secondary market due to its distortionary impact on money supply growth. It was however reasoned that such regulatory measures to curb activities in the market may end up being viewed as market interference and thus counter-productive as this may indirectly impact financial intermediation, credit delivery to the real economy and cross border capital flow. Furthermore, the suspected players in the secondary market are big institutional portfolio investors who are actively seeking a liquid market to invest their portfolio capital. The practical option was that the Central Bank decided to embrace the knowledge that such a market exists and is functionally liquid. The Bank in essence recognized this new class of money supply as it will have a pronounced fractional/multiplier effect on the monetary base of the economy.

In doing so, the Central Bank of Nigeria reviewed the volume of the bills issued to DMBs that had been discounted to accommodate the additional growth and fractional/multiplier effect of the bills taken off their books. This enabled the CBN to determine the new growth rate of monetary aggregates to include these discounted bills plus the existing measure of M2 thus the additional contribution to the monetary base and money supply growth yielded M3. Following this development, the new structure of money supply aggregates in the Bank is given below:

1) Narrow Money **M1**= ***Currency in circulation*** + ***Currency held in bank vaults + Demand Deposits***

2) Broad Money **M2**= ***M1*** + ***Quasi money***

3) Broad Money **M3** = ***M2*** + ***OMO Bills discounted by DMBs + Treasury bills discounted by DMBs.***

# CHAPTER 5

## 5.0 DEVELOPMENTS IN THE FINANCIAL MARKETS

In the review period, the Nigerian financial markets experienced episodes of capital outflow, reflecting developments in the global and domestic financial and economic environments. Primary amongst the global developments were: the continued trade tensions between the US and its key trading partners, particularly, China; progressive normalization of monetary policy by the US and the beginning of normalization in the euro area; increasingly difficult BREXIT negotiations between the United Kingdom and the European Union; as well as the existence of pockets of geo-political tensions in the Middle East. The weakening of crude oil prices also threatened to reverse the tepid recovery amongst major oil exporting countries. In some emerging market economies, the rapid outflow of capital to US dollar denominated assets re-introduced exchange rate pressures, which modestly passed through to domestic prices.

Activities in the money market strengthened during the review period, with market rates fluctuating in response to liquidity conditions in the banking system, sometimes breaching the upper band of the Standing Facilities Corridor. With the US Federal Reserve pushing forward with monetary policy normalization, capital outflow intensified during the early part of the review period. This was, however, contained towards the end of the period as the CBN maintained a steady pace of intervention in the foreign exchange market to boost investor confidence. In addition, the Bank increased foreign exchange sales to BDCs and encouraged more direct transactions in the naira and the yuan, through the bilateral currency swap between the CBN and the People's Bank of China. This initiative greatly eased foreign exchange demand pressure. These developments notwithstanding, the Nigerian stock market witnessed a decline in the All-Share Index (ASI) by 17.89 per cent in the review period, from 38,278.55 at end-June, 2018 to 31,430.50 at end-December, 2018.

## 5.1 The Money Market

The money market remained active during the review period, with rates fluctuating in response to liquidity conditions in the banking system. The fluctuation in market rates were traceable to: Federation Account Allocation Committee (FAAC) disbursements; maturing CBN bills and other government securities; and OMO auctions. Others included: implementation of the 2018 Federal Government budget; ongoing intervention by the CBN in the real economy and spending towards the 2019 general elections. The increased transactions in the Open Buy Back (OBB) segment of the money market, compared with the Interbank (IB) segment, reflected the increased risk perception in the money market as a result of the ensuing volatility.

In consideration of these developments, the MPC maintained a tight monetary policy stance throughout the period. Accordingly, the MPR was maintained at 14.0 per cent along with the asymmetric corridor of +200/-500 basis points, as well as the Cash Reserve Ratio (CRR) of 22.5 per cent and Liquidity Ratio (LR) of 30.0 per cent.

### 5.1.1 Short-term Interest Rate Developments

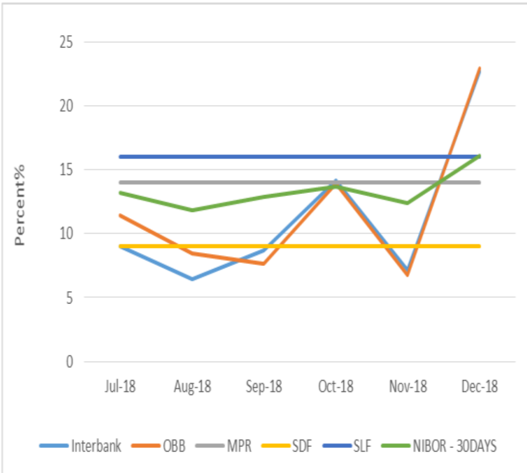
In the second half of 2018, a number of factors shaped liquidity conditions in the banking system and hence the development of short term rates in the money market. These were: statutory FAAC disbursements; OMO auctions; issuance of Nigerian Treasury Bills (NTB); maturing government securities and CBN bills as well as the liquidity impact of the implementation of the expansionary 2018 FGN budget. OMO remained the key instrument for managing liquidity in the banking system, supported by continued interventions in the foreign exchange market by the Bank. While there were occasions of inactivity at the interbank segment, the OBB segment remained largely active throughout the review period. As a result, the interbank call rate ranged between 6.44 and 22.68 per cent, averaging 11.36 per cent, while the OBB rate ranged between 6.76 and 22.94 per cent, averaging 11.86 per cent. Overall, the average interbank call rate was marginally lower than the OBB rate.

**Table 5.1**
**Weighted Average Monthly Money Market Interest Rates (July - December 2018)**

| MONTHS | Interbank | OBB | MPR | SDF | SLF | NIBOR - 30DAYS |
|---|---|---|---|---|---|---|
| Jul-18 | 9 | 11.44 | 14.00 | 9 | 16.00 | 13.18 |
| Aug-18 | 6.44 | 8.42 | 14.00 | 9 | 16.00 | 11.87 |
| Sep-18 | 8.68 | 7.64 | 14.00 | 9 | 16.00 | 12.90 |
| Oct-18 | 14.18 | 13.93 | 14.00 | 9 | 16.00 | 13.71 |
| Nov-18 | 7.17 | 6.76 | 14.00 | 9 | 16.00 | 12.44 |
| Dec-18 | 22.68 | 22.94 | 14.00 | 9 | 16.00 | 16.09 |
| **Average** | **11.36** | **11.86** | **14.00** | **9.00** | **16.00** | **13.37** |

**Source: (Statistics, CBN)**

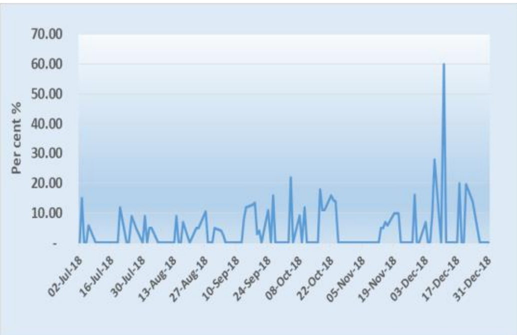
**Figure 5.1**
**Weighted Average Monthly Money Market Interest Rates (July - December 2018)**




### (i) The Interbank Call Rate

During the review period, there were several no-transaction days in the interbank call segment of the money market. The high frequency of non-trading days in the uncollateralized segment of the market, in preference for the collateralized segment, clearly signals increased risk aversion amongst deposit money banks (DMBs), resulting in wider fluctuations in money market rates. The rate decreased from 9.0 per cent in July to 6.44 per cent in August, rising sharply to 14.18 per cent in October, before declining to 7.17 per cent in November and closed at a high of 22.68 per cent in December, 2018. The interbank call rate averaged lower at 11.36 per cent in the second half of 2018, compared with 15.12 per cent in the preceding period. A review of the daily rates showed that the call rate ranged from 2.50 to 60.00 per cent between July and December 2018. Various factors were responsible for the hikes recorded in the review period. These included: issuance of OMO bills; increased capital outflows by portfolio investors, following an increased perception of sovereign risk in the build-up to the 2019 general elections; amongst other factors. By end-December 2018, the rate eased to 14.00 per cent following the monthly statutory FAAC injection, payment of matured OMO bills, and foreign exchange purchases. In summary, the injections and withdrawals of liquidity, as well as the Bank's sustenance of its tight monetary policy influenced the movement of the market rates.

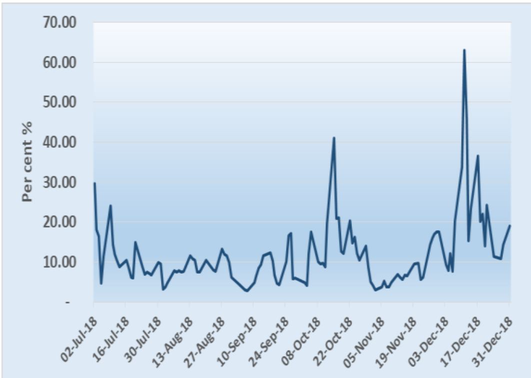
**Figure 5.2**
**Daily Interbank Call Rate (July– December 2018)**




### (ii) The Open Buy Back (OBB) Rate

The OBB segment of the money market remained active throughout the review period, recording no non-trading days. The OBB rate fell from 11.44 per cent in July to 8.42 per cent in August, before rising to 13.93 per cent in October, 2018. The rate, further dropped to 6.96 per cent in November before closing at a high of 22.94 per cent in December, 2018. The spikes observed in the OBB rate in October and December 2018, were largely associated with dips in overall market liquidity conditions attributed to the issuance of OMO bills. The OBB rate averaged lower at 11.86 per cent in the review period compared with 12.58 per cent in the preceding half year. Analysis of the daily rates showed that the OBB rates oscillated between 2.84 and 63.00 per cent between July and December 2018. By end-December 2018, the rate eased to 18.95 per cent following the monthly statutory FAAC injections, payments of matured OMO bills, and foreign exchange purchases.

**Figure 5.3**
**Daily Open Buy Back Rate (July– December 2018)**



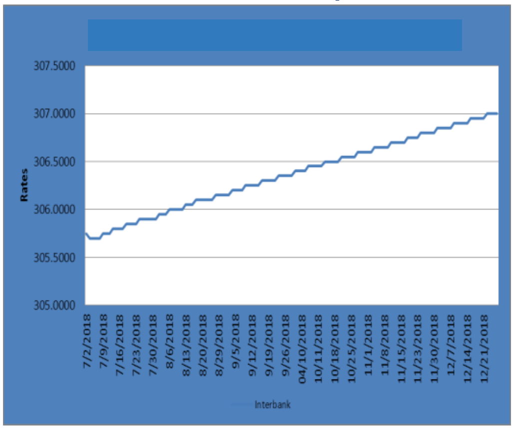
### (iii) The Nigeria Interbank Offered Rate (NIBOR)

Relative stability was observed in the review period across all tenors of the Nigerian money market reference rate, the NIBOR. On average, the rate generally fluctuated upwards in tandem with movements in the interbank call and OBB segments. The weighted average 30-day NIBOR, fell from 13.18 per cent in July to 11.87 per cent in August 2018, but rose to 13.71 per cent in October, and closed at 16.09 per cent in December 2018. During the review period, the NIBOR averaged 13.37 per cent compared with 14.25 per cent in the preceding half year, indicating improved financing conditions in the money market (Table 5.1).

## 5.2 Foreign Exchange Market

In the second half of 2018, the continued normalization of monetary policy in some major advanced economies, particularly the United States, led to the appreciation of US dollar denominated assets and thus increased capital reversals from emerging market economies, posed a considerable challenge to the stability in the Nigerian foreign exchange market. The increased accretion to external reserves in the first half of 2018 and improved activities at the Investors' and Exporters' (I&E) window sustained the stability in the foreign exchange market in the review period. The Bank also continued the implementation of existing demand management measures such as: the restriction of access to foreign exchange for 41 items and the inclusion of fertilizer in the list; monitoring the adoption of Bank Verification Number (BVN) in BDC transactions; the continuation of the policy on repatriation of export proceeds as well as return of unutilized foreign exchange sourced from the CBN auctions. The direct purchase of the Chinese yuan by importers under the naira-yuan swap deal also helped moderate the demand pressure in the market. On the supply side, market liquidity was sustained through direct interventions and periodic sales to BDCs by the Bank and International Money Transfer Operators (IMTOs), special foreign exchange auctions to the real sector and sales to small and medium scale enterprises. These policies, amongst others, provided stability in the foreign exchange market in the review period.

**Figure 5.4**
**Daily Naira/US Dollar Exchange Rate (July - December 2018)**



### 5.2.1 Average Exchange Rates

The exchange rate at the Interbank foreign exchange market depreciated marginally by 0.19 per cent, to an average of ₦306.38/USD in the second half of 2018 from ₦305.79/USD in the first half of 2018. In the BDC segment, the rate appreciated by 0.40 per cent, from an average of ₦362.25/USD to ₦360.79/USD in the same period, a reflection of trend towards convergence in market rates (Table 5.2).

