



Central Bank of Nigeria Communiqué No. 96 of the Monetary Policy Committee Meeting, July 21-22, 2014

The Monetary Policy Committee (MPC) met on July 21 and 22, 2014 against the backdrop of continuing QE3 tapering by the U.S Federal Reserve which has resulted in the slowing of inflows to emerging markets and frontier economies; and the attendant uncertainties in the outlook for monetary policy and financial stability in the post-tapering period. The meeting was attended by 10 members. A new member, Prof. Dahiru Hassan Balami, whose appointment had recently been confirmed by the Senate, was also in attendance. The Committee deliberated on key external and domestic economic developments and considered the Banking Stability Report since the MPC meeting of May 2014 as well as the outlook for the rest of the year.

The global monetary policy environment appears to be further complicated by risks posed by continued currency crisis and fragility in Europe, geo-political tensions in the Middle East and a number of emerging and developing economies. Domestically, the policy challenges remain. These include the uptick in inflation, anticipated increased spending towards the general elections and the possible effects of US tapering on the domestic market.

International Economic Developments

The Committee noted that the rebound in global economic activity strengthened in the first half of 2014; although at levels lower than previously projected. The tapered growth arose mainly from the emerging and developing economies owing to the rising real interest rates and geo-political crisis. On the whole, the effects of the global financial crisis have continued to wane even as the issues of rising income inequality, unemployment and poverty appear to be gaining prominence; engaging the attention of the monetary authorities. These latest projections indicate that the euro area is gradually coming out of recession, as growth projection for 2014 is

positive for all member countries albeit with significant variation. Growth is expected to be stronger in the core EU countries while high debt and financial fragmentation continue to weigh on aggregate domestic demand in the peripheral countries. For the entire euro zone, there is a risk of low inflation or outright deflation which could result in higher real interest rates that may constrain output expansion.

In the emerging and developing economies, growth is projected at 5.0 per cent in 2014 from 4.7 per cent in 2013, buoyed by stronger external demand from the advanced countries. The key downside risks in the developing and emerging economies include: political uncertainty, exchange rate realignment in response to changing fundamentals, further monetary tightening to address emerging currency crisis, and tighter external financing conditions arising from the rapid normalization of the US monetary policy. Inflation is projected to remain subdued in 2014 and 2015, partly reflecting the significant output gaps in the developed economies, weaker domestic demand in developing and emerging economies, and

sliding commodity prices, especially fuels and food. In the advanced economies, inflation is currently below target and its return to the long run trend could take a while due to the slow pace of economic recovery. Likely depreciation in currencies, domestic demand pressure, and capacity constraints could pose upside risks to inflation in the emerging market economies.

The Committee noted that the stance of monetary policy could diverge across regions over the medium term on account of variations in risks and other challenges confronting various economies. The US is expected to commence tightening by the second half of 2015 as inflation hits the long run target and unemployment rate falls to the threshold level. The euro area and Japan are expected to continue with supportive monetary policy due to low inflation including threat of deflation in some countries, weak recovery, weakness in bank balance sheets, and strong demand for their bonds as a result of low sovereign risk.

Majority of the central banks remained cautious with regard to the stance of monetary policy. While most advanced economies are

likely to maintain an accommodative stance for monetary policy for the rest of the year to firm up aggregate demand and employment, the major impetus for monetary policy adjustments in the emerging markets and developing economies could come from the effects of the US Fed's tapering of QE3 on their currencies and the financial markets.

Domestic Economic and Financial Developments

Output

The National Bureau of Statistics (NBS) reported revised growth numbers from 2010 to 2013 and the first quarter of 2014, as part of the GDP rebasing exercise. Accordingly, the estimated growth rate for 2013 now stands at 5.49 per cent, compared with 5.31 and 4.21 per cent recorded in 2011 and 2012, respectively. Similarly, the revised estimate of 6.77 per cent for the fourth quarter of 2013 was an improvement over the 5.17 and 3.64 per cent in the previous quarter and the corresponding period of 2012, respectively. In the first quarter of 2014, real GDP growth was 6.21 per cent, which was higher than the corresponding quarter of 2013. In line with the trend,

the non-oil sector was the main driver of growth in the first quarter of 2014, recording 8.21 per cent growth. The key growth drivers in the non-oil sector in the first quarter of 2014 remained industry, agriculture, trade, and services which contributed 1.77, 1.26, 1.26 and 3.15 per cent, respectively. The oil sector continued to record improvements in performance with its growth rate improving from -9.36 and -11.40 per cent, respectively, in the fourth and first quarters of 2013, to -6.60 per cent in the first quarter of 2014.

The Committee welcomed the impressive growth performance but noted that the country has the potential to do better with appropriate supportive macroeconomic policies. The Committee, therefore, stressed the imperatives for monetary policy to sustain efforts aimed at supporting non-inflationary growth in key sectors of the economy. The Committee also emphasized the need for government to sustain and deepen tax revenue and enhance efforts aimed at fast-tracking the structural transformation of the economy with a view to making it resilient to adverse shocks as well

as creating the necessary platforms for reducing unemployment, income inequality, and poverty in the country.

Prices

Developments in the aggregate price level suggest an underlying inflationary pressure since January 2014. The year-on-year headline inflation steadily inched up marginally from 7.9 per cent in April to 8.0 per cent in May 2014 and further to 8.2 per cent in June. The up-tick in June was, however, largely attributed to the rise in food inflation which rose from 9.7 per cent in May 2014 to 9.8 per cent in June while core inflation, on the other hand, rose from 7.7 per cent in May 2014 to 8.1 per cent in June. The Committee noted that all measures of inflation have witnessed progressive upward trend since February 2014 and agreed that this trend should be monitored closely to achieve a reversal.

