



**Central Bank of Nigeria Communique No 107 of the Monetary
Policy Committee Meeting of Monday and Tuesday 23rd and 24th
May 2016**

The Monetary Policy Committee met on 23rd and 24th May 2016 against a backdrop of challenging global and domestic economic and financial conditions. The Committee assessed the global and domestic macroeconomic and financial developments, the short-to medium-term prospects for the domestic economy and the outlook for the rest of the year. In attendance were 9 out of the 12 members.

International Economic Developments

The Committee noted with concern, the tapered growth and continued decline in global output since 2014. At an estimated 3.2 per cent, global output in 2016 was only 0.1 percentage point below the 3.1 per cent in the corresponding period of 2015. The sluggish global output was traced to weak fundamentals in both the advanced economies and Emerging Markets and Developing

Economies (EMDEs), including increased volatility in global financial markets, sustained softness in commodity prices, sluggish global trade, resulting in persistent fragility, particularly in the EMDEs.

The United States (US) economy slowed to 0.5 per cent in Q1 2016, a steep decline compared with the 1.4 per cent growth recorded in the last quarter of 2015. The deceleration in US growth was attributed to contraction in non-residential fixed investment and energy businesses, a strong dollar which harmed exports, slowdown in government spending and moderation in private consumption expenditure (PCE). Japan which is currently in deflation is projected to grow by 0.5 per cent in 2016, the same as in 2015, on the back of persistently weak aggregate demand. The Bank of Japan's (BoJ) monthly asset purchase of ¥6.7 trillion (US\$61.73 billion) resulted in the Bank holding about one-third of outstanding government bonds, while the economy remained largely intractable with a credit crunch, indicating that the programme may have lost its steam. In response to the contraction in credit, BoJ since January 2016, adopted a negative interest rate policy.

Real GDP growth in the Euro area at 0.6 per cent in Q1, 2016 was a phenomenal improvement compared with the 0.3 per cent achieved in Q4 2015. The European Central Bank (ECB), at its meeting of 21st April, 2016 maintained the soft policy stance by holding its refinancing rate at 0.0 per cent, lending rate at 0.25 per cent and deposit rate at -0.4 per cent. The Bank also maintained its monthly asset purchase program of €80 billion (US\$87.2 billion), hoping to further stimulate output growth and achieve its 2 per cent inflation target.

The Bank of England (BoE) also retained its monthly assets purchase programme, financed through the issuance of reserves at £375 billion (US\$543.75 billion). At the end of its April 13, 2016 meeting, BoE retained its policy rate at 0.5 per cent, with a commitment to raise inflation to its 2.0 per cent long run path.

Weaknesses in major EMDEs, including low capital inflows, rising costs of funds and continuing geopolitical factors, have been identified as key constraints to growth. Adverse commodity prices continued to provide strong headwinds against growth, defining other economic and financial conditions in the EMDEs. Consequently, the IMF (WEO April 2016 Update) downgraded the

2016 growth forecast for this group of countries from 4.3 to 4.1 per cent.

Disruptions to oil supply in Canada, Nigeria and Kuwait and demand spikes following expectations of a US interest rate hike and build-up of crude oil inventories, contributed to mild oil price recovery in April 2016. Inflation remains largely suppressed in the advanced countries but tepid consumption spending and vulnerabilities in the financial markets continue to hamper financial intermediation and growth. Consequently, the monetary policy stance in most advanced economies remained largely accommodative and most likely to be maintained throughout 2016. On the contrary, monetary policy in the EMDEs could continue to diverge substantially, reflecting the diversity of shocks confronting them.

Domestic Economic and Financial Developments

Output

In the first quarter of 2016, the economy suffered from severe shocks related to energy shortages and price hikes, scarcity of foreign exchange and depressed consumer demand, among

others. Consequently economic agents could not undertake new investments or procure needed raw materials. Shortage of foreign exchange arising from low crude oil prices manifested in low replacement levels for raw materials, other inputs as well as new investments. In addition, the energy crisis experienced in the first five months of the year, resulted in increased power outages and higher electricity tariffs, as well as fuel shortages; which led to factory closures in some cases. The prolonged budget impasse denied the economy the timely intervention of complementary fiscal policy to stimulate economic activity in the face of dwindling foreign capital inflows. Aggregate credit to the private sector remained highly tapered while credit to government grew beyond the programmed benchmark for the period. The Committee, however, noted that many of the prevailing conditions in the economy during the review period were outside the direct control of monetary policy, but hopes that the implementation of the 2016 Federal Budget, supported by relevant sectoral policies and easing supply shocks in energy and critical inputs, would provide the needed boost to the economy.

Against this backdrop, data from the National Bureau of Statistics (NBS) for May 2016, indicated that domestic output in Q1, 2016 contracted by 0.36 per cent, the first negative growth in many years. This represents a drop of 2.47 percentage points in output from the 2.11 per cent reported in the last quarter of 2015, and 4.32 percentage point lower than the 3.96 per cent recorded in the corresponding period of 2015. Aggregate output contracted in almost all sectors of the economy, with the non-oil sector declining by about 0.18 per cent in Q1 2016, compared with 3.14 per cent expansion in the preceding quarter. Only agriculture and trade grew by 0.68 per cent and 0.40 per cent, respectively, while Industry, Construction and Services recorded negative growth of -0.93, -0.26 and -0.08 percentage point, respectively.

Prices

The Committee noted a further increase in year-on-year headline inflation to 12.77 per cent and 13.72 percent in March and April 2016, respectively, from 11.38 per cent in February 2016. The increase in headline inflation in April reflected increases in both food and core components of inflation. Core inflation rose sharply for the third time in a row to 13.35 per cent in April from 12.17 per

cent in March, 11.00 per cent in February and 8.80 per cent in January having stayed at 8.70 per cent for three consecutive months through December, 2015. Food inflation also rose to 13.19 per cent from 12.74 per cent in March, 11.35 per cent in February, 10.64 per cent in January and 10.59 per cent in December, 2015. The rising inflationary pressure continued to be traced to legacy factors including energy crisis reflected in incessant scarcity of refined petroleum products, exchange rate pass through from imported goods, high cost of electricity, high transport cost, reduction in food output, high cost of inputs and low industrial output. The Committee observed that in an economy characterized by high import dependence, the shortage of foreign exchange provided some basis for price increases as currently being experienced. The Committee noted that the economy needed to aggressively earn and build up its stock of foreign reserves in order to avoid distortions when faced with severe shocks. The Committee further noted that the current inflation trend, being largely a product of structural rigidities and inadequate foreign exchange earnings would continue to be closely monitored, and in coordination with fiscal policy, with a

view to addressing the underlying drivers of the upward price movements.

Monetary, Credit and Financial Markets Developments

Broad money supply (M2) grew by 3.49 per cent in April 2016, a 1.29 percentage growth from the March level of 2.20 per cent and compared with the 3.67 per cent in April 2015. When annualized, M2 grew by 10.47 per cent in April 2016 against the provisional growth benchmark of 10.98 per cent for 2016. Net domestic credit (NDC) grew by 7.87 per cent in the same period and annualized at 23.61 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 significant growth in credit to government of 35.97 per cent in the month, annualized to 107.91 per cent. Credit to the private sector grew by 3.52 per cent in April 2016, which annualized to a growth of 10.56 per cent, below the benchmark growth of 13.28 per cent.

The Committee observed with concern, the continuous dismal performance of growth in credit to the private sector, noting that in spite of the Bank's efforts, DMBs continued to direct credit

largely to low employment elastic sectors of the economy, a phenomenon that had significantly contributed to the low performance of the economy. Money market interest rates reflected the continuing liquidity surfeit in the banking system. Average inter-bank call rate, which stood at 4.50 per cent on 21st March 2016, closed at 8.67 per cent on March 18, 2016. Between March 25th and 14th April 2016, interbank call rate averaged 2.00 per cent. The Committee noted a decline in activity in the inter-bank market in the period under review, which was due to the payment of FAAC statutory allocations and the maturity of CBN securities.

