



Central Bank of Nigeria Communique No 109 of the Monetary Policy Committee Meeting of Monday and Tuesday 19th and 20th September 2016

The Monetary Policy Committee met on 19th and 20th September 2016, amidst persistently subdued global and domestic economic and financial environments. The Committee thoroughly assessed the global and domestic macroeconomic and financial developments and risks to the domestic economy up to September 2016, and the outlook for the last quarter of the year. In attendance were 10 out of 12 members.

International Economic Developments

The Committee acknowledged the tepid growth performance of global output, arising from legacy factors, the June 23rd Brexit vote as well as contagion from emerging markets' weak demand and contracting productivity. Whereas growth appears to be slowly recovering in advanced economies, especially the United States, the outlook remains fraught with uncertainty as long-term government bonds have nosedived to multi-year lows on expectations of loose monetary policy from advanced economies and the continued sub-optimal performance of the Euro Area, Japan and China. Consequently, the IMF had in July 2016, further downgraded its baseline forecast for

global growth to 3.1 per cent from 3.2 in April. The World Bank in its June 2016 Report on Global Economic Prospects showed even less optimism with a global output growth projection of 2.4 per cent for 2016 from the 2.9 per cent in January. The subdued global growth prospects is traced to persistently weak fundamentals, mainly in emerging markets and developing economies (EMDEs), mostly due to soft commodity prices, diminished investment, contracting trade, weak demand and rising inflation. Volatility in global financial markets appeared to have subsided in the second quarter of the year, after a wild ride following the UK Brexit vote, and against the backdrop

of less likely US rate hike expectations and some stability in the crude oil market.

The United States (US) economy firmed up at a seasonally-adjusted annualized rate of 1.1 per cent in Q2 2016, although with a downward adjustment of 0.1 per cent from the first estimate of 1.2 per cent. It, however, still represents a noticeable improvement compared with the 0.8 per cent growth recorded in Q1 2016. The improved performance of the economy was attributed to increased private consumption spending, a robust labor market and increased exports, even as retail sales and manufacturing output declined.

Japan's economy expanded at a seasonally adjusted annualized rate of 0.2 per cent in Q2 2016 compared

with 1.7 per cent in Q1 of 2016, against the backdrop of weak wage growth and an external sector that is undermined by a strong yen. Fearing that monetary policy may be approaching its limits, the government on 2nd August, approved a fiscal stimulus of ¥13.5 trillion (US\$132 billion) in a spirited attempt to jumpstart the economy, even as the Bank of Japan (BOJ) dismissed market speculation that it was planning to stop its monthly monetary stimulus program of ¥6.7 trillion (\$69.07 billion). The massive fiscal and monetary stimuli are, however, yet to have the desired impact.

Real GDP in the Euro area expanded by 0.3 per cent, a significant decline compared with the 0.6 per cent

recorded in Q1 2016. Downside risks from the Brexit vote seems to have dissipated with no attendant major economic shock to the zone's economy thus far. As such, many of the conditions that had driven the recovery remained in place, suggesting that Q3 growth may continue in the direction of the second quarter.

Following its September 8th, 2016 meeting, the Governing Council of the European Central Bank resolved to leave its key interest rates on the main refinancing operations, the marginal lending facility and the deposit facility unchanged at 0.00, 0.25 and -0.40 per cent, respectively. The Council also reaffirmed its commitment to sustain the monthly asset purchases of €80 billion (US\$90.4 billion) until end of

March 2017 or until a sustained adjustment is seen on the path of inflation, towards the 2.0 per cent policy target.

The Bank of England (BoE), at its August 4th meeting, and in attempts to further blunt the aftershocks of the Brexit vote, decided to cut its benchmark interest rate for the first time since 2009, by 25 basis points from 0.5 per cent to 0.25 per cent, the lowest ever in the Bank's history. The Committee voted to increase its monthly assets purchase program financed through the issuance of reserves by another £60 billion (US\$80.4 billion) from £375 billion (US\$502.5 billion) to £435 billion (US\$582.9 billion). Furthermore, the BoE revived its financial crises-era U.K. government

bond buying program financed through the issuance of reserves, up to £10 billion (\$13.4 billion), in effort to stimulate the economy and steer inflation towards its 2.0 per cent target.

