



## **Central Bank of Nigeria Communiqué' No. 106 of the Monetary Policy Committee Meeting of Monday and Tuesday, March 21 and 22, 2016**

The Monetary Policy Committee met on 21<sup>st</sup> and 22<sup>nd</sup> March 2016 amidst uncertain global economic prospects and continuing challenges in the domestic economy. In attendance were 8 out of the 12 members. The Committee appraised the international and domestic economic and financial environments in the first two months of 2016 as well as the outlook for the rest of the year.

### **International Economic Developments**

The Committee noted with concern the further decline in global output at the end of 2015, which grew at 2.3 per

cent, year-on-year in Q4, its slowest in three years, representing a 0.3 percentage point decline compared with 2.6 per cent in Q3. This deceleration stemmed from the continuous slowdown of growth in the emerging market economies, worsened by deteriorating conditions in the Euro area and China as well as key emerging market economies. Other factors include sustained pressure in global financial markets arising from US monetary policy normalization, depressed global oil market and persistently weakened global aggregate demand.

The slowdown in growth in the United States to 1.0 per cent in Q4 from 2.0 per cent in Q3 was attributed to slowdown in private consumption expenditure (PCE) and non-residential fixed investments. In Japan, output declined by 1.4 percentage points in Q4, 2015 in contrast

to the 1.3 per cent growth recorded in Q3. The Bank of Japan's monthly asset purchase program of ¥6.7 trillion (\$56.71 billion) remains substantially sub-optimal, as the economy continues to lurch between contraction and expansion, with the adoption of a negative interest rate policy in January 2016.

In the Euro area, GDP grew by 1.5 per cent in Q4 of 2015, and projected to grow at 1.7 per cent in 2016. The European Central Bank (ECB), at its meeting on 10<sup>th</sup> of March, 2016 eased monetary policy by further reducing its refinancing rate to 0.0 per cent and deposit rate to -0.4 per cent. The Bank also expanded its monthly asset purchase program from €60 billion (\$65.4 billion) to €80 billion (\$87.2 billion) to further stimulate output growth and move inflation towards its long term objective of 2.0 per cent.

On the other hand, the Bank of England (BoE) sustained its stock of assets purchase, financed through the issuance of reserves at £375 billion (\$536.25 billion), while retaining its policy rate at 0.5 per cent. The BoE further committed to investing £8.4 billion (\$12.01 billion) of cash flows associated with redemption of the January 2016 government securities held in the Asset Purchase Facility, with a commitment to bring inflation closer to the 2.0 per cent target, reducing unemployment and promoting growth.

Uncertainties and geo-political tensions in the Middle East, including a negotiated ceasefire agreement in Syria and Iran's re-entry into mainstream international oil market may have further redefined conditions in the oil market. The market witnessed some uptick in prices

following the resolve of the Organization of the Petroleum Exporting Countries (OPEC) and some non-OPEC members to pursue a higher anchor price, coupled with smaller-than-anticipated build-up in stocks at the Cushing Oklahoma delivery hub for United States crude futures.

The Emerging markets and developing economies (EMDEs) were forecast to grow at 4.3 per cent in 2016, an improvement over the 4.0 per cent recorded in 2015. However, external and domestic challenges have persisted, stemming from low commodity prices, troubled financial markets, tepid global demand, policy uncertainty as well as continuously feeble growth in global trade. In addition, weaknesses in major emerging market economies, diminished capital inflows, rising borrowing costs and geopolitical factors have been

identified as possible deterrents to growth in the EMDEs. In the environment of suppressed inflation, slow growth, weak global demand and volatile financial markets, the stance of monetary policy in the advanced economies is expected to remain accommodative in 2016, while in the EMDEs, it is expected to be underpinned by currency adjustments and other complementary policies.

## **Domestic Economic and Financial Developments**

### **Output**

The Bank had adopted accommodative monetary policy since July 2015 in the hope of addressing growth concerns in the economy, effectively freeing up more funds for DMBs by lowering both CRR and MPR, with excess liquidity arising from the lower CRR warehoused at the CBN. DMBs were to access these funds by submitting verifiable investment proposals in the real

sector of the economy. The funds have not impacted the market yet because the CBN was still processing some of the proposals submitted by the DMBs. In the first episode of easing which resulted in injecting liquidity into the Banking system, DMBs did not grant credit as envisaged. Moreover, the delay in passage of the 2016 Budget has further accentuated the difficult financial condition of economic agents as output continues to decline due to low investment arising from weak demand. The cautious approach to lending by the banking system underpinned by a strict regulatory regime conditioned by the Basel Committee in the post global financial crisis era has further alienated investors from access to credit as banks prefer to build liquidity profiles in anticipation of government borrowing.