The Committee also noted a further improvement in the equities segment of the capital market as the All-Share Index (ASI) rose by 3.34 per cent from 25,899.91 on March 24, 2016 to 26,763.86 on May 18, 2016. Similarly, Market Capitalization (MC) rose by 3.14 per cent from N8.91 trillion to N9.19 trillion during the same period. However, relative to end-December 2015, the indices declined by 6.56 per cent and 6.70 per cent, respectively. Globally, however, the equities markets were generally bearish.

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 197.00/US\$ and closed at N197.00/US\$, with a daily average of N197/US\$ between March 25 and May 13, 2016. The Committee, therefore, remains committed to its mandate of maintaining a stable naira exchange rate. The MPC noted the level of activity in the autonomous foreign exchange market especially, following the deregulation of the downstream petroleum sector with attendant increased demand in the interbank market, thus further exerting pressure on the naira.

The Committee recalls that over the last two consecutive meetings, it had signalled the imperative of reform of the foreign exchange market. In the intervening period, the Committee interrogated the issues around the current foreign exchange market regime, tracing them to the low foreign exchange earnings of the economy. Consequently, in the Committee's opinion, the key issue remains how to increase the supply of foreign exchange to the economy. The Committee observed that

while the Bank has been working on a menu of options to ensure increased supply of foreign exchange, there was no easy and quick fix to the foreign exchange scarcity problem as supply remained essentially a function of exports and the investment climate.

The Committee is aware that a dynamic foreign exchange management framework that guarantees flexibility could not replace the imperative for the economy to increase its stock of foreign exchange through enhanced export earnings. Consequently, such a structure must evolve to provide basis for radically improved investment climate to attract new investments. The Committee recognizes the exchange rate as a very important macroeconomic variable, which must be earned by increased productive activity and exports, noting with satisfaction that the Bank had made very significant and satisfactory progress with the reforms framework.

The Committee was of the view that the current adverse global and domestic economic and financial conditions and the imperative imposed by the demand and supply shocks to the domestic economy and considering the express intensions of

Government as enunciated in the 2016 budget, policy must respond appropriately as the market continues to demonstrate confidence in the Bank's ability to deliver a credible foreign exchange market. Accordingly, the MPC decided that the Bank should embrace some level of flexibility in the foreign exchange market. Given the imperative for growth, the Management of the Bank has been given the mandate to work out the modalities for achieving the desired flexibility that is in the overall interest of the Nigerian economy and when the implementation of the new framework would begin.

The Committee's Considerations

The Committee acknowledged the severely weakened macroeconomic environment, as reflected particularly in increased inflationary pressure, contraction in real output and rising unemployment. The Committee recalls that in July 2015, it had hinted on the possibility of the economy falling into recession unless appropriate complementary measures were taken by the monetary and fiscal authorities. Unfortunately the delayed passage of the 2016 budget constrained the much desired fiscal stimulus, thus edging the economy towards contractionary output.

As a stop-gap measure, the Central Bank continued to deploy all the instruments within its control in the hope of keeping the economy afloat. The actions, however, proved insufficient to fully avert the impending economic contraction. With some of the conditions that led to the contraction in Q1, 2016 still largely unresolved, the weak outlook for growth which was signaled in July 2015 could extend to Q2. To this effect, today's policy actions have to be predicated on a less optimistic outlook for the economy in the short term, given that, even after the delayed budgetary passage in May 2016, the initial monetary injection approved by the Federal Government may not impact the economy soon, as the processes involved in MDAs finalizing procurement contracts before the disbursement of funds may further delay the much needed financial stimulus to restart growth.

The Committee noted that the CBN had implemented accommodative monetary policy from July 2015, with the hope of achieving growth, up until March 2016, when the MPC switched into a tightening mode. However, while the underlying conditions necessitating tight monetary policy remained largely in place, sundry administrative measures implemented by the Bank and

recent macroeconomic conditions on the back of the 2016 Budget are expected to significantly dictate a key policy preference in the dilemma now faced by monetary policy - stagflation. Given the current limited policy space, it is imperative to balance stability with growth stance while working on options that in the short term, are certain to isolate seasonal and transient factors fuelling the current price spiral.

Other than credit to government, growth in all monetary aggregates remained largely below their indicative benchmarks, yet; headline inflation spiked in April 2016, far above the upper limit of the policy reference band. Inflation has continued to be driven mainly by supply side factors such as fuel scarcity, increase in tariff and deterioration in electricity supply, increase in the price of petrol, higher input costs as a result of scarcity of foreign exchange, persistent security challenges and exchange rate pass-through to domestic prices of import. While the Committee believed that the recent deregulation of the downstream sector of the petroleum sector was in the right direction and would lead to increased supply, the pass-through effect of prices to other products has to be factored in policy considerations. Mindful of

the limitations of monetary policy in influencing structural imbalances in the economy, the Committee stressed the need for policy coordination with the fiscal authorities in order to effectively address the identified pressure points.

The Committee noted that the continued excess liquidity in the banking system was responsible for the low level of activity in the interbank market. This is in addition to contributing to the sustained pressure in the foreign exchange market. The Committee expressed hope that efficient implementation of the recently passed 2016 Federal Budget, especially; the capital expenditure portion, would help invigorate growth in the economy as business confidence rejuvenates.

The Committee expressed concern over sustained pressure in the foreign exchange market and the necessity of implementing reforms to engender greater flexibility of rate and transparency in the operation of the inter-bank foreign exchange market. Accordingly, the Committee noted that it was time to introduce greater flexibility in the management of the foreign exchange market. The Committee reaffirmed commitment towards maintenance of price stability and reiterated the need to

reappraise the coordination mechanism between monetary and fiscal policy and initiate reforms, for the purpose of more efficient policy synchronization and management.

The Committee's Decisions

The Committee, in its assessment of the relevant risk profiles, came to the conclusion that although, the balance of risks remains tilted against growth; previous decisions need time to crystalize. Consequently, in a period of stagflation, the policy options are very limited. To avoid complicating the conditions, the Committee decided on the least risky option to hold. The foreign exchange market framework, now ready, the MPC voted unanimously to adopt greater flexibility in exchange rate policy to restore the automatic adjustment properties of the exchange rate. Consequently, all 9 members voted to hold and introduce greater flexibility in managing the foreign exchange rate. The Bank would however, retain a small window for funding critical transactions. Details of operation of the market would be released by the Bank at an appropriate time.

In summary, the MPC voted to:

- i. Retain the MPR at 12.00 per cent;
- ii. Retain the CRR at 22.50 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
- v. Introduce greater flexibility in the inter-bank foreign exchange market structure and to retain a small window for critical transactions.

Thank you for listening.

Godwin I. Emefiele

Governor, Central Bank of Nigeria

24th May 2016

PERSONAL STATEMENT BY THE MONETARY POLICY COMMITTEE MEMBERS

1.0 ADELABU, ADEBAYO

The macroeconomic condition has remained challenging since the beginning of the year with the performance of key variables pointing to increasing fragility of the domestic economy. The condition appears a little bit more complicated to the monetary authority because the weakness is intensified from the end of both price and output, heightening the risk of dilemma in policy choices. Acceleration in headline inflation, which was significant throughout fiscal 2015 is not yet moderated with the provisional estimate for April 2016 in the neighbourhood of 14 percent. This is clearly above the acceptable threshold for sustained expansion in economic activities. Furthermore, the softness in output growth, which commenced in the latter half of 2014, has eventually entered a negative territory with the estimated GDP for 2016Q1 being -0.36 percent, raising the probability of a recession in the near future. The precarious condition is further threatened by significant headwinds like the lingering pressure on domestic currency due to low accretion to external reserves, suppression of

aggregate demand on account of default in salaries payments by many sub-national governments, and adverse income shock like the recent upward adjustment in fuel price and electricity tariffs.