Monetary, Credit and Financial Markets' Developments

Broad money (M2) rose by 1.66 per cent in June 2014 over the level at end-December 2013, indicating an annualized growth rate of 3.31

per cent. The annualized growth rate was considerably lower than the growth benchmark of 15.52 per cent for fiscal 2014. For the same period, net domestic credit increased by 0.88 per cent compared with the growth rate of 15.39 per cent over the corresponding period of 2013. When annualized, net domestic credit rose by 1.77 per cent, compared with the growth benchmark of 28.5 per cent for fiscal 2014. The expansion in aggregate domestic credit was mainly due to the increase in claims on the private sector which increased by 2.75 per cent in June 2014, which was however, moderated by the contraction in net credit to Government.

Meanwhile, money market rates remained within the MPR corridor during the review period. The monthly weighted average OBB rate was 10.38 per cent in May 2014 but it increased by 14 basis points to 10.52 per cent in June. The uncollateralized overnight rate was 10.50 per cent in June 2014, compared with 10.63 per cent in May 2014. Overall, both the OBB and overnight call rates were trading closer to the lower bound of the MPR corridor on account of liquidity surfeit in the banking system. Activities in the capital market were bullish

during the period with the All-Share Index (ASI) increasing by 2.8 per cent from 41,329.19 at end-December 2013 to 42,482.48 at end-June 2014. Market capitalization also moved in the same direction.

External Sector Developments

All the segments of the foreign exchange market witnessed a considerable degree of stability during the period. The exchange rate at the retail-Dutch Auction System Segment (rDAS) of the market was flat at N157.29/US\$ in the review period. At the inter-bank market, the selling rate opened at N162.20/US\$ and closed at N162.95, representing a depreciation of N0.75 or 0.46 per cent. Conversely, at the BDC segment, the exchange rate opened at N167.00/US\$ and closed at N168.00/US\$, representing a depreciation of N1.00 or 0.6 per cent.

Gross official reserves rose to US\$40.20 billion by 18 July from US\$37.31 billion at end-June 2014. The increase in reserves was mainly due to increased accretion and moderation in the rate of depletion.

The Committee's Consideration

The Committee was satisfied with the relative stability in the macroeconomy as reflected in the impressive growth rates, stable consumer prices and exchange rate as well as increased external reserves. It was however concerned about the weak translation of stability to microeconomic gains in employment and access to finance especially by small and medium scale businesses. It, therefore, emphasized the need for the MPC decisions to take into account the long run impact on employment level, wealth creation and growth of businesses.

The Committee noted the potential of the power sector to stimulate output growth through enhanced investment and the spill-over effect in employment generation if the challenges confronting the sector are effectively and appropriately addressed. Specifically, it noted that gas-to-power has remained a binding constraint in reaping the benefits of the recently-concluded power sector reforms; urging for the collective efforts of government, private investors and the banks to resolve. Other pressure points include the

underlying pressure from food/core inflation and the risks that could emanate from the likely increase in aggregate spending in the run up to the 2015 general elections. The Committee was also concerned about the implications of the on-going QE3 tapering for inflows and external reserves. The Committee recognized the necessity of sustaining a stable naira exchange even as it has to deal with the delicate balancing of the need for a low interest rate regime. The Committee noted that portfolio flows were not employment generating but were essential in the absence of adequate fiscal buffers.

The Committee welcomed the moderation in the rate of depletion in external reserves in recent months, noting that reserves accretion needed to improve much faster to provide a strong and more resilient buffer to fiscal operations. The Committee, however, noted that a gradual reduction in the country's import bills through domestic production of some of the major food imports should be a key element in the overall reserves accretion strategy. It welcomed

the decision of the Bank to collaborate with other stakeholders in this regard.

The Committee further expressed concern about the liquidity level and the trending uptick in inflation which may not be unconnected with the poor harvest in some agricultural producing areas, particularly in the north eastern and central states of the country. It however, noted that other reform measures could dampen food prices in the short to medium term and restore inflation to a sustainable long-run path. Overall, the Committee noted that the policy direction of inflation, exchange rate and interest rate must be seen not only in the context of price and financial stability but also in enhancing the quality of life of Nigerians and promoting employment generation.

The Committee's Decisions

In view of these developments, the Committee decided by a unanimous vote to retain the current stance of monetary policy with one member voting for an asymmetric corridor around the MPR. Consequently, the MPC voted to:

- (i) Retain the MPR at 12 per cent with a corridor of +/- 200 basis points around the midpoint;
- (ii) Retain the Liquidity Ratio at 30 per cent;
- (iii) Retain the public sector Cash Reserve Requirement at 75.0 per cent; and
- (iv) Retain the private sector Cash Reserve Requirement at 15.0 per cent.

Thank you.

Godwin I. Emefiele

Governor, Central Bank of Nigeria

22nd July 2014

PERSONAL STATEMENTS BY MEMBERS OF THE MONETARY POLICY COMMITTEE

1.0 ADELABU, ADEBAYO

Developments in the macroeconomy in the first half of the year remained broadly positive albeit with cautious optimism about the outlook for the remaining period of the year. The revised GDP following the rebasing exercise, as expected, was lower but the estimate of 5.49 per cent for 2013 could be adjudged robust particularly when cognizance is taken of the weak global economic recovery. Stability in the exchange rate appears strengthened in virtually all the segments of the markets while external reserves witnessed a modest improvement, relative to the position at the last meeting.

There are however a number of risks to macro stability over the short to medium term. First, the evolving trend in price level should give concern to the monetary authority. Although headline inflation is still largely subdued at 8.2 per cent in June 2014, there seems to be considerable degree of underlying pressure given that it has

consistently trended upwards in the last three months. More importantly, food inflation is projected to rise beyond single digit in the second half of the year thereby posing significant risk to the long term inflation target of the Bank. Apart from structural issues that could impinge on food inflation, the electioneering activities would reach the climax in the second half of 2014 cum early period of 2015.