While major EMDEs continue to be constrained by low capital inflow, the intractable macroeconomic environment faced in 2015 and through to the first half of this year is gradually abating. The prospects for near term full economic and financial recovery in the EMDEs remain subdued, with the IMF (WEO July 2016 Update) projected growth rate forecast for this group of countries at 4.1 per cent, a downward review from 4.3 projected in April. However, the resumption of

growth is expected to be powered by rising credits and a surge in government spending.

The potential alliance between OPEC and non-OPEC members like Russia, to reduce quota, in the face of disruptions to production in Nigeria, Libya and Iraq, have aided relative stability in the crude oil market.

Globally, general price levels remained tapered due to sustained low oil and other commodity prices. In the advanced economies, despite the uncertainties arising from the UK referendum, accommodative monetary policy stance of the region's central Banks, negative interest rate in Japan and elsewhere, as well as various fiscal stimuli, global inflation has remained suppressed. As deviations in macroeconomic

fundamentals in the advanced economies and the EMDEs widen, monetary policy could continue to diverge between the two in the short to medium term.

Domestic Economic and Financial Developments

Output

Data released by the National Bureau of Statistics (NBS) in August indicated that the economy had slipped into recession following another contraction in Q2, 2016. The August 2016 data showed domestic output in Q2, 2016 contracted by 2.06 per cent. This represented a decline of 1.70 percentage points in output from the -0.36 per cent recorded in Q1, and 4.41 percentage points lower than the 2.35 per cent

growth in the corresponding period of 2015. The non-oil sector contracted by 0.38 per cent, compared with the 0.18 per cent contraction in the preceding quarter. Agriculture; Other Services; Education; Arts, Entertainment & Recreation; and Information & Communication, grew by 4.53, 4.32, 2.88, 1.80 and 1.35 per cent, respectively.

The shocks associated with energy shortages and price hikes, scarcity of foreign exchange and depressed consumer demand, among others, apparently proved to be more damaging than expected. Recognizing that the conditions which precipitated the current economic downturn were not essentially sensitive to monetary policy interventions,

the MPC again renewed its call for urgent complementary fiscal policies to resuscitate production and engineer aggregate consumption. In particular, members underscored the imperatives of diversification of the economy away from oil into agriculture, manufacturing and services as well as more efforts towards payment of salaries and arrears of public sector employees particularly in states and local governments to stimulate aggregate consumption, as part of the overall fiscal policy menu kit. On the supply side, efforts must be intensified at increased capital expenditure to redress infrastructural deficits, improve the business environment and spur growth.

Prices

The Committee noted that headline inflation (year-on-year) rose again in August to 17.6 per cent, from 17.1 per cent in July 2016, thus maintaining the upward trend since January 2016. The increase in headline inflation in August reflected increases in both food and core components of inflation. Core and food inflation have increased from 16.93 and 15.80 per cent in July to 17.2 and 16.43 per cent, respectively, in August 2016.

The Committee nonetheless, noted that the month-on-month evolution of consumer price inflation has been less phenomenal. The headline inflation index rose by

1.0 per cent in August from 1.3 per cent in July, 1.7 per cent in June; and 2.8 per cent in May 2016. Similarly, the core index has been increasing at a decreasing rate since May when it rose by 2.7 per cent. It moderated to 0.85 per cent in August from 1.22 per cent in July and 1.83 per cent in June. The same pattern of moderation is seen in the food (month-on-month) index which rose by 1.2 per cent in August from 1.21 per cent in July, 1.4 per cent in June and 2.6 per cent in May.

The MPC further noted that the pressure on consumer prices continues to be associated with reform-related legacy and structural factors including high costs of electricity, transport, production inputs, as well as

higher prices of both domestic and imported food products. The MPC expects that with the onset of the harvest season, the restrictive stance of policy as well as the flexible FX regime, prices will begin to taper in the fourth quarter.