From the conventional policy view point, the signal is less cloudy; with headline inflation at about 14 percent and policy rate at 13 percent, it means the effective policy rate is -1.0 percent which is equivalent to an expansionary monetary policy in the face of rising inflationary pressure. Thus, the way forward, from conventional rationale, should logically include an upward adjustment in nominal policy rate. However, from the evolving paradigm in macroeconomic management, which I strongly subscribe to, the issue is not as that straight forward. The policy rate was increased by 100 basis points at the last meeting, though a step in the right direction, but inflation pressure still appears strong. This, among others, points to the appropriateness of engaging in wholesale assessment of our macroeconomic policy principles. A key challenge to policy at this period arises from the fact that the underlying drivers of the current macroeconomic outcomes are not confined to economic factors alone given that

a number of non-economic factors are equally at play. Thus, in as much as the relevance of the conventional approach is not in contention, I am of the view that our response to the unfolding developments should be carefully weighed and hinged on the delicate peculiarities of our economy.

My thoughts on the critical thrust of monetary policy which I have shared a couple of times in my previous statements are not only still current but their validity appears to have been reinforced by the prevailing conditions. A major thrust of our macroeconomic policy should be a coordinated structural and monetary policies to remove the lingering bottlenecks in the production environment which have always been constraining the efficacy of monetary policy. A quick diagnosis of inflationary development shows that both core and food components experienced considerable uptick. On year-on-year basis, farm produce increased by 6.75 percent in March 2016 while transport also increased by 0.88 percent during the period. The implication is that the underlying driver of rising price trend is not much of a monetary factor but structural issue like increase in fuel price and agricultural production shortfall. Thus, further tightening through

interest rate may not really address the underlying issue but rather exacerbate the depression in aggregate demand which is already under threat from non-payment of salaries by some state governments.

Perhaps more disturbing is that while global energy price is plummeting, fuel price in the domestic economy is rising as a result of the impact of the sliding value of domestic currency on importation. It therefore shows that the enduring solution lies in structural policy that would expand domestic supply of refined petroleum products to meet domestic demand. It is against this background that I would re-emphasize the need for the relevant agencies of government like the Central Bank, Ministry of Petroleum Resources, Ministry of Finance, and other government institutions to work together with a view to enhancing domestic production of refined petroleum products to meet domestic needs.

Again, the driver of core inflation is basically imported items. For instance, imported food inflation increased by 16.33 percent in March 2016 on year-on-year basis. This occurred at a time global inflation was easing, suggesting that the rising price of imported

items has much to do with the sliding value of the domestic currency. The naira has been kept at an average rate of N197/US\$ in the official market since last year but economic agents have been referencing the parallel market rate, which is above the official rate by almost 100 percent, in quoting transactions. The behavior of economic agents, even those that access the official market, seems logical in view of the many constraints in the official market. The challenge in the official foreign exchange market could have been exacerbated by the demand side but the well-known underlying cause is from the supply side. The likelihood of an improvement in supply in near to medium term is highly diminished given that the driving force is permanent negative term of trade shock. Apart from the effect of term of trade shocks on current account, available statistics show that the advanced countries' currencies particularly the US dollar has appreciated against emerging countries' currencies since the latter part of 2015 on the backlash of the commencement of monetary tightening by the US Federal Reserves.

The point here is that the current exchange rate framework is not compatible with the realities from the dynamic operating

environment. It is therefore imperative to review the current framework to a model that permits a great deal of flexibility to accommodate shocks from the external environment. Such a model has an advantage of providing forward market guidance, discovering the equilibrium rate, eliminating speculative trading and arbitrage and consequently anchor inflation expectation robustly. One of the major concerns, however, is the usual negative political sentiment associated with the initial downward adjustment of a market determined exchange rate. My view is that such initial downward slide in the exchange rate is not altogether a political liability. Such market determined rate has the inbuilt benefits of raising budget revenue from monetization of oil proceeds and consequently reduce fiscal deficits as well as probably stimulating aggregate demand.

A major non-economic issue which has elicited extensive attention-albeit contentious response- in public discourse is the harsh production environment. It is commendable that the Federal Government is making appreciable progress in the fight against insurgency in the north-eastern part of the country which invariably would enhance economic activities of the region and

by extension, the whole country. The gains of such effort however may be more than offset by the resurgence of another round of militancy in the Niger delta areas. The political and economic dimensions of the activities of the new militants have been comprehensively highlighted but the economic implications could be amplified by the fact that the softening oil prices may make most of the marginal oil fields commercially unviable if the cost of operation rises above certain threshold. As such, the likelihood of permanent shut down of such oil fields may not be ruled out with dire implication for Oil GDP which has been sliding for a fairly long time. It is against this that a robust security arrangement for the protection of vital oil and gas installations become an essential component of our near to medium term macroeconomic policies blueprint.

In the light of the foregoing, I propose that the subsisting monetary policy measures be retained. Specifically, the MPR and the CRR be retained at 12 and 22.5 percent, respectively. In addition, the exchange rate framework should be revisited to allow a flexible model that could permit the exchange rate to accommodate shock rather than passing such shocks to the external reserves.

2.0 ALADE, SARAH O.

While the medium-term outlook remains favourable for the Nigerian economy, in the short-term, there are risks of further deterioration in the global environment and a persistently lower oil price that put substantial pressure on the fiscal and external accounts, resulting in severely depleted buffers which have an adverse effect on the economy. For the first time in many years, the Nigerian economy witnessed negative growth due primarily to severe shocks related to energy shortages and price hikes, scarcity of foreign exchange that have affected both prices and availability of products as new investments are stalled. As a result, headline inflation accelerated to 13.7 percent in April up from 12.7 percent recorded in March, the highest since December 2012. The growth for 2016 has been further downgraded and the prognosis for the rest of the year is not too bright. These mixed developments have put monetary policy at a precarious situation and calls for a delicate balanced and caution in managing both development in the domestic environment. This is in the face of increased inflationary pressure and declining growth. Based on the

above, I support a hold on all variables and some flexibility in exchange rate while we understand the direction of the economy and effect of the budget passage.

Headline inflation continued an upward trajectory accentuated by severe fuel shock and scarce foreign exchange supply. Headline inflation reached 13.7 percent in April 2016, from 12.77 percent recorded in March. Core inflation rose sharply for the third consecutive months to 13.35 per cent in April from 12.17 per cent in March. Food inflation on the other hand, increased to 13.19 percent recorded in January, while food inflation rose to 13.19 from 12.74 recorded in March and 10.64 percent in the February. The rise in inflation is attributable to a number of factors including scarcity of refined petroleum products, increase in the price of the product, the pass-through effect of exchange rate, higher transportation cost as a result of inadequate fuel supply and seasonal effect. In addition, the increase in energy tariff also affected the cost of goods and services and contributed to increase in inflation. The persistent

upsurge in inflation in a normal situation would have necessitated increase in policy rate; however in the midst of negative growth and some structural rigidity in the economy, increasing rate at this time will be counterproductive. Thus, in the short to medium term monetary policy must ensure that the economic engine is not grinded to a halt and should be focused at resuscitating growth. Also, the factors that contributed to the inflation are structural and one time effect and should be monitored before monetary policy reacts to their effect.