**Table 5.2**
**Average Monthly Spot Exchange Rates (Jan – Dec 2018) (₦/US$)**

| Month / Year | Interbank Rate | BDC Rate |
|---|---|---|
| 2018: Jan | 305.78 | 363.20 |
| Feb | 305.90 | 362.48 |
| Mar | 305.74 | 362.07 |
| Apr | 305.61 | 362.25 |
| May | 305.83 | 362.86 |
| Jun | 305.87 | 360.66 |
| **Average** | **305.79** | **362.25** |
| 2018: Jul | 305.81 | 359.36 |
| Aug | 306.06 | 359.00 |
| Sep | 306.27 | 359.25 |
| Oct | 306.51 | 360.81 |
| Nov | 306.72 | 362.88 |
| Dec | 306.92 | 363.46 |
| **Average** | **306.38** | **360.79** |

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

In the second half of 2018, the performance of the naira at the interbank and BDC segments of the foreign exchange market was mixed. At the interbank segment, the naira depreciated by 0.41 per cent to ₦306.47/USD at end-December, 2018 from ₦305.78/USD at end-June 2018. At the BDC segment however, the naira appreciated by 0.20 per cent to ₦361.29/USD at end-December 2018 from ₦362.0/USD at end-June 2018. The narrowing of the premium between the two markets reflects the continued effectiveness of the Bank's foreign exchange policy measures (Figure 5.5 and Table 5.3).

**Table 5.3**
**End-Month Exchange Rates (Jan – Dec 2018) (₦/US$)**

| Month / Year | Interbank Rate | BDC Rate |
|---|---|---|
| 2018: Jan | 305.70 | 363.00 |
| Feb | 305.90 | 362.00 |
| Mar | 305.65 | 362.00 |
| Apr | 305.70 | 362.00 |
| May | 305.95 | 362.50 |
| Jun | 305.75 | 360.50 |
| **Average** | **305.78** | **362.00** |
| 2018: Jul | 305.90 | 359.00 |
| Aug | 306.15 | 359.00 |
| Sep | 306.35 | 360.00 |
| Oct | 306.60 | 361.75 |
| Nov | 306.80 | 367.00 |
| Dec | 307.00 | 361.00 |
| **Average** | **306.47** | **361.29** |

### 5.2.3 Nominal and Real Effective Exchange Rates

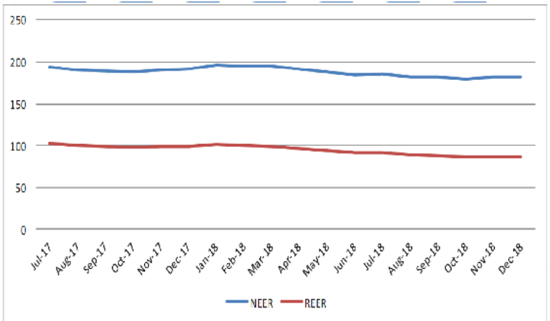
The Nominal Effective Exchange Rate (NEER) appreciated by 5.09 per cent to an average of 181.73 in the second half from an average of 191.48 in the first half of 2018. When compared with

190.17 in the corresponding period of 2017, it also appreciated by 4.44 per cent. Similarly, the Real Effective Exchange Rate (REER) appreciated by 9.12 per cent to an average of 88.20 in the second half from an average of 97.05 in the first half of 2018. When compared with 99.85 in the corresponding period of 2017, the REER appreciated by 11.67 per cent (Table 5.4). From the foregoing, the naira appreciated in both nominal and real terms relative to the currencies of Nigeria's major trading partners in the review period. This reflects a reduced inflation pass-through to domestic prices from its trading partners occasioned by relative stability in the foreign exchange market (Table 5.4 and figure 5.6).

**Table 5.4**
**Nominal and Real Effective Exchange Rates Indices (Jul 2017 – Dec 2018)**

| | NEER | REER |
|---|---|---|
| 2017: Jul | 193.31 | 102.98 |
| Aug | 189.77 | 100.45 |
| Sep | 188.98 | 99.40 |
| Oct | 187.67 | 98.21 |
| Nov | 189.63 | 98.69 |
| Dec | 191.63 | 99.37 |
| **2017:H2 Average** | **190.17** | **99.85** |
| 2018: Jan | 196.82 | 101.42 |
| Feb | 194.48 | 99.75 |
| Mar | 194.86 | 99.13 |
| Apr | 191.14 | 96.68 |
| May | 187.45 | 93.96 |
| Jun | 184.14 | 91.35 |
| **2018:H1 Average** | **191.48** | **97.05** |
| 2018: Jul | 184.94 | 91.42 |
| Aug | 181.18 | 88.82 |
| Sep | 181.32 | 88.27 |
| Oct | 179.22 | 86.75 |
| Nov | 181.68 | 87.18 |
| Dec | 182.01 | 86.74 |
| **2018:H2 Average** | **181.73** | **88.20** |

**Figure: 5.5**
**Nominal and Real Effective Exchange Rates Indices (July 2017 – December 2018)**




### 5.2.4 Foreign Exchange Flows through the CBN

Foreign exchange inflows through the CBN decreased by 4.93 per cent to USD28,910.42 million in the second half of 2018, from USD30,409.51 million in the preceding half year. It was, however, an increase of 13.21 per cent when compared with USD26,861.61 million in the corresponding period of 2017. Outflows rose by 45.53 per cent to USD33,388.79 million in the second half from USD22,942.11 million in the first half, and by 88.37 per cent compared with US$17,724.26 million in the corresponding half of 2017. The transactions resulted in a net outflow of USD4,478.37 million in the second half of 2018 in contrast to the net inflows of USD7,467.40 million and USD9,137.35 million in the previous and corresponding half-years, respectively (Table 5.5 and Figure 5.7). The net outflow in the review period was due largely to increased capital reversals triggered by the progressive normalization of monetary policy in the advanced economies, particularly in the US, as well as the heightened perception of sovereign risk as the 2019 general elections approached. Also, the moderation in crude oil prices during the period reduced inflows and accretion to external reserves required to moderate the outflows.

**Table 5.5**
**Monthly Foreign Exchange Flows through the CBN (July 2017 – December 2018)**

| Dates | Inflow (CBN) | Total Outflow (CBN) | Net Flow (CBN) |
|---|---|---|---|
| Jul-17 | 3,867.04 | 3,358.32 | 508.72 |
| Aug-17 | 3,943.45 | 3,594.32 | 349.13 |
| Sep-17 | 4,425.53 | 2,390.41 | 2,035.12 |
| Oct-17 | 4,132.80 | 2,839.15 | 1,293.65 |
| Nov-17 | 6,811.96 | 2,957.60 | 3,854.36 |
| Dec-17 | 3,680.83 | 2,584.46 | 1,096.37 |
| **2017 H2 Total** | **26,861.61** | **17,724.26** | **9,137.35** |
| Jan-18 | 4,212.56 | 2,734.38 | 1,478.18 |
| Feb-18 | 7,303.15 | 3,163.07 | 4,140.08 |
| Mar-18 | 5,076.48 | 3,754.12 | 1,322.36 |
| Apr-18 | 4,238.05 | 3,437.72 | 800.33 |
| May-18 | 4,373.01 | 4,821.91 | -448.90 |
| Jun-18 | 5,206.51 | 5,030.91 | 175.60 |
| **2018 H1 Total** | **30,409.51** | **22,942.11** | **7,467.65** |
| Jul-18 | 4,722.44 | 6,014.85 | -1,292.41 |
| Aug-18 | 3,957.38 | 5,102.75 | -1,145.36 |
| Sep-18 | 4,239.49 | 6,270.21 | -2,030.72 |
| Oct-18 | 2,871.70 | 4,929.03 | -2,057.33 |
| Nov-18 | 8,061.53 | 5,216.64 | 2,844.89 |
| Dec-18 | 5,057.88 | 5,855.31 | -797.44 |
| **2018 H2 Total** | **28,910.42** | **33,388.79** | **-4,478.37** |

**Figure 5.6**
**Monthly Foreign Exchange Flows through the CBN (Jul 2017 – Dec 2018)**


## 5.2.5 Foreign Exchange Flow through the Economy

Total foreign exchange inflow to the Nigerian economy declined by 37.92 per cent to US$41,552.52 million in the second half of 2018, from US$66,931.28 million in the first half. It also decreased by 26.65 per cent when compared with US$56,646.51 million in the corresponding period of 2017. Similarly, gross foreign exchange outflow decreased by 6.27 per cent to US$23,364.83 million in the second half of 2018, from US$24,928.57 million in the first half. It however, increased by 18.32 per cent when compared with US$19,746.94 million in the corresponding period of 2017.

Consequently, total foreign exchange flows through the economy in the review period resulted in a lower net inflow of US$18,187.69 million, compared with US$42,002.71 million in the preceding half year and US$36,899.57 million in the corresponding period of 2017. The decrease in net inflow through the economy in the review period reflected the impact of continued capital reversals, the effectiveness of the various foreign exchange demand management measures by the Bank, as well as reduced foreign exchange receipts from moderating oil prices.

## 5.3 Capital Market

The Nigerian capital market was mostly bearish in the second half of 2018. The development reflected the flight to safety by investors as yields on US dollar asset improved coupled with the rising domestic sovereign risk which resulted in persistent sell-off and profit taking activities. The dwindling price of crude oil, slowing accretion to external reserves, and increasing domestic and foreign debt stock, amongst others, contributed significantly to dampen investor sentiments in the review period.

### 5.3.1 Equities Market

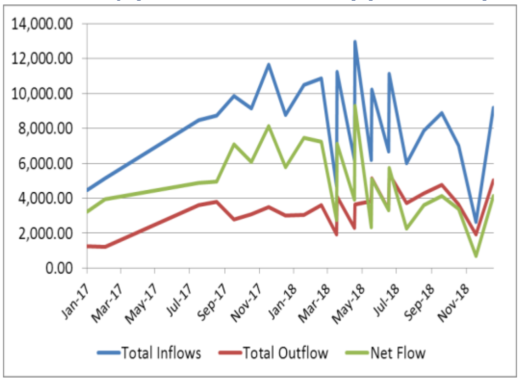
The All-Share Index (ASI) decreased by 17.89 per cent to 31,430.50 at end-December 2018 from 38,278.55 at end-June 2018. It also decreased by 17.81 per cent compared with 38,243.19 at end-December 2017. Similarly, Market Capitalization (MC) decreased by 15.50 per cent to ₦11.72 trillion at end-December 2018 from ₦13.87 trillion at end-June 2018. When compared with ₦13.61 trillion at end-December 2017, it decreased by 13.89 per cent. These significant decreases reflected the sell-off and flight to safety of portfolio investors in the light of progressive normalization of monetary policy in some advanced economies and rising perception of domestic soverign risk as the country moves towards a general election. There was also increased policy uncertainty as the preparations for the elections reduced focus on governance.

### Table 5.6
### Monthly Foreign Exchange Flows through the Economy (January 2017 – December 2018) (US$ Million)

| PERIOD | Inflow (CBN) | Inflow (Autonomous) | Total Inflows | Outflows (CBN) | Outflows (Autonomous) | Total Outflow | Net Flow | Net Flow (CBN) | Net Flow (Autonomous) |
|---|---|---|---|---|---|---|---|---|---|
| Jan-17 | 2,605.50 | 1,880.08 | 4,485.58 | 1,055.84 | 179.12 | 1,234.96 | 3,250.62 | 1,549.66 | 1,700.96 |
| Feb-17 | 2,374.48 | 2,769.45 | 5,143.93 | 978.56 | 224.32 | 1,202.88 | 3,941.05 | 1,395.92 | 2,545.13 |
| Mar-17 | 1,693.40 | 2,997.32 | 4,690.72 | 1,672.59 | 255.20 | 1,927.79 | 2,762.93 | 20.81 | 2,742.12 |
| Apr-17 | 2,874.86 | 3,312.95 | 6,187.81 | 2,164.40 | 129.90 | 2,294.30 | 3,893.51 | 710.46 | 3,183.05 |
| May-17 | 2,712.38 | 3,474.35 | 6,186.73 | 3,676.12 | 162.59 | 3,838.71 | 2,348.02 | -963.74 | 3,311.76 |
| Jun-17 | 3,672.74 | 2,991.45 | 6,664.19 | 3,208.11 | 152.80 | 3,360.91 | 3,303.28 | 464.63 | 2,838.65 |
| **2017 H1 Total** | **15,933.36** | **17,425.60** | **33,358.96** | **12,755.62** | **1,103.93** | **13,859.55** | **19,499.41** | **3,177.74** | **16,321.67** |
| Jul-17 | 3,867.04 | 4,622.05 | 8,489.09 | 3,358.32 | 250.35 | 3,608.67 | 4,880.42 | 508.72 | 4,371.70 |
| Aug-17 | 3,943.45 | 4,802.68 | 8,746.13 | 3,594.32 | 196.61 | 3,790.93 | 4,955.20 | 349.13 | 4,606.07 |
| Sep-17 | 4,425.53 | 5,423.72 | 9,849.25 | 2,390.41 | 379.23 | 2,769.64 | 7,079.61 | 2,035.12 | 5,044.49 |
| Oct-17 | 4,132.80 | 5,016.26 | 9,149.06 | 2,839.15 | 229.12 | 3,068.27 | 6,080.79 | 1,293.65 | 4,787.14 |
| Nov-17 | 6,811.96 | 4,833.41 | 11,645.37 | 2,957.60 | 546.82 | 3,504.42 | 8,140.95 | 3,854.36 | 4,286.59 |
| Dec-17 | 3,680.83 | 5,086.79 | 8,767.62 | 2,584.46 | 420.55 | 3,005.01 | 5,762.60 | 1,096.37 | 4,666.23 |
| **2017 H2 Total** | **26,861.61** | **29,784.90** | **56,646.51** | **17,724.26** | **2,022.68** | **19,746.94** | **36,899.57** | **9,137.35** | **27,762.22** |
| Jan-18 | 4,212.56 | 6,288.40 | 10,500.96 | 2,734.38 | 297.61 | 3,031.99 | 7,468.97 | 1,478.18 | 5,990.79 |
| Feb-18 | 7,303.15 | 3,561.35 | 10,864.50 | 3,163.29 | 447.64 | 3,610.93 | 7,253.58 | 4,139.86 | 3,113.72 |
| Mar-18 | 5,076.48 | 6,147.23 | 11,223.71 | 3,754.12 | 331.74 | 4,085.86 | 7,137.85 | 1,322.36 | 5,815.49 |
| Apr-18 | 4,238.05 | 8,721.00 | 12,959.05 | 3,437.72 | 222.55 | 3,660.27 | 9,298.78 | 800.33 | 8,498.45 |
| May-18 | 4,373.01 | 5,865.39 | 10,238.40 | 4,821.91 | 321.53 | 5,143.44 | 5,094.96 | -448.90 | 5,543.86 |
| Jun-18 | 5,211.73 | 5,932.93 | 11,144.66 | 5,030.91 | 365.18 | 5,396.09 | 5,748.58 | 180.82 | 5,567.76 |
| **2018 H1 Total** | **30,414.98** | **36,516.30** | **66,931.28** | **22,942.33** | **1,986.24** | **24,928.57** | **42,002.71** | **7,472.65** | **34,530.06** |
| Jul-18 | 2,548.53 | 3,452.14 | 6,000.67 | 3,498.61 | 232.18 | 3,730.79 | 2,269.88 | -950.08 | 3,219.96 |
| Aug-18 | 3,411.80 | 4,461.65 | 7,873.45 | 3,927.11 | 349.01 | 4,276.12 | 3,597.33 | -515.31 | 4,112.64 |
| Sep-18 | 3,671.76 | 5,204.58 | 8,876.34 | 4,463.98 | 288.14 | 4,752.12 | 4,124.22 | -792.22 | 4,916.44 |
| Oct-18 | 2,784.31 | 4,229.03 | 7,013.34 | 3,325.66 | 312.95 | 3,638.61 | 3,374.73 | -541.35 | 3,916.08 |
| Nov-18 | 1,844.64 | 774.11 | 2,618.75 | 1,697.48 | 228.96 | 1,926.44 | 692.31 | 147.16 | 545.15 |
| Dec-18 | 3,665.55 | 5,504.42 | 9,169.97 | 4,380.75 | 660.00 | 5,040.75 | 4,129.22 | -715.20 | 4,844.42 |
| **2018 H2 Total** | **17,926.59** | **23,625.93** | **41,552.52** | **21,293.59** | **2,071.24** | **23,364.83** | **18,187.69** | **-3,367.00** | **21,554.69** |

