CENTRAL BANK OF NIGERIA COMMUNIQUÉ NO. 128 OF THE MONETARY POLICY COMMITTEE MEETING HELD ON THURSDAY 23rd AND FRIDAY 24th JANUARY, 2020

The Monetary Policy Committee (MPC) held its 271st meeting, the first in fiscal 2020, on the 23rd and 24th of January, 2020. The Meeting held in an environment of sluggish global economic recovery and financial market vulnerabilities, and tepid domestic growth. The Committee appraised these developments and the outlook for the first quarter of 2020, as well as the rest of the year. All the Eleven (11) members of the Committee were in attendance.

Global Economic Developments

The headwinds that characterized the global economy in 2019 showed signs of moderation, giving way to improved prospects for economic recovery in 2020. Consequently, global output is projected to grow by 3.3 per cent in 2020 from 2.9 per cent in 2019. The downside risks to the global outlook, include: broad slowdown in the advanced economies; resurgence of financial stress in the Emerging Markets and Developing Economies (EMDEs); rising geo-political tensions in the

Middle-East; and extreme weather conditions in some regions. Output growth across major advanced economies, remains fragile, due to weak recovery in manufacturing activities and sluggish rise in global trade. Consequently, growth in the Advanced Economies is projected to slow to 1.6 per cent in 2020, from 1.7 per cent in 2019. With most EMDEs facing brighter prospects, output growth is expected to recover to 4.4 per cent in 2020 from 3.7 per cent in 2019. The major impetus for this recovery is expected to come from India, Brazil and Russia.

In most advanced economies, inflation remained below their long-run targets, reflecting weak aggregate demand in the Euro Area and Japan, as well as moderating wage growth in the US, despite the robust job performance. Central Banks in the advanced economies are thus, expected to continue with monetary accommodation into the medium term. In the EMDEs, however, inflation prospects remain mixed, with some economies facing stronger upside risks than others.

Domestic Economic Developments

Real Gross Domestic Product (GDP) continued to improve, although slowly. It grew to 2.28 per cent in the third quarter of 2019, compared with 2.12 and 1.81 per cent in the preceding and corresponding quarters of 2018, respectively. The improvement in growth was driven, largely, by the performance of the oil sector, which grew by 6.49 per cent, while the non-oil sector grew by 1.85 per cent. Staff projections estimate real GDP in Q4 2019 and Q1 2020 at 2.20 and 2.35 per cent, respectively. The Manufacturing and Non-Manufacturing Purchasing Managers' Indices (PMI) grew further in December 2019, for the 33rd and 32nd consecutive months, to 60.8 and 62.1 index points, respectively. The optimism in growth prospects in Q1 2020, and the rest of the year, is anchored on the enhanced flow of credit to the private sector, to improve manufacturing activities, and financial and exchange rate stability. In addition, the Bank's continued intervention in Agriculture, and Small & Medium Scale Enterprises (SMEs) is expected to boost growth. Identified headwinds to growth, however, include; uncertainty in the oil market, high unemployment, rising public debt and security challenges across the country.

The Committee noted the continued uptick in headline inflation (year-on-year) in December 2019 to 11.98 per cent, from 11.85 per cent in the previous month. The increase in inflation, which was anticipated, was largely attributable to increase in both the food and core components, by 14.67 and 9.33 per cent in December 2019 from 14.48 and 8.99 per cent in November, respectively.

The increase in the food component reflects largely seasonality effect and the impact of the continued insurgency in some food producing areas of the country. Although, Staff forecasts suggest a short-term upward trend in prices, the Committee believes that the Bank's continued intervention in the real sector is expected to increase domestic production and lower prices in the medium-term.

The Committee observed that broad money supply (M3) grew by 6.22 per cent (year-to-date) in December 2019. Aggregate Credit (Net) similarly grew to 27.33 per cent in December 2019, from 23.12 per cent in the previous month. This was largely attributed to an increase in Credit to Government, which grew to 92.95 per cent in December 2019, from 72.36 per cent in the previous month. Credit to the Private Sector also grew to 13.61 per cent in December 2019, from 12.82 per cent in the previous month. Consequently, sectoral distribution of credit between end-May 2019 and end-December 2019 was as follows: manufacturing (N446.44 billion); General Retail and Consumer Loans (N419.02 billion); General Commerce (N248.48 billion); Agriculture, Forestry and Fishing (N160.94 billion); Information and Communications (N156.47 billion); Finance and Insurance (N129.87 billion); Construction (N86.54 billion); and Transportation and Storage (N68.61 billion), amongst others. The Committee observed with delight that, over the last six months, aggregate credit grew by N2.0 trillion and urged the Management of the Bank to sustain the current momentum of improved flow of credit to the Private Sector, while exploring other options with the fiscal authorities to strengthen the legal framework for the enforcement of credit recovery.