Depressed consumer demand is effecting Gross Domestic Product (GDP) growth negatively. The just released first quarter GDP numbers showed that the economy suffered severe shock leading to a negative GDP growth of -.36 percent. Low oil price and the negative impact on government revenue and lower foreign exchange earning pose downside risk for domestic GDP growth in 2016 as growth for the year is projected to be subdued. Shortage of foreign exchange arising from low crude oil prices has

affected new investment and replacement of raw materials for existing plants. In addition, shortages in fuel product and pipeline vandalism resulted in prolonged power outages and higher electricity tariff which lead to factory closures in some cases. In the midst of these events, fiscal policy was not at hand to complement the efforts of monetary policy as the prolonged budget impasse denied the economy the timely intervention needed to stimulate economic activity. These developments suggest that both global events and domestic risks pose huge challenge to growth in the coming months. In addition, the non-payment of salaries by most state government is also depressing consumer expenditure and impacting growth. Policies should be coordinated and complementary to help the country weather the current storm. In addition, efforts at economic diversification should be intensified to diversify the revenue base of the country and consideration should be given to improving tax administration and increase in VAT rate.

The current foreign exchange regime should be reviewed to ensure continuation of economic activities. Reduced inflow as a result of low oil prices is making foreign exchange scarce in the country. While the Central Bank is making all efforts to meet all legitimate foreign exchange demand, more should be done to ensure that economic activities are not grounded. I support the review of current foreign exchange management framework in the country to ensure continuation of economic activities. Policies that will encourage inflows and increase supply of foreign exchange to meet import demand should be encouraged and implemented. The lack of flexibility in the interbank foreign exchange market is fuelling capital outflow and currency weaknesses outside the interbank market. These developments are having a dampening effect on growth and driving inflation. At this time, monetary policy should be focused on restoring confidence in the domestic economy and increasing supply of foreign exchange to attract inflows.

Against this background, I vote for a hold on Monetary Policy Rate at 12 per cent, Private Sector Cash Reserve Requirement (CRR) at 22.5 per cent, and greater flexibility in the management of exchange rate to resuscitate the economy.

3.0 BALAMI, DAHIRU HASSAN

Weak global growth continues to linger, posing a challenge to the implementation of the 2030 Agenda for Sustainable Development. At global level growth was estimated at 3.2 percent down from 3.4 percent for the year 2016. Growth was expected to be driven generally by accommodative monetary policy particularly in the advanced economies. There is also the possibility of deflation pressure in Europe and Japan partly due to falling oil and other commodity prices as argued in my last personnel statement. At the global level some of the constraints include the following: likelihood of Britain's exit from the EU, ongoing slowdown in China, strengthening of the Japanese yen, persistent weak oil and other commodities prices, continued divergence of Monetary policy between US and other major economies, the growing use

of negative interest rate by central banks to stimulate the flow of credits to the real economy, the continuous strengthening of the US dollar against other currencies all of which have implications on the Nigerian economy.

The domestic economy has witnessed a negative growth rate of -0.36 percent, the worst recorded ever in Nigeria. The low level of growth is not unconnected with some of the constraints affecting the Economy, partly from the global level and some domestic. These include falling price of crude oil at the international market. Even though oil price has moved up to \$50.00 per barrel from \$40.00, the activities of the militants in the Niger Delta region has seriously affected and is still affecting the level of the Nigerian capacity to produce, the depreciation of the Naira at the black market and the non-availability of it at the official window of the CBN and DMB'S, low level of electricity supply, and high cost of borrowing particularly the wide gap between the lending rate and the deposits rate etc. On the whole the output in the industrial sectors declined slightly to N3,175.45 billion in Q1 of 2016 in real terms when compared with N3,340.48, Output of the service sector of the economy also declined to N5,984.39 in Q1

2016. The negative growth of 0.18 was partly driven by manufacturing in Q1 2016. The level of unemployment in the economy has risen to 12 percent and inflation rate of 13.8 percent which falls out of the 6-9 percent Bank band. The economy is currently facing stagflation, a situation of rising unemployment and inflation. This is dangerous for the economy. However, the current inflation is not a monetary phenomenon but a cost push inflation due to rise in electricity tariffs, fuel scarcity and the rise in PMS price between N135-N145.00 per litre, transportation cost and imported food items etc.

The NBS shows that the Nigerian economy had two consecutive declines in GDP growth rate for the months of April and May. If the economy goes into recession, going by Keynesian postulation it would require both fiscal and monetary policy stance to move the economy forward. In depression period we require expansionary fiscal and monetary policy. The fiscal side is expected to raise government expenditure and lower down the tax rate to stimulate growth. On the Monetary side it is expected to reduce the interest rate and expand money supply in the economy. During the period of recession, there is low level of consumption of goods

and services (aggregate demand) due to low level of citizens' purchasing power. Stock prices would slump and investors would be wary of such an economy. The solution to the problem of depression is to promote production and stimulate consumption in the economy. To promote growth of output, agriculture which is the bedrock of the economy and the manufacturing sector need to be attended to. For example, what are the challenges of these two sectors of the economy? How do we rebuild the manufacturing as well as the agricultural sectors of the economy? What are the demand and the supply gaps in the foreign exchange market of the economy?

The financial sector stability stress test shows low level of resilience in the banking sector. The financial sector soundness shows that the Capital Adequacy Ratio (CAR) has fallen from 17.66 in the month of March to 16.52 percent, non-performing loans has risen from 5.10 to 10.6, the liquidity ratio has fallen from 48.63 percent to 46.3 percent in April 2016. The Return on Equity (ROE) has deteriorated from 18.07 to 16.37. The Return on Asset (ROA) has also nose-dived from 2.37 to 2.17 in 2016. The total operating costs to gross income declined from 74.18 percent to 69.24 percent. It

can be seen that the level of liquidity in the economy is a source of concern because the DMB's are not lending to the preferred sectors of the economy. There is also the problem of loan concentration particularly among the big seven obligors. However, it should be noted that too much money in the hands of consumers will lead to demand pull inflation. Although inflation rate stands at 23.7 percent, normal Economics requires that interest rates should be above inflation rate to stimulate savings and investments in the economy.

On the foreign exchange market, continued pressure on the foreign exchange reserve is without much visible economic results to the productive sectors of the economy. The foreign exchange rate has been stable since January to date at the official window - N197/N199 to the dollar. However, the black market rate has fluctuated between N320.00 - N365.00 to the dollar. The gap between the interbank window and the black market is too wide leading to incentives for the following: (i) round tripping, (ii) rent seeking, (iii) speculative demand and inefficient use of scarce foreign exchange by economic agents. It is my opinion that there is a need for a framework for the allocation of scarce foreign

exchange to the stakeholders. Such a framework should be transparent to reduce levels of abuse if any.

The current structure of the Nigerian economy suggests we hold to enable earlier policies work out. What do we intend to achieve by voting to hold? It is expected to help resolve the inflation, unemployment and growth problems. However this could be achieved through collaboration between monetary and fiscal authority to pursue a plan that will act as a guide to overcome the current problem of stagflation and possible depression in 2016.

In-line with the above I vote to hold:

- (i) Retain MPC at 12 percent.
- (ii) Retain CAR at 22.5 percent.
- (iii) Retain liquidity ratio at 30 percent
- (iv) Retain the symmetric corridor from +200/_500.
- (v) Liberalization of the foreign exchange market,
- (vi) Collaboration between fiscal and monetary policy.