**Source: Trade and Exchange Department.**

### Figure 5.7
### Monthly Foreign Exchange Flows through the Economy (Jan 2017 – Dec 2018) (US$ Million)

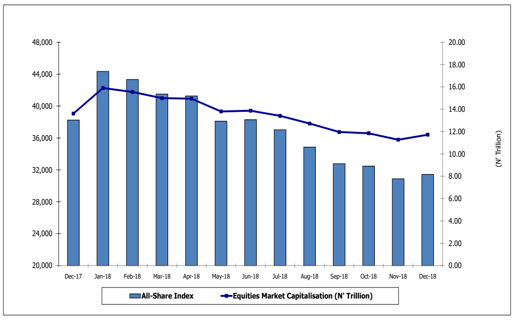



### Table 5.7
### NSE All-Share Index (ASI) and Market Capitalization (MC) (December 2017 – December 018)

| Date | ASI | MC(Equities) N'Trillion) |
|---|---|---|
| Dec-17 | 38,243.19 | 13.61 |
| Jan-18 | 44,343.65 | 15.90 |
| Feb-18 | 43,330.54 | 15.55 |
| Mar-18 | 41,504.51 | 14.99 |
| Apr-18 | 41,268.01 | 14.95 |
| May-18 | 38,104.54 | 13.80 |
| Jun-18 | 38,278.55 | 13.87 |
| Jul-18 | 37,017.78 | 13.41 |
| Aug-18 | 34,848.45 | 12.72 |
| Sep-18 | 32,766.37 | 11.96 |
| Oct-18 | 32,466.27 | 11.85 |
| Nov-18 | 30,874.17 | 11.27 |
| Dec-18 | 31,430.50 | 11.72 |

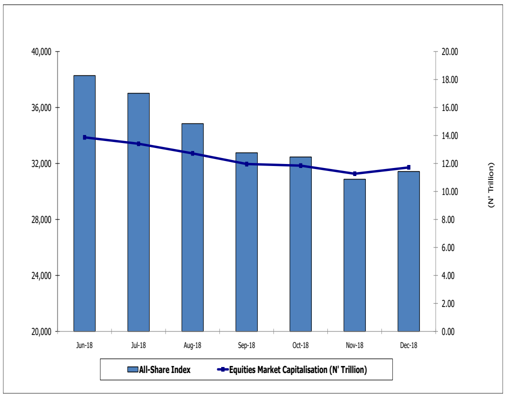
**Source: NSE**

**Figure 5.8**
**NSE ASI and MC (December 2017– December 2018)**




**Source: NSE**

**Figure 5.9**
**NSE ASI and MC (June 2018 – December 2018)**




**Source: NSE**

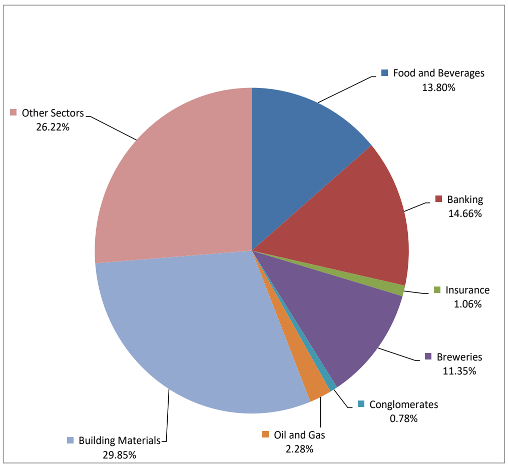
## 5.3.2 Market Turnover

In the second half of 2018, aggregate stock market turnover decreased by 48.31 per cent to 34.56 billion shares, valued at ₦400.50 billion in 400,384 deals compared with 66.86 billion shares, valued at ₦798.63 billion in 646,829 deals in the first half of 2018. Market turnover on a year-on-year basis, also decreased by 41.81 per cent from 59.39 billion shares, valued at ₦803.82 billion in 491,300 deals. Although, total foreign portfolio investment inflows in the second half of 2018 exceeded outflows by ₦194.85 billion, the slowdown in the equities market may imply that portfolio investors are showing a preference for short tenored investments in the money market.

## 5.3.3 Sectoral Contribution to Equity Market Capitalization

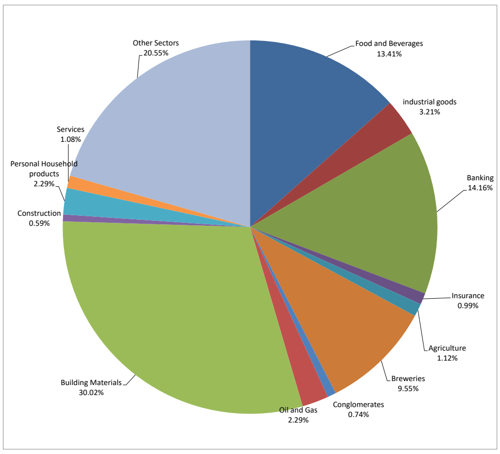
In spite of the slowdown in market activity, the Construction sector continued to dominate overall market capitalization, led by the Building materials sub-sector. The sub-sector's contribution rose to 30.02 per cent at end-December 2018 from 29.85 per cent in the preceding half year. The continued dominance of this sub-sector was largely attributable to the share of Dangote cement in the market. Other major sub-sectors were: banking; food & beverages; and breweries, with market shares of 14.16, 13.41 and 9.55 per cent, respectively, at end-December 2018 (Figure 5.12).

**Figure 5.10**
**NSE Market Capitalisation by Sector as at End-June 2018**




**Source: NSE**

**Figure 5.11**
**NSE Market Capitalisation by Sector as at End-December 2018**

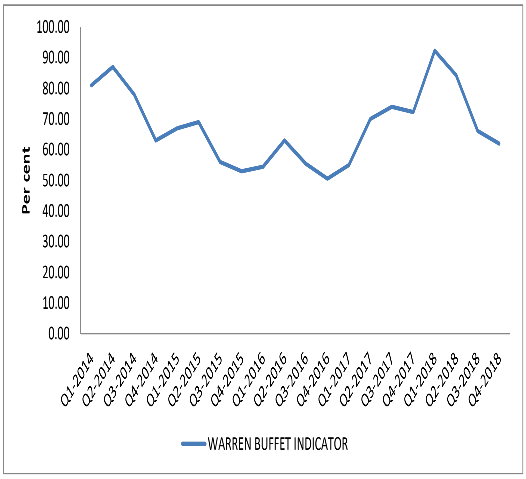



**Source: NSE**

### 5.3.4 The Warren Buffett Valuation Metric and Nigeria's Equities Market

During the review period, the Warren Buffett valuation metric showed that the Nigerian equities market was moderately undervalued. The index measures the market value of securities as a ratio of GDP to determine overall valuation of the market. At 66.16 and 62.0 per cent in the third and fourth quarters of 2018, the metric was below the threshold of normal valuation of 75.0 - 115.0 per cent. Below 75.0 per cent, the market is undervalued and above 115.0 per cent, the market is overvalued. The continued incidence of weak corporate earnings against the backdrop of improving macro-fundamentals, the flight to safety and quality as a result of political uncertainty and monetary policy normalization in some advanced economies were strong contributors to the development. The undervaluation of equities in the review period offers attractive investment opportunities for both domestic and foreign investors to participate in the Nigerian capital market.

**Figure 5.12**
**Warren Buffett Valuation of Nigerian Equities Market**




### 5.3.5 Bond Market

Activities in the bonds market in the second half of 2018 was dominated by Federal Government of Nigeria (FGN) securities. Some minor activity was also recorded in the Sub-national government and corporate bonds segments of the market, with the latter recording the least share by market volume.

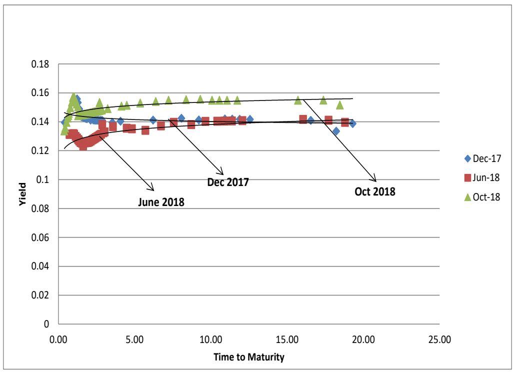
#### 5.3.5.1 FGN Eurobond

The 10-year dollar-denominated bond yield for Nigeria increased by 21 basis points to 6.11 per cent at end-December 2018, from 5.90 per cent at end-June 2018. When compared with 4.47 per cent at end-December 2017, it increased by 164 basis points (Figure 5.14). This increase reflects the perception of rising sovereign risk by foreign investors.

**Figure 5.13**
**10-Year U.S. Dollar-denominated Bond Yield for Nigeria (Dec 29, 2017 – Dec 31, 2018)**

FGN bond yields rose by 172.11 basis points to 14.88 per cent in October 2018 from 13.16 per cent at end-June, 2018 and by 64.81 basis points when compared with 14.23 per cent at end-December 2017. The yield curve is slowly turning positive, suggesting that risks are gradually being appropriately priced (Figure 5.15).

**Figure 5.14**
**FGN Bonds Yield Curves: end-Dec. 2017 vs. end-Jun. 2018 vs. end-Oct. 2018**




### 5.3.5.2 State/Local Government Bonds

Activity in the sub-national bonds market remained generally weak in the review period. Total value of outstanding state/local government bonds declined by 8.94 per cent to ₦515.26 billion at end-December 2018 from ₦565.82 billion at end-June 2018. When compared with ₦562.81 billion at end-December 2017, it also decreased by 8.45 per cent.

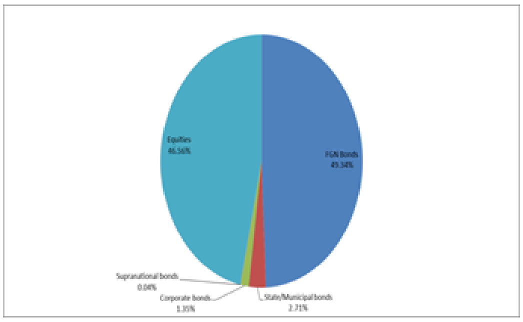
### 5.3.5.3 Corporate Bonds

In the corporate bonds segment, activity weakened in the review period. The value of outstanding corporate bonds at end-December 2018 declined by 4.17 per cent to ₦256.56 billion from ₦267.72 billion in the first half of 2018. When compared with ₦297.44 billion in the corresponding period of 2017, it also declined sharply by 13.74 per cent. The softening in this market, signposts a weakening of investor confidence in the Nigerian economy. This could be due to the slow pace of economic recovery and the dampening effect of the rising perception of sovereign risk as the 2019 general elections approach.