Monetary, Credit and Financial Markets Developments

Broad money supply (M2) grew by 8.08 per cent in August, 2016, compared with the July level of 10.75 per cent. When annualized, M2 grew by 12.12 per cent in August 2016 above the growth benchmark of 10.98 per cent for 2016. Net domestic credit (NDC) grew by 20.09 per cent in the same period, annualized at 30.14

per cent. At this rate, the growth rate of NDC was above the provisional benchmark of 17.94 per cent for 2016. The development in NDC, essentially reflected the relative growth in credit to the private sector of 21.07 per cent in the month, annualized to 31.61 per cent. Credit to government grew by 1.99 per cent in August 2016, which annualized to a growth of 3.0 per cent compared with the growth benchmark of 13.28 per cent. The growth in M2 was traced to exchange rate effect following the depreciation of naira in the second quarter of the year.

Money market interest rates reflected liquidity conditions in the economy. Average inter-bank call rate, which stood at 15.00 per cent on 8th July 2016,

closed at 30.00 per cent on August 26, 2016. Between July 8th and 26th August 2016, interbank call rate averaged 24.95 per cent. The rates increased to 50.0 per cent on July 15, 2016. The sharp increase was attributed to the drop in net liquidity during the period.

The Committee noted a decline in the equities segment of the capital market as the All-Share Index (ASI) fell by 3.51 per cent from 28,733.90 on July 18, 2016, to 27,725.40 on September 15, 2016. Similarly, Market Capitalization (MC) declined by 3.55 per cent from N9.87 trillion to 9.52 trillion during the same period. In addition, relative to end-December 2015, the capital market indices fell by 20.06 per cent and 3.35 per cent, respectively, reflecting the slowdown in the

economy. Overall, the capital market did not show vulnerabilities to domestic and external sector developments.

External Sector Developments

The average naira exchange rate weakened at the inter-bank segment of the foreign exchange market during the review period. The exchange rate at the interbank market opened at N285.25/US\$ and closed at N305.90/US\$, with a daily average of N302.87/US\$ between July 1st and August 26, 2016. The Committee observed that total foreign exchange inflows through the CBN increased by 89.14 per cent, from US\$1,092.21 million recorded in July to US\$2,065.79 million in August 2016. This increase was due mainly

to receipts of foreign flows within the month. Total outflows, however, decreased by 4.57 per cent from US\$2,728.12 million to US\$2,603.35 during the same period. In direct efforts to deepen the foreign exchange market and stabilize the financial markets generally, a number of policy instruments were deployed since the last MPC meeting, including an increase in the benchmark interest rate. Complementary administrative measures were also taken towards achieving this goal, among which was the directive to IMTOs to sell forex directly to Bureau de Change Operators, in order to improve liquidity in that segment of the foreign exchange market. While challenges remained, the Committee expressed optimism that

with the crystallization of current policy measures, noticeable improvements should be observed in the financial markets.

The Committee's Considerations

The Committee acknowledged the weak macroeconomic performance and the challenges confronting the economy, but noted that the MPC had consistently called attention to the implications of the absence of robust fiscal policy to complement monetary policy in the past. The Committee also assessed the impact of its decision to tighten the stance of monetary policy by raising the MPR in July 2016. At the time, the Committee understood the complexity of the challenges facing the economy and

the difficulty of arriving at an optimal policy mix to address rising inflation and economic contraction, simultaneously. The Committee also recognized that monetary policy had been substantially burdened since 2009 and had been stretched. The Committee noted that new capital flows into the economy, approximately US\$1 billion, had come in since July, while month-on-month inflation has declined continuously since May 2016. Against this background, members reemphasized the need to prioritize the use of monetary policy instruments in dealing essentially with stability issues around key prices (consumer prices and exchange rate) as prerequisites for growth.

The MPC noted that stagflation is indeed a very difficult economic condition with no quick fixes: having been imposed by supply shocks as well as fiscal and current account (twin) deficits. Consequently, the policy framework must be reengineered urgently to provide a lever for reversing the negative growth trend. While the imperative for ensuring financial system stability remains, the MPC reiterated the fact that monetary policy alone cannot move the economy out of stagflation.