4.0 BARAU, SULEIMAN

This is surely a defining moment in our economic history with the latest data confirming the contraction of GDP in Q1 of 2016, the first time since 2004. The fragility in the macroeconomic space is further complicated by strong inflationary and exchange rate pressure. Monetary policy, therefore, is at a crossroad as there are compelling arguments for accommodative policy stance in as much as tightening appears to be a desirable path. Monetary easing is appealing to halt the imminent slide into recession by bolstering aggregate demand which has been subdued by income shock from such factors like default in payment of salaries by many state governments, upward adjustment of petroleum products prices, and higher electricity tariffs. On the other hand, elevated price level, rising trade imbalances, and unprecedented pressure on the domestic currency are issues for consideration. A most worrisome dimension is the ascendancy of non-economic factors in the current episode of macroeconomic downturn.

Though the issues call for conflicting solutions, I opt for retention of existing tight measures of monetary policy, largely informed by the

need to rein-in inflation expectation. Other considerations include building sufficient safeguard against the perennial disruptive liquidity surfeit in the banking system as well as reducing incentives for speculative trading in the foreign exchange market. It is not in doubt that the decision might be accompanied by trade-off in the short run, notably the likelihood of accentuation of the output gap, but my view is that, given the prevailing global and domestic challenges including structural rigidities, any other option remains a sub-optimal choice.

Issues/Pressure Points

Global

Prolonged Slow Recovery in the Global Economy: Recovery in the global economy since 2014 is not only at a slow pace but it has remained fragile. There are ample evidences to substantiate renewed episode of global asset market volatility and reduction in momentum of growth in key advanced economies, heightening fear that the possibility of recession is not completely averted. The IMF has twice downgraded its 2016 projection of global growth with the latest one at 3.2 percent, a downward adjustment of 0.2

and 0.4 basis points from the October 2015 and January 2016's projection, respectively. In as much as the frequent downward revision is a serious issue but of grave concern are the underlying currents which are not limited to economic factors as non-economic factors are becoming highly pronounced. Economic factors such as monetary tightening in the US, financial market volatility in the Euro zone and fiscal consolidation in a number of systematically important economies would continue to weigh on global growth, even into 2017. China for example, is currently passing through a phase of critical but complex transformation of growth process to a consumption and services driven model. Although the long run beneficial effect of such transformation would not be limited to China alone as the externalities would rub on global trade, the initial hiccups would definitely constitute a drag on global output in the near term. Apart from economic issues, non-economic factors such as uncertainty about the forthcoming (June 2016) referendum in the United Kingdom with regard to its continuous membership of the European Union, uncertainty regarding the direction of US economic and foreign policies in the aftermath of the forthcoming general elections,

rising geo-political strains including the extremism and sectarian strife, unprecedented upsurge in the inflow of illegal migrants to the EU, climate change with the attendant flooding and drought are all potential headwinds in global economic activities.

Domestic

Macroeconomic Environment: Key macroeconomic indicators have never been highly stressed as currently witnessed in a period of over a decade. The softness in GDP which commenced in the last quarter of 2014 has finally snowballed into contraction with data showing a GDP growth of -0.36 percent in Q1 of 2016. Headline inflation at 13.72 percent in April 2016 is clearly above the threshold conducive for meaningful economic activities. Thus, the economy is now confronted with the conundrum of negative growth in the face of rising price level. It is a welcome development that the 2016 Federal Government budget has been finally signed to law and implementation commenced with the recent release of N350 billion for capital projects. The development is expected to address the physical infrastructural deficit as part of the overall strategy of tackling the structural constraints. However, the impact on fixed capital formation and

by extension the GDP may take quite a while, thus the performance of GDP could still be below the long run trend.

Exchange Rate Pressure: The naira has been under intense pressure since the latter half of 2014 for the well-known reason of negative term of trade shock through the slump in crude oil price at a time of liquidity surfeit. Up to this period as well as foreseeable future, the softness in the price of crude oil has shown no signs of abating. To complicate the precarious condition of the domestic currency is the global financial condition. The rebound in asset prices and ECB monetary stimulus notwithstanding, financial condition has assumed a tightening mode in the US and even some emerging economies. This, invariably would accentuate capital outflows and exacerbate depreciation in domestic currency. The stress on Naira may show further increase with the recent payment of about N42 billion subsidy claim to independent oil marketers who may need to source foreign exchange at the interbank market. In other words, the already elevated demand pressure in the foreign exchange market may be further heightened. Another round of exchange rate depreciation would not only have inflation effect but it would equally worsen

corporate balance sheet with implication for employment and growth.

Upward Adjustment in Fuel Prices: One of the key drivers of core inflation since the beginning of the year is transportation cost on the heel of the acute fuel scarcity in various parts of the country. A simple trend analysis of transport component of headline inflation shows that it has consistently trended up from 0.67 percent in January 2016, reaching 0.88 percent by April 2016, 0.21 basis point increase during the period. With the recent upward adjustment in petroleum product prices, further uptick albeit not of the same magnitude should be expected in transportation cost. In addition, the development is likely going to filter into inflation expectation with attendant impact on contract and wage setting. In essence, the prospect of near term deceleration in current elevated price level appears significantly diminished.

Agitations by the Organized Labor: Following the recent upward adjustment in pump prices of petroleum products, the organized labor has continued to issue threat of mass protest, something similar to 2012 episodes of massive production shutdown. If the situation is not well managed, the attendant loss of man-hours

would definitely exacerbate the already faltered growth path. Besides, another dimension of the protest would be in the form of demand for upward adjustment in wages, with the likely implication of retrenchment or further upward review in prices.

Renewed wave of Militant's Activities in the Niger Delta: It is commendable that the Federal Government is making significant progress on war against insurgency in the North Eastern part of the country as this would naturally restore economic activities in the zone and add to growth. However, the overall economic gain to the entire country's business climate is heading for a setback with the resurgence of militant activities in the Niger Delta area. Recently released information confirmed the destruction of Escravos and Forcados pipelines which supply gas to major power stations in the country. This development has both direct and indirect consequences on the GDP. On the direct effect, oil prospecting and drilling in the area would slow down and directly reduce oil GDP. Indirectly, electricity generation would nose dive with dire consequence on production outfits.

Way Forward/Recommendation

Given that the underlying causes of the current fragile economic conditions transcend monetary factors, the way forward calls for multi-pronged approach of structural, fiscal, and monetary policies. Some of the measures should be geared towards the following objectives;

Build and Sustain Confidence in the Macroeconomic Environment:

The need to build the confidence of economic agents in the macroeconomic environment cannot be more critical at any other period than now. Among other issues, stemming the inflation tide is imperative. Current inflationary pressure is from both the core and food components, reinforcing the call for robust policy response. Available statistics (growth in monetary aggregates) shows that aggregate demand is not a key driver of current inflationary pressure, indeed, there appears to be a suppression of aggregate demand. As such, I would like to keep the Monetary Policy Rate (MPR) at the subsisting level. Major components of core inflation that have experienced significant uptick in price level on year-on-year basis included imported food inflation which increased from 11.22 to 16.33 percent between January and April

2016. This is at a time when global inflation is on the downward trend, suggesting that a key driver is the depreciation of the domestic currency. Managing expectation in terms of exchange rate stability is therefore crucial to prevent the destructive self-reinforcing inflationary phenomenon. The interbank rate should be properly managed and thus the issue of excess liquidity cannot be tolerated at this period, as such the CRR should be appropriately used. Besides, the exchange rate should also be allowed to reflect basic economic fundamental like supply and demand factors in order to prevent undue speculation. As such I would like to canvass for some flexibility in the exchange rate in line basic fundamentals in order to effectively manage expectation and reduce speculation in the market.

Concrete Programme for Expanding Refineries Capacity: The recurring fuel scarcities, reduction cum removal of subsidy have been a thorny issue in the management of the economy for decades. Recently released statistics show that the existing refineries could only meet 40 percent of total domestic consumption if all of them are operating at full capacity. This, invariably suggests continuous reliance on importation to meet

domestic needs. With the current slow accretion to external reserves, this is definitely an unsustainable model but the development also offers the right opportunities for complete deregulation. Subsidy is unsustainable given the huge fiscal deficit. As such concrete efforts should continue to lay the foundation of sustainable economic prosperity by expanding the refineries through private investment.