### 5.3.5.4 Overall Analysis of the Nigerian Capital Market

The value of FGN bonds increased marginally by 1.3 per cent to ₦9.38 trillion at end-December 2018 from ₦9.26 trillion at end-June 2018, and by 11.27 per cent when compared with ₦8.43 trillion at end-December 2017. FGN bonds accounted for 42.87 per cent of aggregate market capitalization at end-December 2018. State/municipal bonds, corporate bonds and supranational bonds had values of N515.26 billion, N256.56 billion and N8.09 billion, respectively, representing 2.35, 1.18 and 0.04 per cent of aggregate market capitalization. At end-December 2018, the equities segment of the market contributed 53.56 per cent of aggregate market capitalization, while the combination of FGN bonds, state/municipal bonds, corporate bonds and supranational bonds accounted for the balance of 46.44 per cent (Figure 5.16). Thus, during the review period, the Nigerian capital market was dominated by the equities segment.

**Figure 5.15**
**Structure of the Nigerian Capital Market (December, 2018)**




## 5.4 Global Financial Market Developments

In the second half of 2018, the global financial markets continued to experience volatility spillovers from the first half. Key factors driving the volatility included: the continued monetary policy normalization by the US Fed and the Bank of England (BOE); commencement of monetary policy normalization by the European Central bank (ECB); on-going trade wars between the US and some of its key trading partners; increasing uncertainty on the direction of BREXIT; weakening oil prices; and the imposition of primary and secondary sanctions on Iranian oil. However, the commencement of trade negotiations between the US and China, temporary lifting of secondary sanctions on some major buyers of Iranian oil and indications from OPEC and non-OPEC members of the imposition of a production ceiling, helped in moderating the volatility. Overall, the US dollar continued to appreciate against most currencies, thus increasing the flow of capital into US dollar-denominated assets.

### 5.4.1 Money Market and Central Bank Policy Rates

The continued withdrawal of monetary accommodation by some major advanced economies influenced liquidity conditions in the global financial markets in the review period. This was as a result of improved growth conditions and rising inflation above their long term objectives. With the US Fed progressively raising its benchmark policy rate, the BOE continuing with policy normalization and the ECB terminating its quantitative easing programme in the review period, there was a marked improvement in the pricing of US dollar-denominated assets. In the United Kingdom and the EU however, asset price recovery followed a slower pace mired by the uncertainties surrounding

BREXIT, with their markets experiencing episodes of volatility. In Japan and China, growth remained generally tepid with weak price developments and a relatively hazy macroeconomic and trade environment. In the emerging markets and developing economies, the earlier recovery in the first half of the year in oil and other commodity prices, which helped reverse currency depreciations appeared to be moderating as oil prices weakened progressively, thus constraining their central banks from major downward revisions of the benchmark policy rates.

Accordingly, the US and the UK raised their policy rates to improve yields on domestic assets and contain inflationary pressures, while the EU and Japan retained their rates in the review period. Amongst the emerging markets and developing economies, Russia, India, South Africa, and Indonesia raised their policy rates to douse price pressures and attract foreign capital, while China, Brazil, Ghana and Kenya maintained their policy rates to support on-going recovery of output, and stabilize inflation expectations. The CBN also maintained its policy rate to stem capital outflow and stave off domestic price developments.

**Table 5.8**
**Policy Rates of Selected Countries June – December 2018**

| Country | Jun-18 | Jul-18 | Aug-18 | Sep-18 | Oct-8 | Nov-18 | Dec-18 |
|---|---|---|---|---|---|---|---|
| Kenya | 9.50 | 9.00 | 9.00 | 9.0 | 9.00 | 9.00 | 9.00 |
| S. Africa | 6.50 | 6.50 | 6.50 | 6.5 | 6.50 | 6.75 | 6.75 |
| Ghana | 17.00 | 17.00 | 17.00 | 17.0 | 17.00 | 17.0<br>0 | 17.0<br>0 |
| Nigeria | 14.00 | 14.00 | 14.00 | 14.0 | 14.00 | 14.0<br>0 | 14.0<br>0 |
| Brazil | 6.50 | 6.50 | 6.50 | 6.5 | 6.50 | 6.50 | 6.50 |
| USA | 1.75-<br>2.00 | 1.75-<br>2.00 | 1.75-<br>2.00 | 2.00<br>2.2 | 2.00-<br>2.25 | 2.00-<br>2.25 | 2.25-<br>2.50 |
| Japan | -0.10 | -0.10 | -0.10 | -0.1 | -0.10 | -0.10 | -0.10 |
| Euro Area | 0.00 | 0.00 | 0.00 | 0.0 | 0.00 | 0.00 | 0.00 |
| India | 6.25 | 6.25 | 6.50 | 6.5 | 6.50 | 6.50 | 6.50 |
| Russia | 7.25 | 7.25 | 7.25 | 7.5 | 7.50 | 7.50 | 7.75 |
| China | 4.35 | 4.35 | 4.35 | 4.3 | 4.35 | 4.35 | 4.35 |
| UK | 0.50 | 0.50 | 0.50 | 0.7 | 0. 75 | 0. 75 | 0. 75 |
| Indonesia | 5.25 | 5.25 | 5.50 | 5.7 | 5.75 | 6.00 | 6.00 |

### 5.4.2 Global Capital Market

During the review period, major stock markets showed mixed performance, in response to global developments. The continued normalization of US monetary policy played a strong role in the redirection of capital flows as well as uncertainty surrounding the BREXIT negotiations, and the possibility of a no-deal BREXIT, promoted the US as a choice destination for portfolio capital. The weakening of oil prices in the second half of 2018 also increased uncertainty around major oil exporters as their external reserves and hence currencies became the subject of increased pressure. The on-going trade war between the US and its key trading partners, though appearing to be easing, continued to create some uncertainty in the market.

Following these developments, various stock markets reacted differently. In Europe, the Russian MICEX index increased by 2.72 per cent while, the UK FTSE 100, French CAC 40 and German DAX indices decreased by 11.90, 11.14 and 14.20 per cent, respectively. In North America, the United States S&P 500, Canadian S&P/TSX Composite and Mexican Bolsa indices decreased by 7.78, 12.01 and 12.64 per cent, respectively. In South America, the Brazilian Bovespa and Argentine Merval indices increased by 20.79 and 16.34 per cent, respectively, while, the Columbia COLCAP index decreased by 15.92 per cent. In Asia, the Indian BSE Sensex index increased by 1.82 per cent, while the Japanese Nikkei 225 and Chinese Shanghai SE indices decreased by 10.27 and 12.43 per cent, respectively. In Africa, the Nigerian NSE All-Share, South African JSE All-Share, Kenyan Nairobi NSE 20, Egyptian EGX CASE 30 and Ghanaian GSE All Share indices all decreased by 17.89, 8.46, 13.75, 20.26 and 13.18 per cent, respectively, indicating the effect of capital reversals from the African market.

**Table 5.9**
**Selected International Stock Market Indices as at December 31,2018**

| Country | Index | 29-Dec-17 | 29-Jun-18 | 31-Dec-18 | December 29, 2017-December 31, 2018 % Change | Jun 29 - Dec 31, 2018 % Change |
|---|---|---|---|---|---|---|
| **AFRICA** | | | | | | |
| Nigeria | ASI | 38,243.19 | 38,278.55 | 31,430.50 | -17.81 | -17.89 |
| South Africa | JSE African AS | 59,504.67 | 57,610.98 | 52,736.86 | -11.37 | -8.46 |
| Kenya | Nairobi NSE 20 | 3,711.94 | 3,285.73 | 2,833.84 | -23.66 | -13.75 |
| Egypt | EGX CSE 30 | 15,019.14 | 16,348.60 | 13,035.77 | -13.21 | -20.26 |
| Ghana | GSE All Share | 2,579.72 | 2,878.66 | 2,499.33 | -3.12 | -13.18 |
| | | | | | | |
| **NORTH AMERICA** | | | | | | |
| US | S&P 500 | 2,673.61 | 2,718.37 | 2,506.85 | -6.24 | -7.78 |
| Canada | S&P/TSX Composite | 16,209.13 | 16,277.73 | 14,322.86 | -11.64 | -12.01 |
| Mexico | Mexico Bolsa (IPC) | 49,354.42 | 47,663.20 | 41,640.27 | -15.63 | -12.64 |
| | | | | | | |
| **SOUTH AMERICA** | | | | | | |
| Brazil | Bovespa Stock | 76,402.08 | 72,762.50 | 87,887.26 | 15.03 | 20.79 |
| Argentina | Merval | 30,065.61 | 26,037.00 | 30,292.55 | 0.75 | 16.34 |
| Colombia | COLCAP | 1,513.65 | 1,577.01 | 1,325.93 | -12.40 | -15.92 |
| | | | | | | |
| **EUROPE** | | | | | | |
| UK | FTSE 100 | 7,687.77 | 7,636.93 | 6,728.13 | -12.48 | -11.90 |
| France | CAC 40 | 5,312.56 | 5,323.53 | 4,730.69 | -10.95 | -11.14 |
| Germany | DAX | 12,917.64 | 12,306.00 | 10,558.96 | -18.26 | -14.20 |
| Russia | MICEX | 2,109.74 | 2,295.95 | 2,358.50 | 11.79 | 2.72 |
| | | | | | | |
| **ASIA** | | | | | | |
| Japan | NIKKEI 225 | 22,764.94 | 22,304.51 | 20,014.77 | -12.08 | -10.27 |
| China | Shanghai SE A | 3,463.48 | 2,982.00 | 2,611.38 | -24.60 | -12.43 |
| India | BSE Sensex | 34,056.83 | 35,423.48 | 36,068.33 | 5.91 | 1.82 |

**Source: Bloomberg**

### 5.4.3 Commodities

The earlier indication of commodity price recovery observed in the first half of 2018 was reversed, particularly following moderation in global growth, continuing trade war between the US and China, and easing of secondary sanctions on eight (8) countries after the earlier imposition of both primary and secondary sanctions on Iranian oil. As a result, the IMF energy index fell from 163.9 points in June to 133.3 points in December 2018. This was reflected in the OPEC reference basket which decreased by 22.23 per cent to an average of US$56.94pb in December 2018 from US$73.22pb in June 2018. Prospects of recovery in the oil market were, however, raised following the discussions and final agreement by OPEC and non-OPEC member countries to impose ceilings on crude oil production.

The non-fuel price index also fell from 110.2 points to 104.1 points between June and December 2018. Consequently, the price of metals declined in the review period. The price of Aluminum fell by 14.18 per cent to US$1,920.38/mt in December from US$2,237.62/mt in June 2018. Similarly, the price of Zinc fell by 15.29 per cent to US$2,616.29mt in December 2018 from US$3,088.57/mt in June.

The Food and Agriculture Organization (FAO) Food Price Index fell by 6.31 per cent to 161.8 points in December 2018 from 172.7 points in June. The sub-indices of meat, vegetable oil and dairy fell, while cereals and sugar increased. The development was due to strong export supplies of meat from Oceania; ample supplies of vegetables, particularly in South America; as well as high export supplies of dairy from Europe. Cereals production faced inclement weather particularly in the Southern hemisphere.

### 5.4.4 Global Foreign Exchange Market

In the second half of 2018, most currencies depreciated against the US dollar, largely on account of continuing normalization of monetary policy by the US Fed which led to rising yields in US treasuries and other financial assets, and improving macroeconomic conditions in the United States.

As a result, in North America, the Canadian dollar depreciated by 3.70 per cent, while the Mexican peso appreciated by 1.31 per cent; In South America, the Argentine peso and Colombian peso both depreciated by 23.20 and 9.82 per cent, respectively; while the Brazilian real appreciated by 0.05 per cent.

In Europe, the British pound, the Euro, and Russian ruble all depreciated against the U.S dollar by 3.41, 1.88 and 10.0 per cent, respectively. In Asia, the Chinese yuan, and Indian rupee both depreciated by 3.74 and 1.86 per cent, respectively, while the Japanese yen appreciated marginally by 0.98 per cent.

In Africa, the Nigerian naira, South African rand, Kenyan shilling, Egyptian pound, and Ghanaian cedi all depreciated against the U.S. dollar by 0.41, 4.33, 0.82, 0.02 and 3.81 per cent, respectively.

**Table 5.10**
**Exchange Rates of Selected Countries (value in currency units to US$)**

| Exchange Rates of Selected Countries (Value in currency units to US$) | | | | |
|---|---|---|---|---|
| | **Currency** | **29-Jun-18** | **31-Dec-18** | **Jun 18 - Dec 18 (% App/Dep)** |
| **AFRICA** | | | | |
| Nigeria | Naira | 305.75 | 307.00 | -0.41 |
| South Africa | Rand | 13.73 | 14.35 | -4.33 |
| Kenya | Shilling | 101.01 | 101.85 | -0.82 |
| Egypt | Pound | 17.92 | 17.92 | -0.02 |
| Ghana | Cedi | 4.73 | 4.92 | -3.81 |
| | | | | |
| **NORTH AMERICA** | | | | |
| Canada | Dollar | 1.31 | 1.36 | -3.70 |
| Mexico | Peso | 19.91 | 19.65 | 1.31 |
| | | | | |
| **SOUTH AMERICA** | | | | |
| Brazil | Real | 3.88 | 3.87 | 0.05 |
| Argentina | Peso | 28.93 | 37.66 | -23.20 |
| Colombia | Peso | 2930.50 | 3249.75 | -9.82 |
| | | | | |
| **EUROPE** | | | | |
| UK | Pound | 0.76 | 0.78 | -3.41 |
| Euro Area | Euro | 0.86 | 0.87 | -1.88 |
| Russia | Ruble | 62.74 | 69.72 | -10.00 |
| | | | | |
| **ASIA** | | | | |
| Japan | Yen | 110.76 | 109.69 | 0.98 |
| China | Yuan | 6.62 | 6.88 | -3.74 |
| India | Rupee | 68.47 | 69.77 | -1.86 |
| Source: bloomberg | | | | |

**BOX 5.1: THE NIGERIA – CHINA CURRENCY SWAP AND POLICY IMPLICATIONS**

Currency swap is an agreement between two parties to exchange cash flows in different currencies at a predetermined rate for specified terms and conditions. It enables two countries or institutions to exchange payments in one currency for the equivalent amount in another currency to fast track trade and investments. Currency swaps also provide liquidity support to financial markets, and hedge against exchange and interest rate risk and in some cases avoidance of transaction costs and taxes. The initiator may be required to pay interest on the amount exchanged at the end of the transaction, which can be a fixed or floating rate. Interest rates are usually the prevailing interbank lending rates in both markets.