The MPC considered the numerous analysis and calls for rates reduction but came to the conclusion that the greatest challenge to the economy today remains incomplete fiscal reforms which raise costs, risks and

uncertainty. The calls came mainly from the believe that reducing interest rates will spur credit growth, not only in the private sector but also by the public sector, which will help provide liquidity to stimulate consumption and investment spending. The Committee was of the view that in the past, the MPC had cut rates to achieve the above objectives; but found that rather than deploy the available liquidity to provide credit to agriculture and manufacturing sectors, the rate cuts provided opportunities for lending to traders who deployed the same liquidity in putting pressure on the foreign exchange market which had limited supply, thus pushing up the exchange rate.

With respect to providing opportunity to the public sector to borrow at lower rates to boost consumption and investment spending, the Committee agreed that while it was expected to stimulate growth through aggressive spending, doing so without corresponding efforts to boost industrial output by taking actions to deepen foreign exchange supply for raw materials will not help reduce unemployment nor would it boost industrial capacities. The Committee was also of the view that consumer demand for goods which will be boosted through increased spending may indeed be chasing too few goods which may further exacerbate the already heightened inflationary conditions. The urgency of a monetary-fiscal policy retreat along with

trade and budgetary policy, to design a comprehensive intervention mechanism is long overdue.

The Bank has since 2009 expanded its balance sheet to bail out the financial system and support growth initiatives in the economy. While stimulating economic growth and creating a congenial investment climate always is and remains essentially the realm of fiscal policy; monetary policy in all cases only comes in to support sound fiscal policy. Nevertheless, the Bank has and shall continue to deploy its development finance interventions to complement the overall effort of fiscal policy towards reinvigorating the economy. The interest rate decisions of the Bank are, therefore,

anchored on sound judgment, fundamentals and compelling arguments for such policy interventions.

The Committee also feels that there was the need to continue to encourage the inflow of foreign capital into the economy by continuing to put in place incentives to gain the confidence of players in this segment of the foreign exchange market. Consequently the Committee considers that loosening monetary policy now is not advisable as real interest rates are negative, pressure exists on the foreign exchange market while inflation is trending upwards.

The Committee noted the positive response of the deposit money banks (DMBs) to the Bank's call for increased credit to the private sector between July and

August. As the growth in the monetary aggregates spiked above their provisional benchmarks, headline inflation continued its upward trajectory in August 2016, and now close to twice the size of the upper limit of the policy reference band. Supply side factors including energy and utility prices, transportation and input costs, have continued to add to consumer price pressures. Members emphasized that improved fiscal activities, especially, the active implementation of the 2016 Federal Budget, and payment of salaries by states and local governments, will go a long way in contributing to economic recovery. In the same direction, the Committee urged the fiscal authorities to

consider tax incentives as a stimulus on both supply and demand sides of economic activities

Outlook

The data available to the Committee and forecasts of key variables suggest that the outlook for inflation in the medium term appears benign. First, month-on-month inflation has since May 2016 turned the curve; second, harvests have started to kick-in for most agricultural produce and should contribute to dampening consumer prices in the months ahead; and third, the current stance of monetary policy is expected to continue to help lock-in expectations of inflation which, has started to improve with the gradual return of stability in the foreign exchange market. In this light,

the MPC believes that as inflows improve, the naira exchange rate should further stabilize. Overall, the major pressure points remain the challenges in the oil sector (production and prices), output contraction, and other financial system vulnerabilities as well as foreign exchange shortage.

The Committee's Decisions

The Committee assessed the relevant risks, and concluded that the economy continues to face elevated risks on both price and output fronts. However, given its primary mandate and considering the limitations of its instruments with respect to output, the Committee elected to retain the current stance of

policy. Conscious of the need to allow this and other measures like the foreign exchange market reforms to work through fully, the Committee decided to retain all the monetary policy instruments at their current levels.

In summary, all 10 MPC members voted to:

- (i) Retain the MPR at 14.00 per cent;
 - (ii) Retain the CRR at 22.5 per cent;
 - (iii) Retain the Liquidity Ratio at 30.00 per cent;
- and
- (iv) Retain the Asymmetric Window at +200 and -500 basis points around the MPR

Thank you for listening.

Godwin I. Emefiele

Governor, Central Bank of Nigeria

20th September 2016