Adequate Security Measures around Oil and Gas Facilities: It is most disturbing that revenue from oil is not dwindling on account of softness in price alone but shortfall in production is becoming a greater threat. Average crude oil production in April 2016 was about 1.64 million bpd compared to about 1.86 million bpd Q2 of 2015. Besides, between March and April 2016, there was an average production shortfall of 0.056 million bpd. The crude oil production benchmark in the 2016 Federal Government budget is 2.2 million bpd. This statistics clearly shows that if the trend continues, the planned budgetary revenue is at a risk. This new trend calls for serious concern because unlike in the previous episodes of militancy activities, the current price of crude oil prices has reduced the incentives for oil prospecting and drilling. The

prevailing price regime has reduced the bottom lines of the oil companies with the implication that any phenomenon that jerks up the cost of operation such as unfriendly production environment could make them operate below viability level and consequently leads to total shut down of operations. Consequently government would need to scale up security around oil and gas facilities in the country.

Decisions

Given that non-economic factors have played significant role in the prevailing economic challenges, it is expedient that we continue to call for the structural issues highlighted earlier to be addressed. With respect to monetary policy, maintaining stability in macroeconomic environment is germane, thus I would like to keep monetary condition tight by maintaining all the existing measures of monetary policy. Specifically, MPR and CRR at 12 and 22.5 percent, respectively, while the asymmetric corridor around the MPR remains at +200/-500 basis points.

5.0 GARBA, ABDUL-GANIYU

Context

My attention focused on four core issues at the March 2016 MPC meeting: (i) the urgent need for rigorous, critical, mandate focused and evidence based diagnostics; (ii) dangers of quick-fix measures because of the their damaging long term effects; (iii) the growth of the public debt stock and their crowding-out effects on fiscal operations and constraints to effective monetary policy and (iv) the urgent need to harness, direct and put to effective use the best available intellectual and political resources to engage the fiscal authorities to develop a forward looking strategic macroeconomic management framework for Nigeria" for the medium to the long term effectiveness of macroeconomic management compatible with the long term wellbeing of Nigerians." The four issues remained the core of my concerns at the May 2016 MPC meeting. Indeed in my view, they have become more urgent.

The excellent reports by Bank Staff and the growth, expenditure, employment and inflation data of the National Bureau of Statistics (NBS) and the PMI (Purchasing Manager's Index) all point to an

even more challenging time for Nigerian macroeconomic management in May than when MPC last met in March. The conditions for fiscal operations, monetary policy and other associated policies could hardly be more challenging. Governments, real businesses and households have to deal with stagnation and inflation co-existing amidst rising inequality and poverty.

What we know about stagflation (coexistence of stagnation and inflation) is from the experience of the 1970s and the research that sought to explain it. We know for instance, that the use of traditional demand management tools worsened the two problems in the United States and that the negative effects spilled-over to the rest of the world. We also know that Volcker's cure –disinflation policy through monetary contraction was very costly for the United States and for the global economy: it triggered global recession of 1982 and unemployment levels not seen since the Great Depression. The global recession was transmitted to Nigeria and many developing countries through negative commodity price shocks, exchange rate pressures, debt overhang and macroeconomic instability. The debt overhang

though triggered by Volcker's cure on interests rates on sovereign and commercial debts, was caused by strategic failures inherent in decades of fiscal policy. We now know that it took Nigeria almost a quarter of a century to exit the debt trap at costs (financial and opportunity) that have not been fully evaluated.

We now know from the global experience of the 1970s and the 1980s that there is no quick-fix for the problem of stagflation. Also, that every option has heavy costs that have long lasting impacts. Stagflation like cancer is a problem that is better prevented than cured. Unlike the stagflation of the 1970s and 1980s, the current situation is complicated by the hysteresis of the costs of past policy conflicts; the domestic and external vulnerabilities of the economy and the negative growth of key components of aggregate demand (capital accumulation and private consumption) and by supply shocks due to rising energy costs, declining value of the Naira and shortages of forex and PMS. Indeed, the inflationary pressures have been moderated by at least three factors: (i) the negative budget effects of the cost push inflation on fixed income earners; (ii) the non-payment of salaries and pensions by many state governments and many local government councils and (iii)

the negative wealth effects of the collapse of the capital market bubbles. Traditional monetary policy is no match for stagflation in a situation with the type of initial conditions in Nigeria today. Disinflation policies will be ineffective to reduce prices which are being driven primarily by self-inflicted supply shocks. On the other hand, with the Naira losing value and with financial institutions unwilling to pass on the benefits of lower interest rates to borrowers, increasing the supply of Naira will not reduce pressure on the Naira or lower interest rates to agents with the most employment and output elasticities. In addition, in the malfunctioning credit market where-in credit is concentrated by obligors and by sectors and interest rate spread is rising, small and medium scale enterprises and real sector operators with high employment and growth elasticities are squeezed out by the preference of financial institutions for a limited set of big ticket obligors and relatively highest risk sectors.

The cross-cutting causes of the stagflation demands analytical breadth, depth and clarity well beyond the typical requirements for monetary policy because the networks of cause-effect relations that produce stagflation extend far beyond the domain

and reach of monetary policy. It is a potentially disastrous error to expect and to demand that monetary policy carries the economy either through traditional instruments or in combination with expansions in its balance sheet. It should be common sense to expect that two hands will more easily carry a heavy load than one hand. Even Usain Bolt would lose a 100 dash were he to choose to hop on one leg or two discordant legs while his rivals run on two coordinated legs. That is why in my last personal statement I used the example of the US to argue that even the largest economy would not remain in its position were it to handicap its macroeconomic management.

I have consistently argued for “the urgent need to harness, direct and put to effective use the best available intellectual and political resources to engage the fiscal authorities to develop a forward looking strategic macroeconomic management framework for Nigeria” for the medium to the long term effectiveness of macroeconomic management compatible with the long term wellbeing of Nigerians.” Unfortunately, the longer the *recognition, consensus* and *action* lags by the relevant actors

in the macroeconomic policy space, the higher will be the economic and welfare costs in all runs.

Decision

My vote is to hold. This means I vote to keep CRR at 22.5%; increase MPR at 12%; Asymmetric Corridor of -5 (SDF), +2 (SLF) and liquidity ratio at 30%.

I have no doubts that monetary policy is at its limits and that piecemeal policy in a global economic system characterised by interests driven networks is dangerous. Monetary policy in the last six years has been relatively more effective in achieving price stability but at avoidably high sacrifice ratios (due mainly to a lack of coordination between key macro and prudential authorities and policies). To pursue price stability as Volcker did, given, the already high sacrifice ratios; will be counterproductive hence, ill advised. Yet, holding does not address the stagnation problem: declining growth and rising unemployment none of which started in the first quarter of 2016! This is why a *mandate guided* strategic, coordinated and forward looking macroeconomic and prudential

plan developed jointly by monetary and fiscal authorities is **urgently** needed.

At the risk of repeating myself in each MPC personal statement, my vote is; for changing the strategic character of Nigeria's macroeconomic and prudential management. To want yet, do nothing, is not to have: **nothing concrete can be produced out of nothing!**

6.0 SALAMI, ADEDOYIN

At the conclusion of this meeting, I voted with my colleagues to retain the status quo with respect to monetary policy parameters – Monetary Policy Rate (MPR), Corridor around MPR, Liquidity Ratio (LR) and Cash Reserve Ratio (CRR). In my view changing any of these parameters would not deal with any of the issues confronting our economy.