In the light of these developments, domestic output growth in 2015 remained subdued as reported by the

National Bureau of Statistics (NBS). Consequently, real GDP grew by 2.11 per cent in the last quarter of 2015, more than half a percentage point lower than the 2.84 per cent recorded in the third quarter and 3.83 percentage points in the corresponding period of 2014. Overall, growth in 2015 was estimated at 2.79 per cent, compared with 6.22 per cent in 2014. The major impetus for growth continued to come from the non-oil sector which grew by 3.14 per cent in Q4, 2015 compared with 3.05 per cent in the preceding quarter. The key drivers of growth in the non-oil sector were Services, Agriculture and Trade; contributing 1.23, 0.83 and 0.76 percentage points, respectively.

The Committee noted that the sluggish growth in output was directly attributable to certain fiscal uncertainties, which inadvertently hampered movement of labor and

goods; fuel scarcity, increased energy tariffs, foreign exchange scarcity as well as slow growth in credit to private sector in preference to high credit growth to the public sector. The Committee noted that many of these factors were outside the control of monetary policy and given these limitations, in the absence of complementary fiscal and structural policies, the only option was to continue with the existing measures. The MPC believes that complementary fiscal and structural policies are essential for reinvigorating growth.

## **Prices**

The Committee noted the increase in year-on-year headline inflation to 11.38 per cent in February 2016, from 9.62 per cent in January and 9.55 per cent in December, 2015. The increase in headline inflation in February reflected increases in both food and core components of inflation. Core inflation rose sharply for

the first time to 11.00 per cent from 8.80 per cent in January after a lull of three consecutive months at 8.70 per cent through December, 2015. Food inflation also inched up to 11.35 per cent from 10.64 per cent in January and 10.59 per cent in December, 2015. The rising inflationary pressure was traced to the lingering scarcity of refined petroleum products, exchange rate pass through from imported goods, seasonal factors and increase in electricity tariff. The Committee noted that the factors responsible for rising inflation were more structural in nature than monetary, but reaffirmed its commitment to monitor the developments closely and to work with the relevant authorities to address the underlying drivers of the upward price movements.

## **Monetary, Credit and Financial Markets Developments**

Broad money supply (M2) grew by 2.29 per cent in February, 2016 in contrast to 1.69 and 0.25 per cent in January 2016 and February 2015, respectively. When annualized, M2 grew by 13.74 per cent in February 2016 against the provisional growth benchmark of 10.98 per cent for 2016. Net domestic credit (NDC) grew by 3.71 per cent in the same period, annualized, at 22.26 per cent. At this rate, the growth rate of NDC was below the provisional benchmark of 17.94 per cent for 2016. Credit to the private sector grew by 1.45 per cent in February 2016, which annualized to a growth of 8.70 per cent, below the benchmark growth of 13.28 per cent. The Committee noted with concern, the dismal performance of growth in credit to the private sector, noting that even at that, credit went primarily to low employment

elasticity sectors of the economy. This had a significant negative impact on output growth.

Money market interest rates reflected the liquidity situation in the banking system. Average inter-bank call and OBB rates, which stood at 0.5 and 2.77 per cent on 25 January 2016, closed at 4.00 and 5.00 per cent, respectively, on March 9, 2016. Between January 25<sup>th</sup> and end-February 2015, interbank call and OBB rates averaged 1.43 and 2.68 per cent, respectively. This was traced to liquidity surfeit in the banking system. The deposit money banks were, however, reluctant to grant new credit because of rising non-performing loans (NPLs), mainly in the oil sector, amongst other reasons.

The Committee also noted the slight improvement in the equities segment of the capital market during the review period. The All-Share Index (ASI) rose by 8.1 per cent from 23,916.15 on January 29, 2016 to 25,853.58 on

March 14, 2016. Similarly, Market Capitalization (MC) rose by 8.02 per cent from N8.23 trillion to N8.89 trillion during the same period. However, relative to end-December 2015, the indices declined by 9.73 per cent and 9.74 per cent, respectively.

### **External Sector Developments**

The average naira exchange rate remained stable at the inter-bank segment of the foreign exchange market during the review period. The exchange rate at the interbank market opened at N197.00/US\$ and closed at N197.00/US\$, with a daily average of N196.99/US\$ between January 25 and March 14, 2016. The Committee reiterated its commitment to maintaining a stable naira exchange rate. The MPC took note of the level of activity in the autonomous foreign exchange market as well as the rising demand in the interbank market but observed

that the data on demand for foreign exchange, was being overshadowed by speculative demand. However, the Committee charged the Bank to speed up reforms of the foreign exchange market to improve certainty and eliminate noise and opportunities for arbitrage.