Besides, the development in price level has implications for banking system stability. The weighted average deposit rate as at May was 6.32 per cent, suggesting that depositors earned negative real interest rate which may fuel loss of deposit from the banks with the attendant impact on the banking system stability. As a result, reduction of the policy rate which could further lead to reduction in deposit rate without a concomitant reduction in lending rate may not be appropriate at the moment.

Again, the relative modest improvement in the external reserves notwithstanding, there has been persistent demand pressure in the foreign exchange market since January. Cumulative net outflow as

at end- May 2014 was about US\$7.5 billion as against cumulative net inflow of US\$3.72 billion in the corresponding period of 2013. The prospects in the medium term horizon appear dim with the tighter external financial conditions being a key issue. Unemployment rate in the US fell to an all-time low of 6.1 per cent in June 2014, a clear evidence of strong recovery process, which informed the Federal Reserve to shift the termination of its asset purchase program to the fourth quarter of 2014 as against the initially planned 2015. Thus, appropriate monetary policy measures need to be in put place at least to provide soft landing for the economy during the adjustment period.

This said, monetary policy environment is facing a difficult dilemma at this point in time as improvement in the macroeconomy has not sufficiently translated to impressive socio economic indicators. For example, statistics on unemployment rate revealed that it has virtually been trending upwards since 2009, reaching 24.70 per cent in 2013 against the 5-year (2009-13) average of 23.36 per cent. In the light of daunting challenges of high unemployment and poverty

confronting the economy, an accommodating monetary policy that would foster inclusive growth and poverty reduction is desirable.

It is imperative, however, to bring to bear that if stability is not achieved in the short term, the anticipated long term objective of growth, unemployment, and reduction in poverty may remain elusive. It is equally important to recognize the limitations of monetary policy in addressing most of the fundamental problems including building reserve buffers. Some of the issues require active support of the fiscal authority particularly building of external reserves through accretion from oil earnings. Perhaps, more importantly, there are a number of deep rooted problems that limit access to finance by real sector operators which could render reduction of policy rates by the central bank ineffective. The problems are mainly due to uncompetitive business environment resulting from poor state of infrastructure, security challenges, and weak institutions. These problems require major structural reforms. To this end, I believe a robust engagement with the fiscal authority is a *sine qua non*.

On the whole, pending the time the necessary building blocks for the resilience of the economy would be put in place, it is worthwhile to maintain stability in the macroeconomy by holding steady the subsisting monetary policy measures. Consequently, I vote for retention of MPR at 12%, private sector CRR at 15%, public sector CRR at 75%, and LR at 30%.

2.0 ALADE, O. SARAH

Global economic growth forecast have backpedalled due to revision in the first quarter performance of the U.S. economy. The downward revision in the U.S. is due to severe winter weather disruptions, subdued consumer spending, construction and industrial activities. In spite of these developments, growth is expected to accelerate as the year progresses and is projected to reach 3.4 and 4.0 percent respectively in 2014 and 2015 according to July IMF WEO. In emerging markets, while earlier risks have diminished, there are increased geopolitical risks from the Middle East and euro area. In the domestic environment, the renewed inflationary pressure and expected fiscal spending as the election year approaches poses

some concern for monetary policy. Based on the above, I support a hold in policy rate.

While there are some downside risks to global growth, the US Economy is showing some impressive momentum. Growth in the United States is showing some momentum with strong consumer confidence index. U.S. employers accelerated their hiring last month, adding a robust 288,000 jobs and helping drive the unemployment rate to 6.1 percent, the lowest rate since September 2008. This is the fifth straight monthly job gain above 200,000 jobs in the US, although wages are yet to rise significantly. In the Euro zone, slowing inflation has raised real interest rate which may affect growth in the zone. Countries in the zone are at different stages of economic activities as general confidence is waning. These developments coupled with the effects of the tapering could dampen domestic conditions, thus the need for monetary policy to be proactive and guarded.

Headline inflation increased to 8.2 percent in June compared to 8.0 percent recorded in May 2014. Headline inflation increased to 8.2

percent in June, suggesting that inflation may be expected to stay elevated in the coming months, due to possible food supply shortage. This is the fourth consecutive month of year-on-year increases in the Headline index since February. Both food and core inflation rose slightly. Food inflation increased from 9.7 percent in May to 9.8 percent in June, while core inflation increased from 7.7 percent in May to 8.1 percent in June. Staff projection suggests that inflation is expected to exceed the upper bound of the implicit inflation threshold of 9 percent before the end of 2014, although it will still remain in the single digit range. This suggest that even with the anticipated fiscal risk as a result of pre-election and increased security spending, monetary policy cannot ignore the inflationary outlook. Based on this, monetary policy should remain cautious to anticipate the impact of fiscal, security and food supply shocks.

While domestic growth has remained strong, some risks to growth are evident. The newly rebased GDP forecast for 2014 GDP remained strong and robust with 2013 fourth quarter growth estimated at 6.77 percent compared with 5.17 percent in the

preceding quarter. The 2014 first quarter GDP growth rose by 6.21 percent which is higher than the 4.45 percent recorded in the corresponding period of 2013, but lower than the 6.77 percent in last quarter of 2014. The rebased GDP show a more diversified economy that will require a multi-agency coordination for sustaining the growth momentum and achieving inclusive growth. The sustenance of this robust growth rate and the achievement of broad-based growth will require the creation of an environment that is conducive, competitive and attractive to both foreign and domestic investors. Monetary policy must therefore continue to ensure the maintenance of macroeconomic stability.