Lower money market interest rates, in the review period, reflected the liquidity overhang in the banking system, resulting from the restriction of individuals and non-bank corporates in the domestic economy from participating in OMO bill auctions. Consequently, the monthly weighted average Inter-bank call and Open Buy Back (OBB) rates fell sharply to 3.82 and 3.24 per cent, in December 2019, from 11.42 and 10.73 per cent, respectively, in the previous month.

The Committee noted the improved performance in the equities market, as the All-Share Index (ASI) and Market Capitalization grew by 11.61 and 18.27 per cent, respectively, between end-October 2019 and 10th January, 2020. This was indicative of the shift by domestic investors from the money market to the equities market in response to the Bank's policy to restrict their investments in the OMO bills auction.

The MPC also noted the improved performance and sustained resilience of the banking system, evidenced by the continued moderation of the Non-Performing Loans (NPLs) ratio from 6.6 per cent in October to 6.1 per cent in December 2019. The Committee noted that the improvement reflected the Bank's continued deployment of heterodox policies to ensure that NPLs fell below the prudential benchmark of 5.0 per cent.

Outlook

Although global output is projected to expand moderately in 2020, compared with the previous year, the overall medium-term outlook for the global economy remains uncertain, due to the persistence of several headwinds. These include: the lingering trade tensions between the US and its major trading partners; rising levels of both corporate and public debts; continued geopolitical tensions in the Middle-East; fragile recovery of manufacturing activities; and the narrowing policy space by which central banks in the advanced economies can respond to future macroeconomic shocks. In addition, predicted weather-related disasters could pose further threats to global output recovery.

On the domestic side, available data on key macroeconomic indicators show prospects of improved output growth for the economy in 2020. Revised projections for 2020, show that the economy is expected to grow by 2.50 per cent (IMF), 2.10 per cent (World Bank) and 2.35 per cent (CBN). The underlying projection is anchored on the following conditions: enhanced flow of credit to the real sector of the economy; sustained stability in the exchange rate; continued CBN interventions in agriculture and non-agricultural Small and Medium Enterprises (SMEs); and the effective implementation of the Economic Recovery and Growth Plan (ERGP). The downside risks to this projection are primarily the rising stock of public debt and lack of fiscal buffers. Others include the persistent security threat in major food-producing areas, poor and inadequate infrastructure and weak public and private sector investment.

The Committee's Considerations

The Committee noted the persistent increase in the inflation rate, which stood at 11.98 per cent in December 2019. It also noted that the inflation was driven by both monetary and structural factors. Having addressed the monetary factors, the headroom for further monetary policy measures has become constrained, being supported by empirical evidence which suggests that inflation above 12.00 per cent is inimical to output growth in the Nigerian economy. The MPC thus called on the fiscal authorities to speedily address legacy structural impediments giving rise to upward-trending price developments. Amongst these, the Committee identified infrastructure deficit and the long-standing clashes between herdsmen and farmers, which are constraining domestic production and contributing substantially to the rise in food inflation. The MPC, therefore, urged the Federal Government to relentlessly seek innovative ways of addressing security challenges across the country in order to boost aggregate food supply. The Committee further noted the contribution of imported food and other tradeables to the rise in price levels but emphasized the opportunity to ramp up production of domestic substitutes supported by the Bank's development finance initiatives, particularly in agriculture and manufacturing sectors.

The Committee noted the improvement in the financial soundness indicators, growth in assets of the banking system and the gradual switch in the composition of DMB assets from investments in government securities to growth in credit portfolio. It, however, noted that lending rates at the retail segment of the market had remained fairly sticky downwards as deposit rates had declined substantially. It also noted that in some cases, DMBs were not encouraging term deposits in their portfolios and therefore, emphasized the Bank's commitment towards the implementation of the Loan-to-Deposit ratio (LDR) policy.

On fiscal operations, the Committee applauded the Government for the recent signing of the 2020 Finance Bill which opens a new vista of opportunities in public financial management. The MPC, however, cautioned that public debt was rising faster than both domestic and external revenue, noting the need to tread cautiously in interpreting the debt to GDP ratio. The Committee also noted the rising burden of debt services and urged the Fiscal Authorities to strongly consider building buffers by not sharing all the proceeds from the Federation Account at the monthly FAAC meetings to avert a macroeconomic downturn, in the event of an oil price shock.

It urged Government to gradually reduce reliance on oil receipts and focus on revenue diversification through reforms of the tax system. The Committee also called on Government to rationalize fiscal expenditure towards reducing the current excessively high cost of governance.