Bilateral currency swap is usually arranged by countries to promote trade, economic integration and other beneficial purposes. For example, in order to facilitate the internationalization of the Renminbi, China signed twenty (20) Bilateral Currency Swap Agreements (BCSAs) with various countries.

Nigeria experienced a period of prolonged foreign exchange demand pressures due to the import dependent nature of the economy. The situation worsened with the sudden decline in international crude oil prices from Mid-2014, which led to sharp depreciation of the naira, depletion of external reserves and negative output growth. In response to the unfavourable outcomes of the crash in crude oil prices and recession, government commenced fiscal injections and the CBN embarked on several policy measures; including deepening of foreign exchange market, providing financial support to the real sector and entering into negotiations for a Nigeria-China Currency Swap arrangement to reverse the trend. During the recession, the economy experienced the challenge of providing sufficient foreign currency liquidity to support trade. The swap agreement was an innovative response to this problem.

The negotiation for the Nigeria-China Currency Swap Agreement started on April 12, 2016 between Chinese President Xi Jinping and Nigeria's President Muhammad Buhari in Beijing, China. Subsequently, the Industrial and Commercial Bank of China Limited and the CBN signed a deal on Yuan transaction. In recognition of China's strategic importance, the CBN had as far back as 2014, increased the Chinese Yuan portion of its external reserves from 2.0 to 7.0 per cent. In 2014, the world recognised the Renminbi (Yuan) as a likely global reserve currency, which made other countries to integrate the Chinese currency into their financial markets.

The Currency Swap deal was in three parts:

A bilateral currency swap arrangement between the People's Bank of China and the Central Bank of Nigeria (CBN) whereby both countries exchange their currencies.

A structured, secured, cross currency swap between the Industrial and Commercial Bank of China Ltd. (ICBC) and the CBN. In this arrangement, the CBN will agree to exchange a specified amount of naira for Yuan, which the ICBC converts into US dollars and loans it to CBN. However, Nigeria would have to place its investments overseas as collateral.

Adoption of Nigeria as the clearing hub for the Yuan in West Africa, with the ICBC acting as the liaising bank in China.
Having reviewed and agreed on the terms and conditions of the bilateral currency swaps, the Governor of the Central Bank of Nigeria, Mr. Godwin Emefiele, on behalf of the Nigerian government on April 27, 2018, signed a 3-year agreement along with his counterpart, the Governor of the Peoples Bank of China, Mr. Yi Gang who represented the People's Republic of China. The signing was held in Beijing, China and the amount involved was Renminbi (RMB) 15.0billon or ₦720.0billon (about U$2.5 billion), which could either be extended by mutual consent at expiration in 2021 or reversed. The aim is to provide liquidity to facilitate trade transactions for both Nigerian and Chinese businesses.

**Implications for Policy**

The rationale for the currency swap is to eliminate the challenges of searching for third currencies for businesses involving Nigeria and China. Its operationalization would also enhance foreign exchange management, financial system stability and economic cooperation. Overall, it is likely to facilitate speedy recovery of the Nigerian economy from the recent economic recession. Specifically, the BCSA will benefit Nigeria in the following ways:

**Reduction in Cost of Funding:** with the agreement, Nigeria will benefit from reduction in transaction costs of cross-border trade and direct investment for firms in the participating countries. Invoicing and settling of cross-border trade and investment in a third party currency, carries added degree of foreign exchange risk, which the swap agreement eliminates.

**Hedge against Exchange Rate Fluctuations and Reduce Concentration Risk**: Swap will help the country hedge against exchange rate volatility. To realize this benefit, the BCSA must specify that the exchange rate for initiating and terminating a transaction should be the same. The agreement will help Nigeria reduce exposure to interest and exchange rate risks.

**Exports and Trade Deficit:** The swap can help Nigeria shore up her exports and reduce trade deficits. It can also help reduce pressure on the naira. If Nigerian importers from China begin to get the RMB directly rather than buying USD, and then converting to RMB, it will help reduce pressure on the USD as it would be the first step towards isolating the legitimate demand for the USD from speculative practices. It would also help reduce the foreign exchange costs for importers.

**West Africa Renminbi Hub:** The agreement would facilitate the setting up of a clearing bank thereby making it a first step to making Nigeria a West African hub for the RMB.

**Encourage Cooperation and Exchange between Countries:** It will encourage cooperation and exchange between the two countries, and help the development of mutual trade and investment.

**Cross-border Settlement and Investment in RMB:** The swap with China will aid efficient settlement of cross-border trade and direct investment in RMB.

# CHAPTER 6
# ECONOMIC OUTLOOK

## 6.1 Overview

Global output grew by 3.7 per cent in 2018, down from 3.8 per cent in 2017 (IMF WEO January, 2019), and was also lower than the earlier estimate of 3.9 per cent for the year. Global growth in 2018 was largely driven by growth in the advanced economies, resulting from increased household spending, non-residential investments, strong export in the US and the UK and improved performance in France and Spain. In the EMDEs, growth was supported by strengthening investment and private consumption, and improved external environment resulting from higher commodity prices and access to capital markets.

The moderating factors to global growth, however, were: the difficult BREXIT negotiations; ongoing US-China trade war; tighter financial conditions due to continued monetary policy normalization in the advanced economies; capital flow reversals and exchange rate pressures in emerging markets; rising oil import bills; continued geopolitical tensions and other country-specific factors.

In the advanced economies, output growth was estimated at 2.3 per cent in 2018, down from 2.4 per cent in 2017. The development was due to the moderation witnessed in the Euro area, UK, Japan and Canada as well as the impact of elevated trade tensions. The United States economy grew by 2.9 per cent in 2018, compared with 2.2 per cent in 2017 as a result of fiscal stimulus, despite the ongoing normalization of monetary policy. In the Euro area, growth slowed to 1.8 per cent in 2018 compared with 2.4 per cent in 2017, while in the UK it also weakened to 1.4 per cent in 2018 from 1.8 per cent in 2017, due primarily to difficult BREXIT negotiations. In Japan, growth slowed to 0.9 per cent in 2018 compared with 1.9 per cent in 2017 owing to the impact of natural disasters.

In the Emerging Market and Developing Economies, growth moderated to 4.6 per cent in 2018, from 4.7 per cent in 2017. The development reflected weak recovery in commodity exporting economies, deceleration of growth in commodity importers, continued capital flow reversals, exchange rate pressures and pockets of geopolitical tensions. Growth in China was estimated at 6.6 per cent in 2018, compared with 6.9 per cent in 2017, owing to slowing external demand and internal financial regulatory tightening. In India, the economy expanded by 7.3 per cent in 2018, from 6.7 per cent in 2017 due to stronger demand and recovery from earlier currency and tax shocks. Output growth in Brazil improved to 1.3 per cent in 2018 compared with 1.1 per cent in 2017 owing to strengthened oil prices and private investment. Growth in Russia was estimated at 1.7 per cent in 2018 up from 1.5 per cent in 2017, due to improved oil prices and recovery in domestic demand.

In sub-Saharan Africa, growth was estimated at 2.9 per cent in 2018, same as in 2017, with varied performance across countries. The growth momentum was driven largely by higher commodity prices and improved access to international markets. Output growth in South Africa was estimated at 0.8 per cent, down from 1.3 per cent in 2017, due largely to political uncertainty in the run-up to the 2019 general elections. In Nigeria, growth was estimated at 1.9 per cent in 2018, up from 0.8 per cent in 2017 supported by improved oil prices and sustained implementation of the ERGP.

## 6.2 Outlook for Global Output

Global growth projection for 2019 was revised downwards as a result of the slowdown witnessed in the second half of 2018. The downward revision was due to a number of factors such as: the lingering trade war between the US and China; newly introduced fuel emission standards in Germany, expected to slow down activity in the auto industry; residual impact of natural disasters in Japan; and substantial financial market pressures in some large emerging markets and developing economies. Other factors underlying the revision were: the continued rebalancing in China and slowdown in its export demand; pockets of geopolitical tensions; uncertainty over BREXIT negotiations; and slower-than-expected recovery in oil and other commodity prices. Accordingly, global growth is projected to slow to 3.5 and 3.6 per cent in 2019 and 2020, respectively, from 3.7 per cent in 2018.

Growth in the advanced economies is projected at 2.0 and 1.7 per cent in 2019 and 2020, respectively, down from 2.3 per cent in 2018, largely due to expected slowdown in growth in the United States from 2.9 per cent in 2018 to 2.5 per cent in 2019 and further to 1.8 per cent in 2020. This is expected to occur as the rapid pace of monetary policy normalization overshadows the current expansionary fiscal policy. Normalization is expected to continue due to rising domestic demand associated with strong wage growth and low unemployment rate.

In the Euro area, growth is expected to moderate from 1.8 per cent in 2018 to 1.6 per cent in 2019, but pick-up slightly to 1.7 per cent in 2020. The weaker projection for the region is predicated on: the impact on industrial production in Germany's automobile sector, as new emission standards come into effect; the likely adverse effect of workers protests on output in France; uncertainty over BREXIT negotiations; continued trade wars between the US and its key trading partners; and geopolitical tensions in Spain. In the UK, in spite of difficult BREXIT negotiations, output growth is expected to rise moderately from 1.4 per cent in 2018 to 1.5 and 1.6 per cent in 2019 and 2020, respectively, on the back of expected improvements in household spending and domestic exports.

In Japan, output growth is forecast to rise moderately from 0.9 per cent in 2018 to 1.1 per cent in 2019 before falling to 0.5 per cent in 2020. Growth in the Japanese economy continues to be hampered by an ageing labour force and the impact of natural disasters.

In the emerging market and developing economies, growth is projected to moderate slightly to 4.5 per cent in 2019 from 4.6 per cent in 2018, but rise to 4.9 per cent in 2020. This will be due largely to an expected dip in emerging and developing Europe from 3.8 per cent in 2018 to 0.7 per cent in 2019, moderated by expected growth in sub-Saharan Africa and Latin America. Growth in China is expected to decline to 6.2 per cent in 2019 and 2020 apiece from 6.6 per cent in 2018, on the back of continuing internal financial regulatory measures and slowdown in external demand. The decline is, however, expected to be moderated by proposed stimulus packages in 2019. In India, growth in 2019 and 2020 is expected to rise to 7.5 and 7.7 per cent, respectively, up from 7.3 per cent in 2018. The development is traceable to the expected rebound in external demand, strengthened investment and private consumption.

In the Middle East and North Africa (MENA) region, growth is forecast at 2.4 per cent in 2019 same as in 2018, before rising to 3.0 per cent in 2020, premised on recovering oil prices. In Sub-Saharan Africa, growth is expected to rise to 3.5 and 3.6 per cent in 2019 and 2020, respectively, from 2.9 per cent in 2018. In Nigeria, growth is estimated to rise to 2.0 and 2.2 per cent in 2019 and 2020, respectively, from 1.9 per cent in 2018, anchored on sustained recovery in oil prices. In South Africa, growth is projected to rise from 0.8 per cent in 2018 to 1.4 and 1.7 per cent in 2019 and 2020, respectively.

## 6.3 Downside Risks to Global Outlook

In the present environment of elevated policy uncertainty, risks to the global economic outlook in the short to medium term appeared skewed to the downside. These risks include: the unresolved trade tensions between the US and China; policy uncertainty thrown up by the US-Mexico-Canada (USMCA) free trade agreement; fiscal policy upheavals in Italy; and impact of China's internal financial regulation. The continued risk of capital flow reversals from emerging market economies is also expected to heighten foreign exchange volatility in countries with weaker fundamentals.

In the advanced economies, the risks to growth remains increased volatility in financial markets as monetary policy normalization progresses, causing economic agents to reassess risks. In addition, financial conditions are expected to tighten as negative output gaps closes and price development picks up pace.

In the emerging markets and developing economies, the progressive normalization of monetary policy in the advanced economies, particularly the US, could tighten financial conditions as US Treasury yields improve. This will result in heightened capital outflows and coupled with weak fiscal buffers, accentuate pressure on exchange rates. The development will also lead to increased debt service payments and cost of new borrowing, thus, encroaching further on the limited fiscal space. The uncertainty, surrounding domestic elections in some countries is also expected to increase sovereign risk and dampen investment growth.

In the Middle East and North Africa region, lingering geopolitical tensions are likely to continue to weaken economic performance. Other factors that may hurt growth and investment in the region include: moderation in economic activity in China; and US sanctions on Iran.