The risk of fiscal expansion in the run up to the general election is very likely. There will be pressure to increase the speed of implement of the budget by both the legislative and the executive as the general election approaches. In addition, the security challenges facing the country will also require additional spending to secure the country and its borders, while these are legitimate expenses; they are bound to put upward pressure on both inflation and exchange

rate. Therefore all efforts should be made to ensure that excess liquidity in the system that is not channeled into productive activities should be sterilized. Thus monetary policy should do all it can to help contain inflationary pressure and lowering rate at this point may be counter-productive.

Stability has returned to the Foreign exchange market, though some risks remain. This has been helped by accretion to the foreign reserve and sustained inflow in the local bond market. Reserve as at July 17, 2014 stood at \$40.05 Billion. The risk to this stability will be the impact of the deadline given to the Bureau de change (BDCs) of July 31, 2014 to recapitalize. However, the resolve to build buffers would help counter any adverse market reaction to the change. An added risk is the effect of tapering on the economy as advanced economies recovery continues. Therefore, global and domestic events should be monitored to avoid downside risk to the Naira exchange rate

Money market conditions suggest ample liquidity in the banking system. Rates at the Interbank and Open Buy Back (OBB) rate have

remained within the corridor at weighted average rate of 10.50 and 10.48 percent, respectively, between May, 2014 and July 18, 2014. These indicate excess liquidity in the system as banks accessed the Standing Deposit facility (SDF), but were rarely at the Standing Lending Facility (SLF) window since the last MPC in May. In addition, prime lending rate was steady at 16.5 percent between May and June, suggesting that care must be taken to manage the structural liquidity and the structural impediments to credit growth in the economy. These developments coupled with anticipated upward inflationary pressure would suggest that monetary easing at this time may be counter-productive.

While pressure at foreign exchange has eased, there are some downside risks. Inflationary pressure has persisted in the last consecutive four months and the projection is trending upwards. In an election year coupled with fragile and uncertain global environment, macroeconomic stability is very important. Based on these, I vote for a hold on Monetary Policy Rate, the maintenance of 75 percent increase in public sector deposits Cash Reserve

Requirement (CRR) and a 15 percent increase in private sector Cash Reserve Requirement.

3.0 BALAMI, DAHIRU HASSAN

On the basis of the review of the macro economic data on the current situation of the economy, I voted to hold the current monetary policy rate of 12 percent, cash reserve ratio of 75 percent for public deposit, and 15 percent for private sector deposit with symmetric corridor of +/-2 percent be maintained.

REASONS

Global Economy

The global economy is fairly establish with favorable growth recovery in the US and Japan with improving employment figures. Although the picture in the Euro zone is weaker with only the Germany economy fairly better. For China, its growth rate at is about 7.5 percent and largely stable. In Africa the growth remains strong for most of the countries. Some tools to stimulate the European economy are being put in place. Global prices are subdued to the

fact that inflation is currently lower than policy goals. The implication of the above is that import inflation is not a problem to the Nigerian economy for now. However progressive tapering of QE3 in the United States of America poses some challenges to the management of exchange rate, foreign reserves and the financial as a whole.

The international price for crude oil has been steady. The threats to Nigerian oil revenue exist due to share oil and gas from the US and other countries.

Domestic Economy

The Nigerian economy has witnessed a robust growth of about 6.2 percent in 2014 Q1. The prospects for sustaining the growth are high because of stable oil price, and other supporting policies in other sectors of the economy which include agriculture, industrial sectors and energy. However, the greatest problems to growth in the economy are: the current insecurity in the north eastern region of Nigeria; high unemployment rate; oil theft and vandalism of oil and gas infrastructure. On a good note is the high level of robustness

of the banking sector in Nigeria; stable prices; exchange rate and financial sector. However, the gap between private deposits and lending rate is a source of concern. There are questions that need to be asked and answered as to the consequences of reducing the interest rate in the near future. Although high interest kills businesses, interest cannot be reduced now partly because most banks invest huge sums of money in providing security, power generations, leases of operating premises, as well as inflationary pressures. If interest rate is reduced, the environment may be too harsh for many banks to operate. There may be out flow of FDI which the economy currently needs.

CONCLUSION

The prospect of growth in Nigeria remains strong; however the growth has to be pro job creation. This would reduce the level of unemployment, inequality and level of poverty in the economy thereby raising the welfare of the people. The stability in the financial sector has been achieved at the expense of strategic sacrifice of monetary policy independence for exchange rate

stability at the risk of medium term macro and financial system stability. It is not appropriate to cut the interest rate.

4.0 DANIEL-NWAOBIA, ANASTASIA

The performance of the domestic economy has remained impressive, given the current level of the macroeconomic indicators. For instance the real GDP grew at 6.21% in the first quarter of 2014; the year-on-year inflation rate, in spite of the rising trend since February, 2014 remained at single digit of 8.2% in June, driven largely by the rise in food prices. The naira exchange rate at the Retail Dutch Action Spot (rDAS-SPT) segment remained steady at \$/N157.29 between May 20, 2014 and July 18, 2014, while the external reserves level stood at U\$40.20 billion as at July 17, 2014, which could cover approximately 7 months of imports.

The outlook for domestic output in the coming months is positive, given the various efforts by the Government to enhance domestic output such as: the successful implementation of the Growth Enhancement Scheme (GES) which was designed to guarantee

timely supply of inputs to farmers on a sustainable basis; and Government's renewed efforts at curbing crude oil theft, as well as addressing the challenges of the energy sector. Furthermore, the continued improvement in global output would have positive impact on Nigeria's oil export and public revenue if government intensifies current effort to curb leakages in the oil sector. However, increase in US oil output and export may dampen demand for Nigeria's crude, especially in Europe.

Staff estimates project a gradual increase in the inflation rate over the next six months based on: acceleration in food inflation due to seasonal effect of the expected increase in prices and demand for staples; expected growth in reserve money and depreciation in the BDC rate. However, the current efforts by the CBN to sanitize the BDC segment of the foreign exchange market could minimize the exchange rate effect on inflation. The year-on-year inflation was projected to remain within single digit in the next six months.