The MPC expressed concern about the rising inflation, which increased consecutively in the last 4 months as at December 2019 to 11.98 per cent and higher than its target range of 6-9%. This rising price level is attributable to a combination of structural and supply side factors, expansionary fiscal policy; and growth in money supply arising from rising liquidity surfeit in the industry due to changes in the Bank's OMO policy. In furtherance of its primary mandate to maintain price and monetary stability and in view of the anticipated medium-term liquidity surfeit from maturing OMO bills held by local private and institutional investors, which would not be rolled over, the Committee considered it prudent to raise the CRR to curtail liquidity surfeit in the banking system.

The Committee is confident that increasing the CRR at this time is fortuitous as it will help address monetary-induced inflation whilst retaining the benefits from the Bank's LDR policy, which has been successful in significantly increasing credit to the private sector as well as pushing market interest rates downwards. The Committee further encouraged the Management of the Bank to be more vigorous in its drive to improve access to credit through its pursuit of the Loan-to-deposit ratio policy as doing this would help, not only in creating job opportunities but also help in boosting output growth and in moderating prices. It is noteworthy that Gross credit in the industry grew by N2 Trillion between May 2019 and December 2019; channeled primarily to the employment-stimulating sectors such as agriculture and manufacturing, in addition to increased lending to the retail and SME segments, which is expected to help boost domestic output growth in the short to medium term. To retain the gains from credit expansion and current industry focus on lending, the Committee advised the Bank to sustain its LDR Policy and in addition continue to deploy its DCRR policy which directs new funding for greenfield projects and expansion to critical sectors of the economy.

The Committee's Decision

On the arguments to tighten, the Committee noted that given that inflation rate inched up in December 2019 and that the rate is still above the upper band of the 6-9 per cent threshold, tightening may be necessary to tame the rising trend in inflation. In addition, the relatively bearish outlook of the equities market indices points to waning investor confidence in equity in preference for coupon rate on bonds. Raising the policy rate, could be a policy choice to reverse the tendency and attract more foreign portfolio investments. Also, the risks to the level of reserves persist as prices of oil futures remain uncertain. Policy tightening would enhance the accretion to foreign reserves and attain relative stability in the foreign exchange market. Moreover, raising rates would reinforce the stability of the foreign exchange market as an upswing in the rate will inhibit demand pressures in the market through a decline in money supply.

Although tightening would limit the ability of DMBs to create money, ultimately leading to a reduction in money supply and curtail their credit creation capabilities, which would eventually lead to rising cost of credit and credit risk as DMBs re-price their risk assets, the MPC believes that the aggressive pursuit of the current loan-to-deposit ratio policy thrust would continue to help to catalyze credit growth and positively impact growth and prices.

On the decision to loosen, members noted that the relative stability in the foreign exchange market provides confidence to foreign investors. There is, therefore, no immediate concern that loosening would exert pressures on the foreign exchange market in the near term. In addition, an accommodative monetary policy stance would motivate banks to lend to maintain their profit performance and would result in decline of the overall cost of production. This would further affirm the Bank's support for stimulating output growth.

The Committee also feels that the downside to loosening is that it could amplify inflationary pressures as the economy experiences increased liquidity surfeit, particularly if loosening drives growth in consumer credit, without corresponding adjustment in output, thus escalating inflationary pressures. An interest rate reduction would increase money supply and exert pressure on the exchange rate. Moreover, an accommodating monetary policy stance may not necessarily lower the retail lending rate, as interest rates are generally sticky downwards.

On the argument for a Hold, the MPC acknowledged that a mix of heterodox monetary and financial policy measures have recently been deployed by the Bank. Noting the existence of a lag between the policy pronouncement and its impact on the economy, a hold in the rate would ensure its efficient impact on the economy. The Committee noted the slow pace and low rate of economic growth as real GDP growth of 2.10, 2.12 and 2.38 per cent in Q1, Q2 and Q3 2019, respectively, being below the population growth rate, still needs sustained policy support. Maintaining monetary policy rate at its present level is essential for sustainable support to growth before any possible adjustments. This will enable policy to react suitably to developments as they occur in the near term. In addition, retaining the current policy position provides avenues to evaluating the impact of the heterodox monetary and financial policies to support lending by the banking industry without altering the policy rate.

On the downsides to holding, the Committee noted that it would reduce the speed of economic recovery relative to loosening, exert a drag on output growth, as DMBs continue to utilize bonds sales instead of engaging in financial intermediation to the private sector.

In view of the foregoing, the Committee by a decision of 9 members, voted to alter the Cash Reserve Requirement (CRR) by 500 basis points from 22.5 to 27.5 per cent, while leaving all other policy parameters constant. Two members voted to leave all parameters constant.

In summary, the MPC voted to:

1. Change the CRR from 22.5 to 27.5 per cent;

2. Retain the MPR at 13.5 per cent;

3. Retain the asymmetric corridor of +200/-500 basis points around the MPR;

4. Retain the Liquidity Ratio at 30 per cent.

Thank you.

Godwin I. Emefiele

Governor, Central Bank of Nigeria

24th January, 2020