In sub-Saharan Africa, the key risk to growth remains the likelihood of declining oil and other commodity prices which may dampen export growth in the region. In addition, the forthcoming 2019 general elections in several countries including in Nigeria and South Africa may also impose a drag on investment as market participants await clarity on the policy direction of the new governments.

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

| | 2017 | 2018 | 2019* | 2020* |
|---|---|---|---|---|
| A. World Output | | | | |
| World Output | 3.8 | 3.7 | 3.5 | 3.6 |
| **Advanced Economies** | **2.4** | **2.3** | **2.0** | **1.7** |
| USA | 2.2 | 2.9 | 2.5 | 1.8 |
| Euro Area | 2.4 | 1.8 | 1.6 | 1.7 |
| Japan | 1.9 | 0.9 | 1.1 | 0.5 |
| UK | 1.8 | 1.4 | 1.5 | 1.6 |
| Canada | 3.0 | 2.1 | 1.9 | 1.9 |
| Other Advanced Economies | 2.8 | 2.8 | 2.5 | 2.5 |
| **Emerging & Developing Economies** | **4.7** | **4.6** | **4.5** | **4.9** |
| Commonwealth of Independent States | 2.1 | 2.4 | 2.2 | 2.3 |
| Latin America and the Caribbean | 1.3 | 1.1 | 2.0 | 2.5 |
| Middle East and North Africa | 2.2 | 2.4 | 2.4 | 3.0 |
| Sub-Saharan Africa | 2.9 | 2.9 | 3.5 | 3.6 |
| **B. Commodity Prices (US' Dollars)** | | | | |
| Oil | 23.3 | 29.9 | -14.1 | -0.4 |
| Non-fuel | 6.4 | 1.9 | -2.7 | 1.2 |
| **C. Consumer Prices** | | | | |
| Advanced Economies | 1.7 | 2.0 | 1.7 | 2.0 |
| Emerging & Developing Economies | 4.3 | 4.9 | 5.1 | 4.6 |

**Source: IMF WEO Update, January 2019**
***Forecast**

## 6.4 Global Inflation Outlook

Global inflation is projected to rise to 3.8 per cent in 2019 from 3.7 per cent in 2018, reflecting the impact of a number of developments. These include recovery in oil and other commodity prices, strong wage growth and accommodative monetary policy in some advanced economies, as well as currency depreciations.

In the advanced economies, inflation is projected to decline to 1.9 per cent in 2019 from 2.0 per cent in 2018, due to continued normalization of monetary policy and expected moderation in oil price. Inflation in the United States is projected to moderate to 2.1 per cent in 2019 from 2.4 per cent in 2018, driven by monetary policy normalization by the Fed and waning effect of tax cut. In the United Kingdom, inflation is expected to decline to 2.2 per cent in 2019 from 2.5 per cent in 2018, due to subdued growth in demand, lower petrol prices and freeze in the rate of fuel and alcohol duties. In the Euro area, inflation is projected at 1.7 per cent in 2019 same as in 2018. Inflation in Japan is forecast to rise to 1.3 per cent in 2019 from 1.2 per cent in 2018, as monetary policy remains accommodative.

In the emerging markets and developing economies, inflation is expected to rise to 5.2 per cent in 2019 from 5.0 per cent in 2018, reflecting upward pressure on prices in key economies in the region. In China, the rise in price level to 2.4 per cent in 2019 from 2.2 per cent in 2018 is expected to be driven by higher food and energy prices. In Brazil, inflation is also projected to increase to 4.2 per cent in 2019 from 3.7 per cent in 2018, driven primarily by rising food prices. In India, inflation is projected to rise to 4.9 per cent in 2019 from 4.7 per cent in 2018, due to expected acceleration in demand and rising energy prices. In Russia, inflation is forecast to rise sharply to 5.1 per cent in 2019 from 2.8 per cent in 2018, the highest increase in the group, driven by weaker rubble, and likely increase in Value Added Tax (VAT). The planned increase in VAT is expected to fuel consumer inflation in Russia.

In sub-Saharan Africa, inflation is forecast to moderate to 8.5 per cent in 2019 from 8.6 per cent in 2018. This will be led by declines in Angola, Democratic Republic of Congo (DRC) and Ethiopia from 20.5, 23.0 and 12.7 per cent in 2018 to 15.8, 13.5 and 9.5 per cent in 2019, respectively. In South Africa, however, inflation is projected to rise to 5.3 per cent in 2019 from 4.8 per cent in 2018. In Nigeria, inflation is also projected to rise to 13.5 per cent in 2019 from 12.4 per cent in 2018, driven by exchange rate pressure arising from capital flow reversals and widening fiscal deficits. In the MENA region, including Afghanistan and Pakistan, inflation is forecast to decline to 10.20 per cent in 2019 from 10.79 per cent in 2018.

## Outlook for Domestic Output Growth

The domestic economy is expected to continue on a path of recovery in 2019. Real GDP in the fourth quarter of 2018 strengthened to 2.38 per cent (year-on-year) from 1.81 and 2.11 per cent in the preceding quarter and the corresponding period of 2017, respectively. This was mainly attributed to the non-oil sector, which grew by 2.70 per cent in the fourth quarter compared with 2.32 and 1.45 per cent in the preceding quarter and the corresponding period of 2017. Overall, the economy expanded by 1.93 per cent in 2018 from 0.82 per cent in 2017.

The outlook for 2019 remains broadly positive. With output growth estimated at 1.9 per cent in 2018, the IMF and the World Bank projected the Nigerian economy to grow in 2019 by 2.0 and 2.2 per cent, respectively. Similarly, the CBN has projected 2019 output growth of 2.28 per cent for the country. This outlook is anchored on expected improvements in oil production and prices, continuing reforms in the foreign exchange market and prospects of improved agricultural output. In addition, the current diversification drive anchored on increased non-oil revenue is expected to improve the fiscal space, thus supporting the implementation of the Economic Recovery and Growth Plan (ERGP).

Key headwinds to the growth outlook however, are the likely moderation in oil prices, capital flow reversal in response to monetary policy normalization, perception of rising sovereign risk associated with the 2019 general elections, persistence of security challenges such as insurgency and herdsmen attack in some parts of the country, and weak intermediation from the banking system to the real economy.

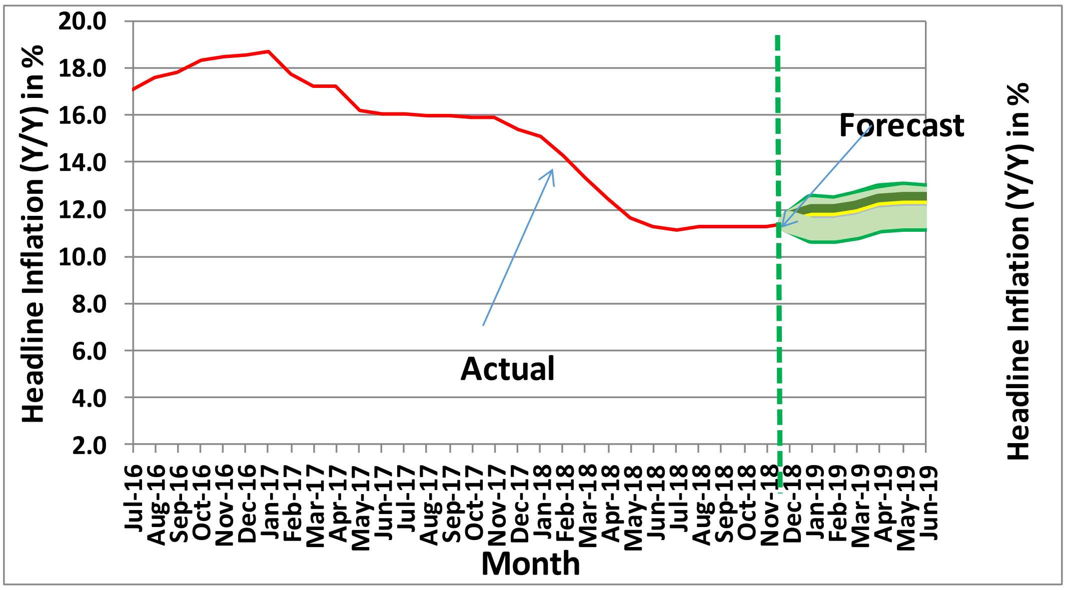
## Outlook for Domestic Inflation

Headline inflation trended upwards in the second half of 2018, remaining above the CBN's 6-9 per cent indicative band. The uptick was attributed to increase in food prices, mainly from adverse weather conditions in some parts of the country, increased spending towards the 2019 general elections and capital flow reversals. Staff estimates suggest that headline inflation (year-on-year) is projected to increase to 11.60, 11.56, 11.73, 12.01, 12.11, and 12.08 per cent in January, February, March, April, May and June 2019, respectively. Upside risks to these estimates are the residual impact of the 2018 flooding on agricultural output, insecurity in some parts of the food producing belt of the country, inflation pass-through from exchange rate depreciation, increased spending towards the 2019 general elections, as well as infrastructure-related challenges. As the Bank continues to manage liquidity conditions in the banking system, price development will continue to be monitored to ensure moderation in the upside risks.

**Fig 1: Inflation Forecast**

| YEAR-ON-YEAR INFLATION RATE | | | | |
|---|---|---|---|---|
| Status | Month | Headline inflation | Food inflation | Core inflation |
| Actual | Jul-18 | 11.14 | 12.85 | 10.18 |
| | Aug-18 | 11.23 | 13.16 | 10.02 |
| | Sep-18 | 11.28 | 13.31 | 9.84 |
| | Oct-18 | 11.26 | 13.28 | 9.88 |
| | Nov-18 | 11.28 | 13.30 | 9.79 |
| | Dec-18 | 11.44 | 13.56 | 9.77 |
| Forecast | Jan-19 | 11.60 | 13.83 | 9.81 |
| | Feb-19 | 11.56 | 13.85 | 9.85 |
| | Mar-19 | 11.73 | 13.76 | 10.18 |
| | Apr-19 | 12.01 | 14.33 | 10.18 |
| | May-19 | 12.11 | 14.57 | 10.02 |
| | Jun-19 | 12.08 | 14.36 | 9.82 |

| 12-MMA INFLATION RATE | | | | |
|---|---|---|---|---|
| Status | Month | Headline inflation | Food inflation | Core inflation |
| Actual | Jul-18 | 13.95 | 17.10 | 11.48 |
| | Aug-18 | 13.55 | 16.50 | 11.28 |
| | Sep-18 | 13.16 | 15.94 | 11.09 |
| | Oct-18 | 12.78 | 15.36 | 10.90 |
| | Nov-18 | 12.41 | 14.80 | 10.70 |
| | Dec-18 | 12.10 | 14.35 | 9.51 |
| Forecast | Jan-19 | 11.82 | 13.98 | 10.34 |
| | Feb-19 | 11.61 | 13.70 | 10.19 |
| | Mar-19 | 11.48 | 13.53 | 10.11 |
| | Apr-19 | 11.45 | 13.50 | 10.06 |
| | May-19 | 11.50 | 13.60 | 10.00 |
| | Jun-19 | 11.57 | 13.69 | 9.94 |




Source: CBN Staff Estimates

## Outlook for Monetary Policy in 2019

Monetary Policy by the Bank in 2019 will continue to provide an anchor for inflation expectations in order to maintain price stability conducive to economic growth. To achieve this, the Bank will maintain its use of heterodox monetary policy strategies to moderate the speculative activities of market agents in response to temporary shocks to the economy.

Risks to monetary policy in 2019 arising from the global environment include: the continuing normalisation of monetary policy in the US and other advanced economies; financial market volatilities arising from a no-deal BREXIT; trade tensions between the US and its key trading partners; as well as currency depreciations due to the strengthening US dollar and expected weak oil price. On the domestic front, the risk to monetary policy include: the rising public domestic debt; 2019 general election spending; constraints to credit growth; and the still fragile economic recovery. With headline inflation projected to trend upwards in the near-term, these issues will continue to demand close monitoring by the monetary authorities.

Factors expected to support the achievement of the objective of monetary policy are: increased accretion to external reserves; stability in the foreign exchange market; improved security situation in the food and oil producing regions of the country; as well as enhanced flow of credit to the real economy.

# Appendices

## CENTRAL BANK OF NIGERIA COMMUNIQUÉ NO 119 OF THE MONETARY POLICY COMMITTEE MEETING OF JULY 23 AND 24, 2018.

### 1.0 Background

The Monetary Policy Committee (MPC) held its 262nd meeting on Monday, 23rd and Tuesday, 24th July, 2018 amid fragile improvements in global growth and the domestic economic recovery. The Committee reviewed developments in the global and domestic economic and financial environments, as well as the outlook for the rest of the year. The MPC also assessed the risks to price stability, credit growth, employment creation and financial system stability, in the short-to-medium term. Ten (10) members of the Committee were in attendance.

### Global Economic Developments

Global growth momentum remained promising despite rising trade tensions, uncertainties in BREXIT negotiations and scepticism over North Korea's commitment to the denuclearise the Korean Peninsula. Global growth was projected at 3.9 per cent in 2018, compared with 3.7 per cent in 2017, largely driven by the recovery in oil prices, rising asset prices and long term yield on major financial markets as well as a rebound in investment, manufacturing output and trade.