The relative stability in the official foreign exchange market is expected to subsist through the third quarter of 2014 with sustained intervention by the CBN. The current effort by the Bank to tackle foreign exchange volatility with increased capitalization of the BDC and curtailing retail currency importation would enhance the stability of the exchange rate in the market.

Pressure points to note, however include: sustaining the stability of the naira exchange rate; managing capital flows, especially the volatile portfolio investments and potential reversals as tapering nears its end in September, 2014; high lending rates and wide interest rate spread; election related expenditure in 2014/15 which could heighten the liquidity profile in the economy; and building of fiscal buffers to insure against global shocks.

In spite of the concerns expressed above, the current relative impressive performance of the economy as well as the outlook in the near to medium term confirm the effectiveness of the current tight

monetary policy stance, particularly in keeping inflation within single digits as well as maintaining stability in the foreign exchange market.

It is, therefore advisable to sustain the current policy stance.

Consequently, I vote as follows:

- (i) The Monetary Policy Rate (MPR) to be retained at the current level of 12% and corridor of +/- 2% for the inter-meeting period.
- (ii) The Private sector CRR should also be retained at 15 per cent, given the current banking system liquidity profile.
- (iii) The current policy on foreign exchange (mid-point and exchange rate band of N155/US\$1 +/- 3%) should be retained, while the CBN continues to intervene to stabilize the rates, when necessary. The Federal Government is already making efforts at rebuilding the fiscal buffers required to sustain the stability of the exchange rate. It is my strong belief that the fiscal and monetary authorities will continue to work closely to sustain the macroeconomic and price stability that will engender growth and create jobs.

5.0 GARBA, ABDUL-GANIYU

I vote:

- to maintain MPR at 12%;
- to maintain Private Sector CRR at 15% and Public Sector CRR at 75%
- to maintain Liquidity Ratio at 30%
- for asymmetric corridor of -5% (Standing Deposit Facility) and +2 (Standing Lending Facility).

This implies that I am voting for the same policy set I voted for at the last meeting in May 19-20, 2014. Maintaining MPR, CRR (private), CRR (public) and Liquidity Ratio at current levels takes due cognizance of (1) the trend of key macroeconomic indicators (growth, inflation, unemployment, fiscal deficit and public debt, external reserves, capital flows, money survey, oil price, etc.); (2) the economic report and inflation forecast by Bank Staff for the last two quarters of 2014; (3) expectations of economic actors and (4) open economy macroeconomic analysis of Nigeria's current policy regimes. The vote also takes due cognizance of the global economic outlook for 2014 particularly, the risks associated with the US Fed's tapering and, the high likelihood of transition from inflationary to deflationary policy by the US Fed and the Bank of England as price levels begin to rise.

In the *short term*, keeping MPR, CRR on private sector deposit, CRR on public sector deposit, Liquidity Ratio and the SLF rate unchanged offer some relative stability for economic agents to implement their economic plans for 2014. It also provides the MPC with the opportunity to develop forward looking *medium term* strategy to adapt seamlessly to a post quantitative easing phase and to repair the transmission mechanism of monetary policy which has been weakened by the changes in the global economy after the 2007-8 crisis and the global policy responses to the crisis.

Market functioning efficiency is a key link in the transmission mechanism that needs to be fixed. In the current monetary policy regime, the interbank market is critical. Yet, in the last few quarters, activities in the interbank market have slowed down. I have argued previously that AMCON effects do not fully explain the slowdown in the interbank market. My argument draws support from the relatively high volumes of activities in the Special Deposit Facility (SDF) and OBB windows as well as the very low spread between SDF and OBB rates. It is clear to me that the *incentive and trade-off principles* are

in play. Consequently, changing the game and strengthening the interbank market requires changing incentives. An asymmetric corridor of -5 (SDF) and plus 2 (SLF) is good starting point. It will however, be necessary to complement an asymmetric corridor with a creative mix of instruments, directives and institutional changes that will progressively reduce the extent of market segmentation, concentration and asymmetries in key markets: money, equities and forex markets. Market segmentation, concentration and asymmetries significantly distort the pricing and allocation functions the markets while generating a set of avoidable opportunity costs.

Without significantly improving market functioning, it will be difficult to repair the transmission mechanisms which have been undermined by dysfunctions in global financial markets. I remain convinced of the need for a forward-looking monetary policy regime anchored in (1) a creative mix of policies and institutional changes; (2) effective monetary-fiscal policy and strategic coordination system and (3) sound macro-prudential and micro-prudential regulations.

6.0 MOGHALU, KINGSLEY CHIEDU

I believe the policy choices facing the MPC at this meeting are whether to leave the Monetary Policy Rate unchanged at this time or to further tighten monetary policy in the face of an uptick in inflation.

With year-on-year headline inflation having increased to 8.2 per cent in June 2014 from 8 per cent in May, food inflation recording a marginal increase to 9.8 per cent from 9.7 per cent in May, and with core inflation at 8.1 per cent in June from 7.7 per cent in May – an unquestionably sharp increase – the questions are:

- (a) What do we do in the face of a seeming reassertion of inflationary trends?
- (b) How can the trilemma be resolved between the present levels of inflation that may ultimately break out of the MPC's previously declared inflation target of single digit-inflation, the desirability of reducing the MPR in order to further support economic growth, set against the need to maintain price stability (without which, in any event, there will be no real growth in a situation of monetary instability), if need be with further monetary tightening.

In my mind, the goal of monetary easing is a medium to longer-term one. It was never the expectation that monetary policy would

remain permanently tight or even so for any longer than is necessary. But there is no rational basis or data that would support a reduction in the MPR at this time. The Committee's main course of action should be to hold rates where they are for now, because inflation figures, while a cause for some concern, are not one for alarm either. The MPC should monitor the monetary horizon carefully and be prepared to act as required should inflationary trends not be reversed, or at least contained, in the months ahead.