Data in the run-up to the meeting confirmed a worsening of the economic environment. A combination of shrinking economic activity and sharply rising inflation, the Nigerian economy was in a very difficult position. Aggregate output growth, estimated by the

National Bureau of Statistics (NBS) at – 0.34percent in Q1-2016, simply confirmed what had been anecdotal evidence of a challenging situation. Rising inflation – the Overall Consumer Price Index (CPI) recorded by the NBS at 13.72percent in April – worsens the 'wind chill' impact of contracting output.

Unsurprisingly, the unemployment situation also continues to deteriorate – rising to 12.1percent at end Q1-2016. This is almost double the 6.4percent in Q4-2014. With underemployment adding a further 19.1percent, the challenge to the social cohesiveness of our nation becomes obvious. From a monetary policy perspective, the figure for non-performing loans as a ratio of total Banking System lending – which provides a sense of threats to financial system – is my biggest concern. At 10.06percent in April 2016, the NPL Ratio has risen from 4.88percent at year-end 2015 and is double the policy threshold. Having continuously drawn attention to the challenge of ensuring financial system stability I hope that the data provided truly captures the complete situation!!

Given the foregoing, the context for and the nature of policy choices will be framed by the answer provided to the questions below –

- Given rising prices, what to do about our primary mandate of price management?
- What can monetary policy do to reverse or at least prevent economic activity from continuing to shrink?
- How does the obvious worsening of Financial System Stability parameters affect the set of available choices?

With respect to prices, I am clear that inflation is not a monetary phenomenon and requires no monetary policy response! Analysis provided by the NBS is unequivocal that inflation is essentially a reflection of costs increasing as a result of supply side pressures. Rising energy costs – both power and fuel – have combined to raise inflationary pressure. If eventually Nigeria is to sustainably resolve her energy challenges, the move towards cost reflective electricity tariffs is inevitable. Similarly, the incomplete deregulation of fuel prices cannot also be avoided. I would hope

that the process of completely deregulating the downstream fuel sector would be completed in the near future.

Notwithstanding official non-recognition of the parallel market, difficulty of access to FOREX at the 'official window' and uncertainty about the framework for exchange rate management have combined to see the adoption of the parallel market exchange rate as the basis for pricing. It is thus not surprising that the rising cost of imported inputs contributes to rising inflation. Noting that informal estimates indicate that household consumption spending and investment spending by firms contracted by almost 1.5percent and 3percent respectively in Q1-2016, it is clear that negative demand side shocks have moderated the extent of rising prices. The foregoing thus rules out the response of raising interest rates to dampen demand. As I suggest above and re-emphasize, it is not about demand. Furthermore, raising interest rates, by reducing investment, will worsen supply side pressures already facing the economy.

Having ruled out an interest rate response to rising prices, what to do with respect to output contraction? In the normal course of events, negative output growth, as recorded in Q1-2016, would warrant considering monetary easing, to reduce the cost of borrowing and thus stimulate investment. These however, are not normal circumstances. Notwithstanding bank liquidity, at 46.3percent, remaining at relatively high levels, the appetite for lending is greatly diminished in the face of very sharp rise in non-performing loans - now officially recognized. Diminution in the appetite for lending is demonstrated by figures that show growth in gross credit, adjusted for inflation, shrank by almost 14percent in the year since April 2015. Lenders are, unsurprisingly, pre-occupied with measures to manage and reduce the vulnerabilities of their risk asset portfolio. Lower rates unlikely to ease access to credit.

Beyond credit, a reduction in the MPR will further worsen the current policy misalignment. As I have argued before now, the policy response to falling commodity prices has resulted in an unsustainable policy mix that combines twin deficits (fiscal and current account) with a fixed exchange rate. In this context,

reducing MPR will worsen the inconsistencies. At the most basic level, with MPR now below the rate of inflation, inflation-adjusted rates are already negative. The adverse implications of negative 'real' rates for 'financialisation' and investment in productive assets are obvious. Any reduction in the policy rate worsens this position. In addition, negative real rates will encourage asset substitution against the Naira thus put further pressure on exchange rates.

In my view, the decision of MPC to approve movement from the fixed exchange rate regime that has occasioned great harm to our economy is a necessary first step towards restoring *credibility, cohesion and internal consistency* to policy. Even as we wait for Bank Management to determine the operational details of the 'new' regime, its implications for rebuilding confidence in the economy and its management cannot be understated.

It is clear to me that flexibility in exchange rate management will weaken the Naira. This weakness will doubtless have beneficial fiscal impact. At the Federal level, depending on the definition of

flexibility, the new regime **may address** the concerns of multilateral lenders on which financing at least half the deficit in the Federal Government's budget enactment depends. For the States and Local Governments, a weaker exchange rate **may provide** additional financial resources that ease the constraint, which has resulted in accumulation of Civil Servant salary arrears.

In light of the above, I joined colleagues in voting to hold all monetary policy parameters unchanged whilst approving that Bank Management abandon the present fixed exchange rate regime and allow greater flexibility in the determination of exchange rate.

7.0 UCHE, CHIBUIKE U

The present precarious state of the Nigerian economy has clearly exposed the limitations of monetary policy. With inflation in double digit territory and still rising, the era of positive interest rates has now become an illusion. This has grave implications for the development of both our industrial sector and banking system. It is for instance not surprising that the stability of our banking system is increasingly being threatened and that our country's industrial productivity is now on the decline. Statistics available to MPC

show that the Nigerian economy now has few obstacles on its way to slipping into a recession.

Tightening monetary policy at the current stage will however hurt both the banks and the country's industrial development. There is also no clear evidence that this will materially stem the inflation that is now trending upwards with no visible sign of being contained. Given the import dependent nature of our economy and the rapid depreciation of the Naira in the parallel market, the official exchange rate of the Naira which has for a long time hovered around \$1 to N199.00 is increasingly becoming meaningless. In my view, it is obvious that market prices in Nigeria are now determined by the parallel market exchange rates for the Naira.

The implication of the above is that the arbitrage opportunities being created by the widening gap between the parallel market and official exchange rates of the Naira are simply being exploited for personal gains. Such corrupt practices can only further undermine the integrity of our foreign exchange rate management system. The recent repricing of petroleum prices based on an artificial exchange rate that is above the official

exchange rate further makes nonsense of the current insistence on an overvalued official exchange rate. Also, our diminishing foreign reserves can only fuel speculation about the future of the Naira thus further depreciating the value of the currency.

Since the formulation and implementation of exchange rate policies are by law within the jurisdiction of the CBN Board of Directors, I strongly recommend that the CBN management should rethink its exchange rate determination mechanism in order to bring it closer to market realities. It is also important that the entire exchange rate management and allocation process should be made more transparent.

It is however important to make it explicit that the above recommendation will in no way provide the magic wand for solving the complex economic problems of Nigeria. At the root of this entire economic crisis lies the inability of the country to diversify its economy away from its dependence on oil rents. The falling oil prices and the current challenges in the oil producing areas of the country have clearly exposed the thoughtlessness of our perennial overdependence on oil rents.

While monetary policy can assist in getting the country out of its current economic malaise, the buck clearly lies with the fiscal authorities. Although the current war against corruption and the implementation of the Treasury Single Account have been bold steps in the right direction, very little progress has been made with respect to diversifying our economy away from its dependence on oil rents. Admittedly, doing this would not be easy especially given the fact that valuable oil rents were wasted in the past four decades to the detriment of the infrastructural development of the country. The consequence is that all the key infrastructural facilities that support economic development which among others include: education, transportation, electricity and security are all in tatters.