In the Advanced Economies, growth was projected at 2.4 per cent in 2018, the same as in 2017. The growth was expected to be driven majorly by fiscal stimulus in the United States coupled with accommodative financial conditions. In the Emerging Markets and Developing Economies output growth was projected at 4.9 per cent in 2018, up from 4.7 per cent in 2017, due largely to sustained recovery in global commodity prices (particularly crude oil); rebound in investment, manufacturing and trade as well as the strengthening of domestic consumption.

The downside risks to global output growth remains the build-up in financial vulnerabilities; rising costs of borrowing in the Emerging Markets and Developing Economies; fragile corporate balance sheets; escalating trade protectionism, uncertainties around the BREXIT negotiations; heightened geopolitical tensions; and fiscal sustainability concerns.

Global inflation was projected at 3.2 per cent in 2018, driven by rising energy prices, and currency depreciations in some emerging market and developing economies. In the advanced economies, inflation was projected to increase to 2.2 per cent in 2018, up from 1.7 per cent in 2017, as a result of increases in the cost of transport, housing, energy and food. Similarly, inflation in the emerging markets and developing economies is projected to rise from 4.0 per cent in 2017 to 4.4 per cent in 2018, due to currency depreciations and rising energy prices. The Committee believes that global inflation is likely to remain subdued over the medium term relative to long term trends despite subsisting monetary accommodation in some advanced economies.

## Domestic Output Developments

Economic recovery was sustained with a positive outlook over the medium-term, anchored on oil price recovery, fiscal spending and stability in the foreign exchange market. Data from the National Bureau of Statistics (NBS) showed that real Gross Domestic Product (GDP) grew by 1.95 per cent in the first quarter of 2018, compared with 2.11 per cent and a contraction of 0.91 per cent in the preceding and corresponding quarters of 2017, respectively. The oil sector, which contributed 1.26 per cent in Q1 2018, compared with 0.76 per cent during Q4 2017 was the major source of the growth. The Purchasing Managers Indices (PMI) for manufacturing, and non-manufacturing activities rose for the fifteenth and fourteenth consecutive months to 57.0 and 57.5 index points, respectively, in June 2018. The Committee noted the positive impact of the sustained improvement in foreign exchange supply on the performance of manufacturing and other key sectors of the economy. The Committee welcomed the positive economic growth, but observed that the recovery was still fragile and called for the speedy implementation of the 2018 Federal Government Budget and the Economic Recovery and Growth Plan (ERGP) to strengthen output growth in the Nigerian economy.

## Developments in Money and Prices

The Committee observed that Narrow money (M1), contracted by 4.25 per cent, annualised to -8.49 per cent, relative to the provisional benchmark of 8.04 per cent. Broad money supply (M2), however, grew by 2.79 per cent in June 2018, annualised to 5.58 per cent, compared with the provisional growth benchmark of 10.84 per cent for fiscal 2018. The increase in M2 was mainly driven by Net Foreign Assets (NFA), which grew by 18.15 per cent in June 2018, annualised to 36.30 per cent, compared with the provisional benchmark of 18.15 per cent for 2018. The development reflected improvements in foreign receipts arising from favourable crude oil prices. On the other hand, Net Domestic Credit (NDC) contracted by 1.40 per cent, annualized to -2.80 per cent, compared with the provisional benchmark of 12.45 per cent. The development was driven largely by the decrease in net credit to government, which contracted by 9.74 per cent in June 2018, annualised to -19.48 per cent against the provisional benchmark of 54.97 per cent. Credit to the private sector similarly contracted by 0.04 per cent, annualised to -0.08 per cent in June 2018, in contrast to the provisional annual benchmark of 5.64 per cent.

A revised and seasonally adjusted money supply aggregate, however, showed an uptick. The new aggregate (M3), which is still being finalised by the Bank, appears to comprehensively capture the liquidity in and outside the banking system, compared with the existing M2. More details about the impact of M3 on macroeconomic variables would be reviewed at future MPC meetings.

Headline inflation (year-on-year) trended downwards for the seventeenth consecutive month to 11.23 per cent in June 2018 from 11.61 per cent in May 2018. Food and Core inflation also fell to 12.98 and 10.40 per cent, from 13.45 and 10.71 per cent, respectively, over the same period. The Committee, however, noted the rise in the month-on-month inflation rate, to 1.24 per cent in June, from 1.09 per cent in May 2018. Food inflation (month-on-month) also increased from 1.33 per cent in May to 1.57 per cent in June 2018, representing an increase of 0.24 percentage point. During the same period, core inflation (month-on-month) also rose by 0.05 percentage point, from 0.98 per cent in May to 1.03 per cent, in June 2018. In view of the trend in rising month-on-month inflation rate, amid the slowly declining year-on-year headline inflation, indications were that inflationary pressures are rebuilding in the domestic economy.

The review of developments in the money market revealed that the average inter-bank call rate fell to 5.0 per cent in June 2018, from 25.43 per cent in May 2018, while the average Open Buy Back (OBB) rate decreased from 18.37 per cent in May 2018 to 10.84 per cent in June 2018. The trend in market rates and the net liquidity position reflected the impact of the auction of Open Market Operations (OMO) bills, foreign exchange interventions, FAAC allocations to various levels of government, as well as the servicing of maturing CBN Bills.

External reserves stood at US$47.2 billion on July 23, 2018. The Committee was optimistic and expected further increases in the level of external reserves in the near term, citing the favourable crude oil prices. The Committee, therefore, advised the Bank to sustain its current efforts to maintain investor confidence and ensure accretion to external reserves. The MPC also called on the Federal Government to continue to build fiscal buffers against possible oil price shocks in the future. Noting that the rise in the monthly distribution of revenues at the FAAC portend the danger of the absence of reserve buffers to absorb shocks in the future.

The All-Share Index (ASI) increased marginally by 0.09 per cent to 38,278.55 on June 29, 2018, from 38,243.19 at end-December 2017. Market Capitalisation (MC) also increased by 1.89 per cent to N13.87 trillion on June 29, 2018, from N13.61 trillion at end-December 2017. However, ASI and MC fell by 7.24 per cent, respectively, on June 29, 2018 compared with the level at end-April 2018, due majorly to profit taking activities of investors, and the effect of monetary policy normalization in the United States. The Committee noted with satisfaction, the relative stability in the foreign exchange market and high level of activities, particularly, at the Investors' and Exporters' (I&E) window.

The Committee noted the commencement of the currency swap deal with the People's Bank of China (PBoC) and observed that the availability of Renminbi currency to Nigerian investors would ease pressure in the foreign exchange market. The MPC called for speedy implementation of the framework of the currency swap and urged the Bank to carry out sensitization programme for the public.

## 2.0. The Overall Outlook and Risks to the Domestic Economy

The forecasts of key macroeconomic indicators point to positive economic growth in the second half of 2018. The expectation is premised on the implementation of the 2018 budget, sustained stability in the foreign exchange market, as well as increase in crude oil production and prices. The MPC, cautioned that the downside risks to the growth outlook include: continuing delay in the implementation of the 2018 budget; worsening farmer-herdsmen conflicts in some parts of the country; continued non-payment of workers' salaries and pensions in some states; rising sovereign debt, as well as uncertainties surrounding the direction of trade, including the external demand for Nigeria's oil.

Inflation forecast for the near term points to further moderation in price level in the short term. However, the downside risks to inflation include: the impact of excess liquidity that could arise from the implementation of the approved N9.12 trillion 2018 FGN budget; pre-election spending; anticipated review of salaries and wages; security challenges; and monthly FAAC injections. Although these could boost aggregate demand, it would equally exert upward pressure on domestic prices for the rest of the year. The Committee, therefore, called for a co-ordinated fiscal, monetary and exchange rate policies to stem the upward build-up in price pressures.

The Committee observed that rates in the foreign exchange market have remained relatively stable in near term, supported by continued intervention in the market by the Bank, sustained increase in the price of crude oil in the international market, as well as positive developments in the external sector.

## 3.0. The Considerations of the Committee

The MPC noted with satisfaction the fourth consecutive quarters of growth in real GDP and the positive growth outlook in the domestic economy. This is shown by the sustained improvement in the Manufacturing and Non-manufacturing Purchasing Managers' indices in the second quarter of the year. The MPC commended the approval of 2018 Federal Government budget and called for an accelerated implementation to further support the fragile growth recovery. The Committee also called for sustained implementation of the Economic Recovery and Growth Plan (ERGP) to further stimulate output growth. The Committee was, however, concerned about the liquidity impact of the 2018 expansionary fiscal budget and increasing FAAC distribution, arising from rising prices of crude oil as well as the build-up in election related spending.

Notwithstanding, the positive direction of the outlook, the MPC reviewed the effects of the sustained monetary policy normalization in the US with implications for capital flow reversals, exchange rate and domestic price pressures, as well as other challenges to growth during the second half of 2018.

The Committee took note of the sustained moderation in inflationary pressures, especially headline inflation, as well as stability in the foreign exchange market, but expressed concern on the threat posed by incessant herdsmen-farmers crisis in some key food producing states and the negative impact on food supply chains which would continue to exert upward pressure on food prices. The Committee, therefore, called on the Bank to continue to build on the progress already made to sustain the moderation in inflation.

The MPC also observed with satisfaction high level of activities in the Investors' and Exporters' (I&E) window of the foreign exchange market which continued to supply liquidity in foreign exchange market, narrow exchange rate premium, and reduce speculative activities in the market.

The MPC noted the continued improvements in the performance of deposit money banks and expressed optimism that the moderation in the levels of non-performing loans in the industry would continue. The Committee, therefore, called on the Federal Government to accelerate the settlement of outstanding contractor debts and also encourage the Bank to ensure strict compliance prudential guidelines.

In discussing the economic report presented to the members, it was observed that as the prices of crude oil rose in 2017 and 2018, the monthly allocation to various levels of government also increased, suggesting that the Federal Government may not be saving adequately for the future. The Committee, therefore, advised the fiscal authority to build-up buffers, especially now that the price of crude oil is relatively high.

## 4.0 The Committee's Decisions

Informed by the developments in the global and domestic economic and financial environments, the Committee painstakingly reviewed the policy options available. In particular, the Committee considered the sustained positive growth in real GDP over the last quarter, stability in the foreign exchange market and high level of accretion to the external reserves.

The MPC deliberated on the rise in food inflation, impact of the expected liquidity from expansionary 2018 FGN budget and rising FAAC disbursement in the second half of the year along with the build-up in pre-election year spending. The Committee strongly considered the option of tightening believing that tightening would curtail the threat of a rise in inflation, even as the injection from the fiscal authorities would still provide the economy with substantial liquidity. Notwithstanding the deceleration in headline inflation, the current double digit inflation rate remains above the Bank's 6-9 per cent target range. In addition, the Committee was of the view that tightening would help stem the tide of capital flow reversals in the face of sustained monetary policy normalization in the US. This, the Committee believed would rein-in inflationary pressure and moderate inflation rate to single digit, increase real interest rate, build investor confidence with attendant positive impact on capital inflows and further stabilize the country's exchange rate.

On the contrary, the Committee was of the view that raising interest rate at this time would weaken consumption and raise the cost of borrowing to investors in the domestic economy. In addition, the policy would trigger the re-pricing of financial assets by deposit money banks, thus further constrict credit to the real sector, and that would promote non-inclusive growth.

In considering the option of loosening, the Committee assessed the potential effects of stimulating aggregate demand through lower cost of capital. This could stimulate consumption and aggregate demand. The Committee, however, considered its potential relevance, taking into account the expected liquidity injections from the 2018 budget, increased FAAC disbursements and election related spending ahead of the 2019 general elections. If these crystalize, it would exacerbate inflationary and exchange rate pressures as well as return the real interest rate into negative trajectory. Moreover, lowering the policy rate may not translate to an automatic reduction in market rates due to poor transmission mechanism owing to structural rigidities. The Committee was also of the view that loosening could reverse the gains already made on reduced importation which has strengthened the current account balance. It would also lower banks risk appetite and possible rise in NPLs which could negatively impact on the banking industry stability.

In the discussion for a hold, it was noted that risks to the macroeconomic and financial environment appears fairly balanced with improvements in output growth and inflation. Holding policy at the current stance would support growth and further moderate inflation. The Committee, however, noted the preference of the public for loosening, concerns that the MPC had held the MPR at 14 per cent since July 2016 and also considering the dynamic nature of the market, the MPR may have lost its signalling effect to the market. The argument in favour of maintaining the current policy stance is to monitor the magnitude of the liquidity impact of the fiscal injections and election-related expenditure ahead of the 2019 general elections.

Overall, the MPC was of the opinion that, while it is difficult to encourage job creation in an environment with deficit infrastructure, the Committee believes that the Bank should continue to encourage deposit money banks

(DMBs) to increase the flow of credit to the real economy to consolidate economic recovery. In this regard, the Committee believed that a heterodox approach to reform the market in order to strengthen the flow of credit would be appropriate at this time. Consequently, credit constrained businesses, particularly the large corporations are encouraged to issue commercial paper to meet their credit needs and the Central Bank of Nigeria may, if need be, buy those instruments to complement the efforts of the DMBs. In addition, as a way of incentivise deposit money banks to increase lending to the manufacturing and agriculture sectors, a differentiated dynamic cash reserves requirement (CRR) regime would be implemented, to direct cheap long term bank credit at 9 per cent, with a minimum tenor of seven (7) years and two (2) years moratorium to employment elastic sectors of the Nigerian economy. Details of this framework are being worked out by the Banking Supervision, Monetary Policy and Research Departments of the Bank and would be released soon.