Taking a forward view, monetary policy will likely be challenged by the trilemma indicated above in the last quarter of the year if inflation levels continue to rise, liquidity in the system remains high (in particular given the anticipated redemption of Asset management Corporation of Nigeria (AMCON) bonds held by private creditors, in October 2014), and the United States Federal Reserve bank ends its quantitative easing program in that period as the Fed has indicated.

The present and near-term scenario is counter-balanced somewhat by the fact that there are possible options besides increasing the MPR, for example increasing the private sector cash reserve ratio.

The depletion of the country's external reserves appears to have been stanchied by a number of measures taken by the CBN to sanitize the bureau de change segment of the market, as well as improved collaboration between the monetary and fiscal authorities and a gradual rebuilding of fiscal buffers.

Accordingly, I believe the MPC should continue to hold its powder dry, for now, in relation to a shift either towards loosening or tightening policy should monetary conditions so warrant.

I therefore vote to:

- Hold the MPR at 12 per cent
- Maintain the minimum liquidity ratio at 30 per cent
- Maintain a symmetric MPR corridor of plus/minus 200 basis points
- Maintain the CRR on public sector deposits at 75 per cent and that on private deposits at 12 per cent.

7.0 SALAMI, ADEDOYIN

The Research Forum which preceded this meeting of the MPC provided, as usual, an opportunity for a stimulating and wide ranging

discussion of background issues relevant to Monetary Policy decision making in the short and medium term. Perhaps the most significant take-away from this session for me is a reinforcement of my view that we are heading into a period when some very significant changes will have to come if the objectives of keeping inflation suppressed and the exchange rate stable without compromising growth is to be realized. Some very important but difficult choices will have to be made – indeed, as I had written in my Statement at the conclusion of the previous meeting, there will be few occasions in the future when we will have the luxury of voting to keep policy unchanged.

To begin with, recent trends in inflation data and the outlook for the rate of increase in prices provided by Bank Staff point, in the short term, to the balance of probabilities tilting towards tighter monetary policy as Headline inflation is projected to rise to 9.4percent at the end of the year. Whilst Headline Inflation remains within the band of 6-9percent announced for this year, the recent upward trend across all definitions of inflation would ordinarily be a cause for concern. However, 6mth ahead projections by Bank Staff suggest that the

rate of increase in prices of non-food items will decline continuously from the 8.1percent in June to close the year at 6.5percent. In contrast, the price of Food items is projected to rise to 11.6percent by year end.

Perhaps a bigger worry in the short-term continues to be the pressure on the Currency. The banks continue, thanks to AMCON disbursement and slow growth in credit, to be awash with liquidity – witness Interbank Call rates remaining below the MPR and the absence of activity in the interbank markets. It is increasingly difficult to escape the conclusion that bankers are/maybe up to the usual game of running rings around the regulator! Despite a NOP limit of 1percent, at the end of H1-2014, consolidated commercial bank foreign currency assets exceeded their liabilities by approximately 30percent. The questions around and risks of this position are self-evident.

Beyond the banks and despite the US\$1.9billion increase in accretion to forex reserves that took the reserves slightly past US\$40bn in July

2014, there continues to be an uneasy feeling about the Naira abroad - see the seemingly relentless increase in private holdings of foreign currency at the expense of Naira deposit.

The real issue on which to reflect is whether the time for a change of monetary policy regime is appropriate and what conditions must hold for such a change to be sustainable.

To begin with there are now serious data challenges which need to be resolved. The World Bank in its document – Nigeria Economic Report, released immediately after the MPC challenges the notion of an unemployment rate in excess of 20percent. If, as the report suggests, unemployment is less than 10percent, a key pillar for easing monetary policy will need to be rebuilt.

I have also followed with interest the media discussion about the possibility of creating additional intervention funds to deal with issues in sectors as diverse as Power, Health and Rice. I am not sure if I am alone in wondering whether the balance sheet of the Central Bank

can bear the additional strain that such intervention will impose. I had hoped that rebuilding the Balance sheet of the Central Bank would be a major task to be accomplished in the relative calm that has followed the crisis in 2009/2010. It appears to that the discussions have lost sight of the rationale for the creation of intervention funds. With banking sector crisis and locked credit markets, the Central Bank of Nigeria (CBN), like many other Central Banks, intervened directly to make credit available to the economy. Though unconventional, the measure, as I recollect the MPC discussion at the time, was intended as one-off!

Intervention funds, such as were created, are essentially fiscal policy instruments. Indeed, I seem to recollect the vilification of the CBN at the time for straying into the domain of fiscal policy! It appears that having acquired a taste for 'intervention', how do we wean ourselves off this? In my view there are other market-based instruments that can serve the intended purpose just as well – perhaps better! A significant shock in the near future will find us denuded and unable to respond meaningfully! Let us be clear, the

banking sector intervention fund, which is what I regard AMCON to be, has shown issues and thrown up challenges which we need to understand carefully before proceeding further in this direction.

The clamour for lower interest rates, which I understand are already forming the basis of market expectation in various post-election scenarios - also require some reflection. The desirability of lower interest rates is not at issue – at the very least, it reduces costs, enhances competitiveness and can provide a boost to job creation and the economy. Movement towards lower interest can happen sustainably in either of the following circumstances: (i) when our forex buffers are rebuilt – however, question is what level of reserves will afford that capacity to reduce interest rates without creating more difficulty; (ii) when we revise our present forex distribution arrangements – key question here is having become used to subsidized access to foreign currency at the R/WDAS window, are we ready to wean this economy away from subsidy. Revising our forex distribution method will doubtless have implications for value and perhaps volatility.