### **The Committee's Considerations**

The Committee noted the weakening macroeconomic environment, reflected particularly in foreign exchange shortages, slowing GDP growth rate and rising inflation. Overall economic growth slowed significantly in 2015, particularly in Q4. Apparently, the conditions responsible for the slowdown – uncertainty around fiscal policy, adverse external environment, security challenges in some parts of the country affecting production and distribution of agricultural produce, low electricity supply, fuel shortages, and sluggish growth in credit to

the private sector – have continued in the first quarter of 2016.

On the monetary side, contrary to the notion of liquidity overhang in the financial system, the wider economy appears starved of the needed liquidity to spur growth and employment. Recent performance of the monetary aggregates lends credence to this fact. With the exception of credit to government, growth in all the monetary aggregates remained largely below their indicative benchmarks, yet; headline inflation spiked to 11.38 per cent in February 2016, substantially breaching the policy reference band of 6 - 9 per cent. Apart from liquidity, the increase in inflation was driven by structural factors such as fuel scarcity, increased electricity tariff, persistent insecurity, exchange rate pass through and seasonality of agricultural produce. The conflicting signals from slowing growth and rising inflation present a

difficult policy challenge. Though mindful of the limitations of monetary policy in influencing the drivers of the current price spiral, the Committee stressed the need to urgently address the key sources of the pressures. In this regard, the Committee reaffirmed its commitment to closely monitor the development while encouraging relevant authorities to address the structural bottlenecks.

From the monetary data, the Committee noted that the excess liquidity in the banking system was contributing to the current pressure in the foreign exchange market with a strong pass-through to consumer prices. The Committee further noted that previous efforts to reflate the economy in order to spur growth did not elicit the required response from DMBs, hence; the surfeit of liquidity in the interbank market. Obviously, the attendant low rates at that market have not transmitted

to the term structure of interest rates. Concerned about the need for low interest rates to support growth and employment, the Committee urged the CBN to explore innovative ways of ensuring the unhindered flow of credit at low cost to key growth sectors even as monetary policy has to, under the circumstance, address the liquidity surfeit in the banking system as well as the pressure on exchange rate and consumer prices. The Committee hopes that fiscal and other structural policies would soon be deployed to strengthen the overall response of macroeconomic policy to the shocks.

The Committee was also concerned that with headline inflation at 11.38 per cent, noting that the policy rate had become negative in real terms. This development has the potential of keeping both foreign and domestic investments on hold. As part of measures to address the supply constraint in the foreign exchange market, yields

on domestic instruments have to be competitive to attract the much needed foreign inflows. On the administrative side, this will have to be complemented by a comprehensive reform of the foreign exchange market which is currently being undertaken. For the avoidance of doubt, the Bank would continue to allow domiciliary account holders unfettered access to funds in their accounts.

The Committee also urged speedy passage of the 2016 Budget in order to halt the depressing effect of the uncertainty that engulfs the waiting period, hoping that the implementation of the budget would go a long way in boosting business confidence, and reinvigorating the financial markets. In the circumstance, the Committee urged the Bank to continue to upscale its surveillance of the financial system with the aim of promptly detecting

and managing vulnerabilities to ensure sustained stability.

Finally, the Committee remains committed to price stability across the range of consumer prices, exchange rate and interest rate, which is fundamental to reviving economic growth and employment generation. In the meantime, the Bank would continue to leverage its development finance policy to support critical sectors of the economy. The MPC also stressed the need to sustain, deepen and speed up reforms designed to ensure focused coordination of monetary and fiscal policies.

### **The Committee's Decisions**

The Committee, in its assessment of relevant internal and external indices, came to the conclusion that the balance of risks is tilted against price stability. The MPC therefore, voted to tighten the stance of monetary

policy. One member voted to retain the CRR at 20.00 per cent while another member voted to retain the current width of the asymmetric corridor.

In summary, the MPC voted to:

- (i) Raise MPR by 100 basis points from 11.00 per cent to 12.00 per cent;
- (ii) Raise CRR by 250 basis points from 20.00 to 22.50 per cent;
- (iii) Retain Liquidity Ratio at 30.00 per cent; and
- (iv) Narrow the asymmetric corridor from +200 and -700 basis points to +200 and -500 basis points

Thank you for listening.

**Godwin I. Emefiele**

Governor, Central Bank of Nigeria

**22nd March 2016**