

Central Bank of Nigeria Communique No. 94 of the Monetary Policy Committee Meeting, March 24-25, 2014

The Monetary Policy Committee (MPC) met on March 24 and 25, 2014 against the backdrop of challenging monetary policy environment; particularly, in the emerging markets and developing economies; coupled with the unfolding risks to stability in the domestic economy. In attendance were 9 members. The Committee reviewed key developments in both the global and domestic economies up to March 2014, and the outlook for the rest of the year.

International Economic Developments

The Committee noted that the recovery of the global economy could accelerate further in 2014 relative to 2013 as a result of increased domestic demand in the advanced economies and the rebound of exports in emerging

markets. The IMF has projected global growth to increase from 3.0 per cent in 2013 to 3.7 per cent in 2014 and then to 3.9 per cent in 2015. In the US, growth is expected to be 2.8 per cent in 2014, compared with 1.9 per cent in 2013, driven by increased domestic demand as well as reduction in the fiscal drag due to the recent deal brokered on the Federal Budget. Although, the euro area has continued to adjust to a high level of indebtedness and financial fragmentation in some countries, growth is expected to recover in the coming years. Thus, growth is expected to rise from 0.4 per cent in 2013 to 1.0 per cent in 2014. This is buoyed by easier credit conditions, increased investor confidence, and expansion in exports. Tight financial conditions since mid-2013 as well as political uncertainty were a drag on growth in most of the emerging markets and developing economies. Notwithstanding, overall growth in this group of

countries is expected to increase from 4.7 per cent in 2013 to 5.1 per cent in 2014.

Reflecting the expansion in economic activities, an upward pressure is expected in global price levels in 2014. Global inflation is projected at 2.71 per cent in 2014, representing an increase of about 40 basis points in relation to the estimates for 2013. It is expected, however, that favorable developments in the prices of food and fuel will help contain the upward movement in the prices of major commodities.

The Committee observed an emerging variance between advanced and emerging market economies (and developing economies) in terms of monetary policy stance since the beginning of 2014. While central banks in a number of advanced economies maintained the cautious posture adopted in 2013 and in Q1 of 2014, the emerging

economies and developing countries have apparently switched to more aggressive monetary policy tightening to support domestic currencies and retain foreign investments by raising interest rates. South Africa, Ghana, Brazil and Russia were among countries that tightened monetary policy to address concerns over rising risks to inflation and exchange rate stability.

Domestic Economic and Financial Developments

Output

Growth remains robust. The National Bureau of Statistics (NBS) has estimated real Gross Domestic Product (GDP) growth rate at 7.72 per cent for the fourth quarter of 2013, which was higher than the 6.81 per cent, recorded in Q3, 2013 and 6.99 per cent in the corresponding period of 2012. Thus, in 2013, GDP grew at an estimated 6.89 per cent, up from 6.58 per cent in 2012. In line with recent trends, the

non-oil sector continued to be the main driver of growth in Q4, 2013, recording 8.76 per cent. The growth drivers in the non-oil sector in Q4, 2013 remained wholesale and retail trade, agriculture and telecommunications which contributed 2.57, 2.27 and 1.97 percentage points, respectively.

Based on the 2013 favorable performance, output growth has been projected at 7.7 per cent for fiscal 2014. The Committee observed that the relatively robust growth projections, despite the sluggish global recovery, reflected the continuing favorable conditions for increased agricultural production, sustained outcome of the banking sector reforms as well as the initiatives of the government to stimulate the real economy. In particular, the Committee noted with satisfaction the rise by about 10 per cent in the national average electricity generation in Q4, 2013; a

development which provided impetus for improved economic activities during the period.

Prices

Inflation has remained in the target range. The downward trend in inflation, which commenced in December 2012 continued up to February 2014. The year-on-year headline inflation fell consistently from 9.5 per cent in February 2013 to 7.9 per cent in November 2013, but rose marginally to 8.0 per cent in December 2013 and January 2014. In February 2014, however, it moderated to 7.7 per cent. The deceleration was largely due to the moderation in food inflation, which moved from 9.3 per cent in January 2014 to 9.2 per cent in February 2014. Core inflation, on the other hand, exhibited a fair degree of volatility during the period; having declined up to the first half of 2013. It commenced an upward trend in the latter half of the period but declined

to 6.6 per cent in January 2014, before inching up to 7.2 per cent in February 2014.

Noting the continued commitment of price stability within the CBN range, the Committee; emphasized the need to maintain the current monetary policy stance. In all, the Committee expressed satisfaction over the sustenance of single digit of all measures of inflation. The Committee, therefore, restated its commitment to sustaining the price stability objective.

Monetary, Credit and Financial Markets' Developments

Broad money supply (M2) contracted by 2.24 per cent in February 2014 over the level recorded at end-December 2013, which, on annualized basis, translated to a contraction of 13.42 per cent as against a growth target of 15.52 per cent for fiscal 2014. Net domestic credit grew marginally by 0.86 per cent in February 2014, translating to an annualized growth rate of 5.15 per cent. The annualized growth in net domestic credit is significantly lower than the provisional benchmark of 28.5 per cent for fiscal 2014. The sluggish growth in aggregate credit was traced mainly to the decline in Federal Government, borrowing which contracted by 2.02 per cent in February 2014 or 12.14 per cent on an annualized basis.