As I indicated at the top of my comments, difficult decisions lie ahead. Whilst our present circumstances allow me, on this occasion, to vote to hold policy parameters unchanged, I think we are heading into a period when we will have limited options but to confront the hard choices ahead.

8.0 UCHE, U. CHIBUIKE

The data presented at the 239th MPC meeting show that the economic and financial outlook of the Nigerian economy continues to be mixed. On the negative side, all the main measures of inflation: food, headline and core, have inched upwards albeit slightly. Also, our banking system, although stable has come under increasing pressure thus the number of banks that failed at least one of the safety ratio tests have increased marginally. Arguably the most troubling development and perhaps the greatest threat to financial system stability in Nigeria is the increasing dollarization of the banking system. This creates structural risks especially given the fact that there is an increasing dysfunction between interest earnings and interest expenses risks in most of the culprit banks. The exchange rate of the

Nigerian Naira, although stable has continued to lie outside the officially allowed band margins and with the imminence of the 2015 elections, there are concerns that increased government spending will add fodder to the already existing pressure on the Naira exchange rate.

On the positive side, our reserves have been inching upwards albeit marginally while the growth rate of our newly rebased economy continues to be in positive territory. In the light of some of the above pressures, some may argue that there is need for further tightening of monetary policy in order to proactively curtail inflation and promote monetary stability. At the current time, however, I have come to the careful conclusion that such a policy move will be an error. This is in part because monetary stability is not an end in itself. Rather, its principal objective is to help promote real sector development. Tightening money supply at the present time will only lead to the crowding out of the real sector in the credit market by the public sector which, at least currently, has less restraint when it comes to demand for borrowing. This insatiable demand by the Nigerian

public sector for credit has, at least in part, created the unfortunate circumstances that have encouraged foreign portfolio flows to prosper and flourish unabated in Nigeria. While in the short run such inflows have been an important pillar in our ability to reasonably maintain exchange rate stability in Nigeria, I am convinced that the consequences of such uncontrolled short term portfolio inflows will greatly harm our economy in the medium term. Given the general but gradual movement towards tapering by the key Western country that has been at the centre of global credit expansion, for instance, it is logical to expect that some material outflows of foreign portfolio investments may occur in Nigeria in the near future. Since the movement of foreign portfolio flows in Nigeria is not entirely within our control, it makes little sense to allow such investments unfettered access to our economy.

In the light of the above, I believe the time has come for us to begin to develop policies that will gradually encourage future portfolio inflows to take a long term position in our economy. I have specifically recommended that we target future portfolio inflows so

as not to ignite unnecessary panic amongst existing investors. A more radical change of policy will certainly not be in the interest of our fragile economy. While the measure proposed above may not be easy, to do nothing will only further increase the powers of such foreign portfolio flows in the Nigerian economy. This will no doubt be to the detriment of our economic development and growth. Admittedly, our economy's addiction to foreign portfolio flows has immense short term benefits especially in the area of assisting the exchange rate stability of the Naira. Unfortunately, addiction to foreign portfolio flows mimics all the characteristics of drug addiction and thus can never lead to a happy ending unless the dependence is ended.

Although I am reluctant to propose further tightening of our current monetary policy stance at the present time, I believe that there is still much we can do administratively to enhance the availability of credit to the real sector of our economy at reasonable rates. In this direction, I am particularly worried about the increasing margins between deposit and lending rates of commercial banks. While this

may have been responsible for the relatively handsome profits banks continue to declare in Nigeria, it will, in the long run harm the intermediation process which is the primary basis and foundation of banking business. Convincing the banks that continued exploitation of the imperfect markets in which intermediation currently take place will in the long run be self-destructive should not be too difficult to achieve. Protagonists of the view that market forces are the main explanatory variable for the widening gap between deposit and lending rates in Nigeria have since lost their audience.

With respect to the need to achieve stability in the exchange rate of the Naira, there are unfortunately no easy options in a mono product import dependent economy. It is for instance public knowledge that should, for instance, the international price of oil collapse, the relative stability that the Naira exchange rate has been experiencing for some time now will disappear. This clearly shows that in a fiscally dominant environment, there are limits to what monetary policy can do. I am, however, convinced that as our democracy develops and deepens, the balance of power in our

governance structure will gradually shift to the advantage of the electorate. When this happens, any government that is unable to diversify our mono product economy will be severely punished by the electorate during elections. There will therefore be a natural incentive for governments to reduce the dependence of the Nigerian economy on crude oil. Until that time, all we can do is to encourage government to adopt fiscally prudent economic policies.

In the light of the above factors, I hereby vote as follows: (1) to retain MPR at 12 percent with interest rate corridor of + 200/- 200 basis points; (2) to retain CRR at on private sector and government deposits at 15 percent and 75 percent respectively, and; (3) to retain Liquidity Ratio at 30 percent.

9.0 YAHAYA, SHEHU

I vote to hold the MPR at its current level of 12%, along with the symmetric corridor of +/-2%, the CRR on public sector deposits at the current level of 75% and 15% for private deposits.

My decision is based on the following considerations:

Trends in the Global Economy

The predominant features of the global economy at the moment are the fairly established growth recovery in the US, with improving employment figures; some recovery in Japan; weak growth in the Eurozone area, with Germany in a slighter better situation. China's growth has been largely stable with a slight downward cast. Growth remains strong in most of Africa, although slightly lower than in 2013.

QE3 continues be rolled back in the US, monetary easing is being maintained in the UK and the ECB is deploying some tools to stimulate the European economy. In all these areas, inflation is currently lower than policy goals and global prices are also subdued.

While imported inflation from our main trading partners is not an issue at the moment, the progressive tapering of QE3 in the US poses considerable challenges to the management of foreign reserves, exchange rate and banking/financial systems

The international price of crude oil has been fairly steady, although the many conflicts raging in the Middle East, Eastern Europe and the volatile situation in some North African countries may engender some volatility in the near future.