In consideration of the foregoing, therefore, the Committee decided by a vote of Seven (7) members to retain the Monetary Policy Rate (MPR) at 14.00 per cent alongside all other policy parameters. Two (2) members, however, voted to increase the MPR by 50 basis points, while one (1) member voted to increase the MPR by 25 basis points.

Consequently, the MPC voted to retain the:

(i) MPR at 14.0 per cent;

(ii) CRR at 22.5 per cent;

(iii) Liquidity Ratio at 30.0 per cent; and

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

Thank you for listening.

**Godwin I. Emefiele**
**Governor, Central Bank of Nigeria**
**24th July, 2018**

## CENTRAL BANK OF NIGERIA COMMUNIQUÉ NO 120 OF THE MONETARY POLICY COMMITTEE MEETING OF SEPTEMBER 24 AND 25, 2018.

### 1.0 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.

## 2.0 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.

## 3.0. 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.

## 4.0. The Committee's Decisions

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**

## CENTRAL BANK OF NIGERIA COMMUNIQUE NO. 121 OF THE MONETARY POLICY COMMITTEE MEETING OF WEDNESDAY 21ST AND THURSDAY 22ND NOVEMBER, 2018

### 1.0 Background

The Monetary Policy Committee (MPC) met on the 21st and 22nd of November, 2018, amidst a resurgence of global inflationary pressures, increased fragilities in the global financial markets, weakening crude oil prices, continuous capital flow reversal and moderate currency depreciations, especially in the emerging markets as well as a strengthening US dollar and subdued global economic growth outlook. The Committee appraised recent developments in the global and domestic macroeconomic and financial environments, as well as the economic outlook for the first half of 2019. In attendance were eleven (11) members of the Committee.

### Global Economic Developments

The Committee noted the contraction in global output, underpinned largely by escalating trade tensions resulting in widespread uncertainty and waning investor confidence. Consequently, global growth in 2018 has been downgraded to 3.7 per cent from the earlier projection of 3.9 per cent. Growth softened in major advanced economies in the third quarter of 2018. In the Emerging Markets and Developing Economies (EMDEs), growth remained divergent, reflecting a combination of country-specific factors.

Thus, growth in the advanced economies is expected to remain at 2.4 per cent in 2018, supported by strong output growth in the US projected at 2.9 per cent. The U.S. expansionary fiscal stance, strong wage growth and continued inflow of capital into U.S. dollar denominated assets, are expected to provide the impetus for growth. In the United Kingdom, growth remained weak, hampered by uncertainties around Brexit negotiations. Growth in the Euro Area, projected at 2.0 per cent, appears to be subdued by low domestic aggregate demand amidst relatively high unemployment and reduced global trade. In the Emerging Markets and Developing Economies, growth was revised downwards to 4.7 per cent from the earlier projection of 4.9 per cent, largely in anticipation of a slowdown in China as the country is confronted with an adverse external trade environment.

Overall, the downside risks to global economic activity remained: elevated financial fragilities and policy uncertainties, the gradual erosion of rule-based multilateral trading system, tighter financial conditions with latent disruptive portfolio adjustments, increased capital flow reversals with potentials for heightened exchange rate depreciation and some volatility, fiscal fragilities and increased debt burden, geo-political tensions and increasingly depressed aggregate demand in some countries. These factors will continue to shape developments for the rest of 2018 and into 2019.

The MPC also noted that monetary policy in most advanced economies, particularly the US, continued on a path of normalisation in view of strong wage growth and declining unemployment. The Bank of England hiked its policy rate in August 2018, while the European Central Bank (ECB) has given guidance to terminate its asset purchase programme in December 2018. The Committee was concerned that these developments will in the medium term, accentuate capital flow reversals from emerging and developing economies, including Nigeria.

## Domestic Output Developments

The Committee noted the positive outlook for output growth, evidenced by the Manufacturing and Non-manufacturing Purchasing Managers Indexes (PMI), which stood at 56.8 and 57.0 index points, respectively, in October 2018, indicating expansion for the 19th and 18th consecutive months. This was attributed to the stability in the foreign exchange market, implementation of the 2018 capital budget and the on-going intervention of the Central Bank of Nigeria (CBN) in the real sector of the economy. However, the recent incidence of flooding across the country and the impact of herdsmen attack on farming communities could affect output growth for the rest of the year.

Overall, the Committee believes that, even though output recovery remains fragile, the effective implementation of the 2018 capital budget, relative improvements in power supply, progress with counter-insurgency in the North-East and sustained intervention by the CBN in the real sector, will improve the investment climate and reduce unemployment. Consequently, the MPC reaffirmed its support for all initiatives designed to stimulate domestic output growth.

## Developments in Money and Prices

The Committee noted that broad money (M2) grew by 6.52 per cent in October 2018 over its level at the end-December 2017; and annualised to a growth rate of 7.82 per cent, which was below the provisional benchmark of 10.48 per cent for 2018. The growth in M2 was largely due to the significant growth in Net Foreign Assets (NFA) which grew by 20.71 per cent in October 2018, annualised to 24.85 per cent which is above the 2018 provisional growth benchmark of 14.50 per cent. Credit to Government and Net Domestic Credit (NDC) expanded by 7.43 and 2.71 per cent, annualized to 8.92 and 3.26 per cent, respectively; but below the annual benchmark of 13.10 and 17.40 per cent, respectively. Credit to the private sector grossly underperformed as it grew by 1.94 per cent, annualised to 2.33 per cent, below the 2018 benchmark of 12.40 per cent. The underperformance of the monetary aggregates was of concern to the MPC, which urged the CBN to ensure improved credit delivery to the small and medium scale industries, particularly to the unbanked urban and rural populations.

The Committee noted the benign performance of inflation, as headline inflation (year-on-year) decreased to 11.26 per cent in October 2018 from 11.28 per cent in September 2018 after two consecutive months of marginal increases. The drop in headline inflation was driven by food inflation, which moderated to 13.28 per cent in October from 13.31 per cent in September 2018. Core inflation, however, inched up marginally to 9.9 per cent in October 2018 from 9.8 per cent in the previous month. On a month-on-month basis, headline and food inflation also moderated to 0.74 and 0.82 per cent in October from 0.84 and 1.0 per cent in September 2018, respectively, while core inflation increased from 0.64 per cent in September 2018 to 0.80 per cent in October 2018.

The Committee noted that the moderation in inflation was largely seasonally driven and was therefore, unsustainable as prices were expected to pick towards the end of the year. However, the MPC observed that the near-term upside risks to inflation remained; the disruption to agricultural production and distribution arising from flooding, insurgency in the North-East, herdsmen-farmer crisis, high cost of energy, anticipated spending in the run-up to Christmas festivities and campaign-related spending towards the upcoming 2019 general elections. Accordingly, the Committee enjoined the appropriate authorities to continue to address these challenges and to sustain the implementation of the 2018 budget and the Economic Recovery and Growth Plan of the Federal Government to ameliorate the supply side constraints.

Money market interest rates oscillated throughout the review period, reflecting fluctuations in banking system liquidity. Inter-bank call and Open Buy Back (OBB) rates, which stood at 16.00 and 17.08 per cent, respectively, on September 26, 2018, declined moderately to 14.00 and 16.31 per cent, respectively, on October 24, 2018. On average, interbank call and OBB rates rose from 8.68 and 7.64 per cent in September 2018 to 14.18 and 13.93 per cent, respectively, in October 2018, closing at 10.00 and 9.72 per cent, respectively, on November 21, 2018. The developments in net liquidity position and flows which culminated in higher market rates reflected the impact of higher risk perception in the market, withdrawals from the banking system for monthly statutory disbursements to states and local governments; OMO sales and foreign exchange interventions.

The average naira exchange rate remained relatively stable and converging at both the Bureau-de-Change (BDC) and the Investors' and Exporters' (I&E) window segments of the foreign exchange market during the review period. The exchange rate at the I&E window opened at N364.00/US$ and closed at N363.90/US$ with a daily average of N363.87/US$ between September 26 and November 16, 2018. At the BDC segment, the exchange rate opened at N360.00/US$ and closed at N361.85/US$, with a daily average of N360.98/US$, over the same period. The relative stability in the foreign exchange market, the MPC noted, was attributable to the sustained policies of the Bank to increase the supply of foreign exchange from autonomous sources. Gross official reserves decreased from US$42.60 billion at end-September, 2018 to US$41.53 billion on 16th November, 2018.

The Committee noted the bearish trend in the equities segment of the capital market during the review period. Thus, All-Share Index (ASI) decreased by 8.70 per cent from 34,848.45 on August 31, 2018 to 32,058.28 on November 16, 2018. Similarly, Market Capitalization (MC) decreased by 8.72 per cent from N12.72 trillion to N11.70 trillion during the same period. Relative to the end-December 2017, the indices decreased by 19.29 and 16.32 per cent, respectively. These developments largely reflect the sustained profit taking activities by portfolio investors as foreign yields become increasingly more attractive abroad. The MPC, however, believes that this trend will reverse in the medium term given the current efforts at further improving investor confidence and the relative stability in the Investors and Exporters (I&E) window of the foreign exchange market.

## 2.0. Overall Outlook and Risks

Forecasts of key macroeconomic variables indicate a positive outlook for the economy in Q4 of 2018. The Committee expects that the effective implementation of the Economic Recovery and Growth Plan (ERGP) and the 2018 budget, improvements in the security challenges, enhanced flow of credit to the real sector and stability in the foreign exchange market will redirect the economy on a path of inclusive and sustainable growth. Increased production in the oil and the non-oil sectors are also expected to drive output growth in the medium term. The Committee, however, acknowledged the downside risks to this outlook to include: reduced portfolio inflows, weak of fiscal buffers, low domestic credit, and sluggish aggregate demand.

The inflation outlook suggests continued but moderate inflationary pressure to the end of 2018, based largely on increased consumer spending for the Christmas festivities, election-related expenditure and increased pace of implementation of the 2018 Federal government budget. Improvements in the security, increased harvests as well as a stable exchange rate are expected to moderate the rise in inflation.

Overall, the outlook for the economy remains positive with a growth projection of 1.75 per cent in 2018.

## 3.0. Committee's Considerations

The Committee assessed the macroeconomic environment in 2018 and noted the modest stability thus far achieved in domestic prices, output growth and the financial system. The Committee noted that the economy was on the right path but some key sectors continued to experience significant challenges. The MPC, however, expressed concern about the tepid growth expectations and growing uncertainty in the global financial markets arising from the poor reception of the Brexit deal by British politicians, continuing trade war between the US and her major trading partners, as well as the commencement of US sanctions on Iran.

The Committee believed that although the domestic economy was recovering modestly from recession, however, the recovery was tepid and efforts should be stepped up to strengthen aggregate output and demand. In this regard, the Committee urged the CBN to deepen and broaden access to finance to high employment elastic sectors with particular emphasis on small and medium scale enterprises. The Committee called on the CBN to extend the success recorded under the Anchor Borrowers Programme to other items including fish and palm oil, etc. by introducing more stringent measures to curb access to foreign exchange for products that can be produced within Nigeria.

The MPC welcomed the moderation in inflation in October, reflecting declining food prices. The Committee believes that given the negative output gap, the proposed increase in the national minimum wage would stimulate output growth due to prolonged weak aggregate demand arising from salary arrears and contractor debt. Consequently, its impact on the aggregate price level would be largely muted, given that the monetary aggregates have largely underperformed in fiscal 2018. In addition, the prevailing stability in the foreign exchange market would continue to moderate pressures on the domestic price level.

The MPC noted the improvements in the financial stability indicators, including non-performing loans, capital adequacy and liquidity ratios of the Deposit Money Banks (DMBs). It urged the Bank to sustain its surveillance over the Banking industry by taking prompt corrective measures to further improve stability in the system. The Committee also called on the fiscal authorities to build significant buffers to strengthen the efficacy of monetary policy.

Overall, the MPC considered the options to loosen, hold or tighten. The Committee continues to hold the view that although loosening would encourage the flow of credit to the real sector, help in reduction of the aggregate cost of credit and spur business spending and investment, thereby reinforcing the CBN's support for output growth and economic recovery, it, however, believed that doing so will reverse more rapidly, the gains of price and exchange rate stability achieved so far given the liquidity impact that would entail. The ensuing liquidity will exert pressure on the exchange rate in the light of increased capital flow reversals arising from monetary policy normalization by the US Fed. This would further depress the capital market.

As for tightening, the MPC hold the view that, while tightening will strengthen the stability of the foreign exchange market because of its dampening effect on the demand for foreign exchange, it was however convinced that this would simultaneously dampen investment growth, widen the output gap, depress aggregate demand and weaken output growth.

The MPC recognizes the fact that it had held the policy rate and other policy parameters constant over the last several meetings. The Committee underscores that by holding its policy position constant, it has confidence in the various policies and administrative measures deployed by the Bank which have resulted in the moderation in domestic price levels and stability in the foreign exchange rate. Thus, a hold position is an expression of confidence in the policy regime, given the gradual improvements in both output growth and price stability. On this premise, the downside risks to growth and upside risks to inflation appears contained.

## 4.0. The Committee's Decisions

In light of the above, the MPC decided by a vote of all eleven (11) members present to HOLD.

In summary, the MPC voted to:

1. Retain the MPR at 14 per cent;
2. Retain the asymmetric corridor of +200/-500 basis points around the MPR;
3. Retain the CRR at 22.5 per cent; and
4. Retain the Liquidity Ratio at 30 per cent.

Thank you.

**Godwin I. Emefiele**
**Governor, Central Bank of Nigeria**
**22nd November, 2018**