During the review period, money market interest rates remained within the MPR corridor, oscillating in tandem with

the level of liquidity in the banking system. The average interbank call rate for the period was 10.17 per cent while the OBB rate was 11.01 per cent. The weighted average inter-bank call and OBB rates which closed at 10.86 and 10.46 per cent in December 2013, respectively, rose to 11.27 and 10.5 per cent in February 2014. Activities in the capital market, however, were bearish as the All-Share Index (ASI) moderated from 41,329.19 at end-December 2013 to 39,269.4 on March 11, 2014 with market capitalization exhibiting similar trends.

External Sector Developments

The end-period exchange rate remained stable at the rDAS window but depreciated at the interbank and appreciated at the BDC segment of the market. The exchange rate at the rDAS-SPT during the review period opened at N157.61/US\$

(including 1% commission) and closed at N157.26/US\$, representing an appreciation of N0.35k or 0.22 per cent. At the Interbank foreign exchange market, the rate opened at N158.83/US\$ and closed at N164.90/US\$, averaging N161.89/US\$, representing a depreciation of 3.68 per cent or N6 for the period. At the BDC segment of the foreign exchange market, the selling rate opened at N173.00/US\$ and closed at N172.00/US\$, representing an appreciation of 0.58 per cent or N1.00k. The BDC segment averaged N170.44/US\$, representing an appreciation of 0.06 per cent.

Gross official reserves as at March 2014 stood at US\$37.83 billion compared with US\$42.85 billion at end-December 2013. The decrease in the reserves level was driven largely by the increased funding of the foreign exchange market in

the face of intense pressure on the Naira and the need to maintain stability.

The Committee's Considerations

The Committee unanimously agreed that a continuation of a tight monetary policy was needed to consolidate recent gains. Recent resurgence of core inflation in spite of the downward trend in headline inflation reinforces this position. Thus, prudent monetary stance would also facilitate better reserve and exchange rate management in an environment where Fed tapering increases pressure on emerging economies financial markets.

The MPC welcomed the growth expectations but expressed concern that the industrial sector has continued to lag behind. The Committee noted that growth remained

consistently in favour of the agricultural sector, noting that the continued achievement of relative exchange rate stability and single digit inflation in 2014 given the risks in the horizon will require extra-ordinary measures. The Committee viewed some of the developments as positive optimism by the market relative to other emerging market economies. While tension in Ukraine over Russia's claims to Crimea remained serious, direct trade and financial links between Nigeria and the duo remained largely limited. Thus, the risk premia could come from rising oil and gas prices which were deemed positive shocks.

On the other hand, the Committee noted that the recent pressure in the foreign exchange market was in response to key developments in the US over the Fed's unwinding of its assets purchase programme. In addition, the pressure on

external reserves was deemed to be consistent with the seasonal annual payment of dividends to foreign investors. On a positive note, inflation forecasts indicate that food inflation may not grow beyond current levels, especially with bumper harvests expected in 2014. However, core inflation could rise. The Committee noted that frontier markets were positioning themselves to attract higher capital inflows by raising their policy rates to contain inflation and also remain competitive. Oil prices remained relatively high while production was improving, and there were signs of accretion to external reserves. The Committee also expressed concern over the sudden surge in domiciliary account balances which may offset the gains from imposing 75 per cent CRR on public sector funds.

The Committee commended the Bank for its continued commitment to exchange rate stability in the face of undue pressure on the Naira. It noted with satisfaction the calm in the foreign exchange market and the relative stability in the interbank exchange rate after the initial turbulence. The Committee acknowledged that while this stability was at a high cost, safeguarding short run macroeconomic stability under the circumstance required firm and bold measures.

In the light of the foregoing, the MPC considered the success of Monetary Policy in attaining price and exchange rate stability; the potential headwinds in 2014; the ultimate goal of transiting to a truly low – inflation environment; and the need to retain portfolio flows. The Committee unanimously voted for further tightening of monetary policy but were divided on the instruments.. While some voted for

an increase in the MPR to retain and attract more inflows, other members felt that such increase could impact access to credit and domestic growth negatively. Consequently, the Committee voted as follows:

- (1) Five (5) members voted to keep MPR at 12%, while four (4) members voted for an increase in MPR.
- (2) Seven (7) members voted to retain the MPR corridor at +/-2%, while two (2) members voted for an asymmetric corridor.
- (3) Seven (7) members voted to increase CRR on private sector deposits by 300 basis points to 15%, while two (2) members voted to retain the CRR on private sector deposits at 12%.

The Committee, therefore, decided by a majority vote of 5 to 4 to hold the MPR and its corridor at current levels but

raised the CRR on private sector deposits by 300 basis points to 15 per cent.

Thank you for listening

Sarah O. Alade

Acting Governor

Central Bank of Nigeria

25th March, 2014