Moreover, it should be repeated that there are significant medium threats to the oil revenues of Nigeria from the rapid expansion in supply of shale oil and gas from the US and other countries

Domestic Economy

The GDP growth rate in Q1 of 2014 remains robust at 6.21%, despite the higher base, which is an improvement over 2013. The growth prospects also remain bright due to the stable oil prices, supportive policies, particularly in the agriculture, energy and industrial sectors. Moreover, some of the sub-sectors in the non-oil sector continue to account for much of the growth momentum.

The most significant challenges to growth prospects relate to the insecurity in the North-eastern part of the country; the persistently high level of unemployment (despite some recent improvement in

the numbers), and in particular graduate unemployment; continuing oil theft and vandalism of oil and gas infrastructure (although there has been an increase in oil output in June 2014); the risk of political tensions in the run-up to the general elections in the country; challenges to the foreign reserve level (despite the improvement in June 2014). Pervasive corruption continues to undermine growth. Huge income inequalities also need to be addressed.

The foreign exchange rate has remained stable for about 3 years significantly due to strong policy intervention, although pressures are mounting on the rate due to future expectations related to QE3 tapering. The capital and money markets, despite fluctuations, are currently fairly stable.

Headline inflation, year-on-year, has increased to 8.17% in June 2014, driven largely by increases in food and non-alcoholic beverages, clothing and footwear, housing, water, electricity, gas sectors and transport. Core inflation is the main overall driver for the currently inflationary hike.

Interest rates, already too high, have risen further in the last month. The gap between lending and deposit rates, again already high, has increased slightly. Broadly, the financial system remains stable.

Federal government fiscal operations have generated an overall surplus in the January-May 2014 period. However, this has largely been achieved at the expense of significant reductions in capital expenditure, which will undermine growth prospects in the medium term.

Conclusion

Growth rates and growth prospects remain strong, although major efforts need to be made to ensure that growth is accompanied by improved income inequality, reduction in poverty and substantial job growth.

While high lending rates are an abiding concern, it is not appropriate at this time to reduce the policy rate or otherwise ease monetary policy. This is due to the upward trend in headline inflation and core inflation in particular, heightened inflation expectations in the next six

months particularly for food prices, increasing pressures on the foreign exchange rate and the possible threats to foreign reserves if there is an acceleration of reverse capital flows. There is clearly a need to keep a close watch on these developments and to respond effectively at the right time. I therefore vote to retain the currently tight monetary stance.

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

The 239th meeting of the Monetary Policy Committee was held against the backdrop of a tentative recovery in the international economic and financial environment. As the impact of the global financial crisis have continued to wane, issues of rising income inequality, unemployment and poverty are becoming the main focus of the monetary authorities around the world, in line with the new normal monetary policy. This situation has prompted a rethink of the entire paradigm of focusing primarily on price stability.

Although monetary policy makers recognize the strong interconnectedness of economies and the enormous scope for

spillovers, they have been largely influenced in their considerations by the stability of domestic financial markets and monetary conditions during these highly uncertain times. The recent projections show that the euro area is slowly coming out of recession and growth could restart in 2015. The peripheral countries, on the other hand are expected to experience low domestic demand due to high debt and financial fragmentation. Growth is projected at 5.0 per cent in the emerging and developing countries in 2014 from 4.7 per cent in 2013.

Like in most jurisdictions, the US Federal Reserve embarked on a massive quantitative easing (QE) programme since 2008 primarily to soothe domestic concerns around output and employment in the face of obvious failure of traditional monetary policy to stimulate aggregate demand. The Fed has since begun to scale back its stimulus package with improving macroeconomic performance. However, this has important consequences for emerging markets and frontier economies, including Nigeria, which attracted significant private capital flows following QE programme. In effect,

the most crucial external consideration for monetary policy makers in emerging markets and frontier economies today appears to be how to mitigate the adverse consequences of QE tapering for markets, currencies and financial flows.

Domestically, the macroeconomy has exhibited relative stability as shown by the encouraging growth rates, stable consumer prices, and exchange rate as well as rising external reserves. The latest figures from the National Bureau of Statistics (NBS) suggest that economic growth is still comparatively impressive even after the rebasing exercise. Estimated growth rate for 2013 at 5.5 per cent compares favourably with 5.3 and 4.21 percent observed in 2011 and 2012, respectively. Similarly, the revised estimate of 6.8 per cent for the fourth quarter of 2013 represented an improvement over the 5.2 and 3.6 percent in the previous quarter and the corresponding period of 2012, respectively. The naira exchange rate at the r-DAS and interbank interest rates has also remained well anchored by prevailing policies. Inflation has remained contained within the

Bank's target zone of 6 - 9 percent, though headline inflation inched from 8.0 percent in May 2014 to 8.17 percent in June.

While I recognize this gradually rising inflationary trend, the challenges posed by high unemployment and limited access to credit deserve to be factored into any considerations aimed at improving the robustness of growth and ensuring the sustainability of price stability. I also recognize other concerns for monetary policy to include the on-going QE3 tapering for inflows and external reserves, likely increase in government expenditure in preparation for the 2015 general elections and balancing the need for low interest rate with price stability.

Accordingly, the options for monetary policy facing the MPC appear to me to be either retention of the current stance of monetary policy while employing other non-conventional means to support a resolution of the broad development bottlenecks or a reduction in the policy rate to stimulate credit to the real sector of the economy. Having considered these developments, I vote as follows:

1. Hold the MPR at 12 per cent with a corridor of +/-200 basis points
2. Retain liquidity ratio at 30 per cent
3. Maintain the public sector Cash Reserve Requirement at 75.0 per cent; and

Retain the private sector Cash Reserve Requirement at 15.0 per cent.