Given the cost dynamics of our currently limited national income, the need to restructure our over bloated, and some would say, corrupt and inept civil service is now urgent. A situation where more than half of our national budget is spent on maintaining the civil service is unacceptable and unsustainable. The current spate of borrowings by both the states and the federal government is also unsustainable. Loans and 'investments' that cannot

demonstrate a clear path for generating future income streams for their retirement should be discouraged. Perhaps the most ridiculous of these kinds of fiscal recklessness in the current widespread borrowing by state governments to pay civil service salaries and the continued unfettered access speculative foreign portfolio flows have to the Nigerian economy. One sometimes wonders where the income streams that would be used to repay such loans would come from in the future.

I hereby conclude by reiterating the fact that given our present troubling economic realities, I am not convinced that our conventional monetary policy tools can provide us much room for manoeuvre at the present time. I will however strongly recommend that the Central Bank should come up with a more realistic exchange rate for the Naira. As it stands now, the parallel exchange rate for the Naira has already been imputed into market prices in Nigeria. The current insistence on maintaining the current official exchange rate of the Naira is therefore not beneficial to either the Nigerian government or the Nigerian people. Further delay in the above direction can only help to further fuel speculation and exacerbate the depreciation pressure

on the Naira. It is however important to reemphasize that without the diversification of the economy, any relief the repricing of the Naira would bring can only be temporary.

Aside from the above recommendations, I hereby vote as follows with respect to the use of our conventional monetary policy tools:(i) to retain the MPR at 12.00 per cent; (ii) to retain the CRR at 22.50 per cent; (iii) to retain the Liquidity Ratio at 30.00 per cent; and (iv) to retain the Asymmetric Window at +200 and -500 basis points around the MPR.

8.0 YAHAYA, SHEHU

The Global Economy

Little has changed in the global economy since the last MPC. There is some slowing down in the growth rate of China; Growth rates in the US during the first quarter of the year are lower than in Q1; unemployment rose slightly and price levels dipped a little-making it unlikely that the Fed will raise rates imminently. UK growth is slightly lower than expected. Growth picked up a bit in the Eurozone, unemployment was flat, while prices were in negative territory. Venezuela, an oil producing economy suffering

from the effects of the fallen oil prices, is experiencing a sharp contraction in GDP of 10%, alongside hyperinflation (140%), a negative real interest rate, rising unemployment and surging debt. This is a demonstration of the serious challenges that oil-producing countries can suffer if the right response to price falls are not well managed.

One important development relates to the modest recovery in oil prices, with Brent spot prices at around \$47 per barrel. It is not clear though, whether this upward trend can be maintained, given the rising global output and the excess supply. Apart from oil, most other global prices are fairly stable

The domestic economy

The Nigerian economy is currently confronted with significant challenges. GDP contracted by 0.36% in Q1 2016. Crude petroleum, manufacturing, construction all experienced a decline. The agricultural sector experienced a positive growth rate, particularly crop production and livestock, but not enough to completely counteract the decline in the other sectors. Unemployment also rose to 12.1%.

This is coming at a time when headline inflation for April, year on year, has also shot up to 13.72 compared to 12.77 in March, which was itself a high. Price increases were driven by both food (farm produce and processed food) and core (largely fuel and electricity costs). Given the substantial reduction in oil and gas output due to the terrorist activities, which is preventing the country from taking advantage of the current upswing in oil prices, as well as the repercussions on electricity, it looks highly likely that GDP will fall again in the next quarter and plunge the country into a deflation. Prices are also likely to remain elevated in the near future. External reserves have fallen by about 2% in the last month.

The financial system remains strong, with DMBs generally above prudential guidelines with respect to capital adequacy and liquidity. Return on equity and on assets is also adequate. Nevertheless, in response to the current economic environment, they are experiencing an upward trend in NPLs and some challenges with respect to profitability. Value and number of new credits are also falling.

One of the major challenges facing the economy is the exchange rate issue. Net forex flows have been negative for the year so far; foreign reserves have been falling. While the official exchange rate has been stable, *par force*, the Naira exchange rate at the unofficial market has been under considerable pressure. There is evidence of significant unmet demand for foreign exchange which has an obvious effect on manufacturing output, among others. There is also strong pressure for rent seeking behavior by those with access to forex at the official rate. The need to address this problem squarely is becoming more urgent. It is continuing to have an unsettling effect on both the commodity and capital markets.

Conclusion and Vote

The combination of negative growth rates and inflationary pressures obviously complicates policy making, especially when there is a strong likelihood that these trends will continue in the near future. Nevertheless, it seems fairly clear that the rise in prices is mainly due to cost push factors as earlier indicated. Tighter monetary policy is therefore unlikely to stem the inflationary pressures at this time. Whereas, such an approach is more likely to

have a further dampening effect on growth, with more serious economic and political consequences. It is also likely to complicate the challenges facing the financial sector, especially the DMBs

As far as the Naira exchange rate is concerned, there is clearly a strong case for introducing greater flexibility, within the context of a medium development strategy. Nevertheless, it must be emphasized that such flexibility must be carefully managed, considering the extant circumstances of declining net forex flows and foreign reserves and must be well aligned with fiscal measures in order to avoid excessive pressure on the value of the Naira.

I therefore vote to retain the current monetary stance with respect to the MPR, the corridor, CRR and liquidity ratio.

**9.0 EMEFIELE, I. GODWIN, GOVERNOR OF THE CENTRAL
BANK OF NIGERIA AND CHAIRMAN, MONETARY
POLICY COMMITTEE**

The fragile performance of the global economic which protracted throughout 2015 prevailed into 2016 as outlook and growth prospects continued to dim. Consequently, forecast of world output growth for 2016 was downgraded by 0.2 percentage point from 3.4 percent in the January 2016 vintage of the IMF World Economic Outlook to 3.2 percent in the April release. With this, medium-term global outlook remains cautiously modest especially vis-à-vis the 2015 growth of 3.1 percent. The tepid global growth continued to reflect weakening demand, rising uncertainties (due to both economic and non-economic factors), immanent volatilities in the global financial markets, and enormous vulnerabilities especially among key emerging markets and developing economies.

Growth prospects in advance economies have also weakened, *albeit* differentially, resulting in a 0.2 percentage point downgrade of 2016 growth forecast to 1.9 percent same as the 2015 outcome. This unexpected fragility is due to weakening

fundamentals. In the US, economic recovery remained cautious as growth slowed to 0.5 percent 2016Q1 from 1.4 percent in 2015Q4 reflecting the effect of slowing exports and contracting domestic demand. As a result, the forecast for 2016 has been reduced from 2.6 percent to 2.4 percent. In the euro, modest rebound is expected to continue in the near-term as strengthening domestic demand outstrips weakening exports. Though growth doubled to 0.6 percent in 2016Q1 from 0.3 percent in 2015Q4, the forecast for 2016 was revised downward by 0.2 percentage point to 1.5 percent which is lower than the 1.6 percent recorded in 2015.

Protracted fragile global economy and relentless waves of economic and financial uncertainties are having toxic effects on the growth prospects of most commodity exporting emerging markets and developing countries – with the exception of China and some emerging Asian countries which seem relatively impervious to the prevailing global shocks. Consequently, average 2016 growth forecast for emerging markets and developing economies was revised downward by 0.2 percentage points, in the April 2016 vintage of the IMF WEO, to

4.1 percent; a marginal increase from the 4.0 percent growth recorded in 2015. The poor outlook in these countries is underpinned by falling commodity and energy prices, capital flow reversals, financial markets fragilities, fiscal imbalances and weak global trade. For the sub-Saharan, economic activities and prospects is less than expected due largely to the same factors. Declining output growth, rising inflation, weakening currency and mounting unemployment remain a uniform feature in these countries which is complicated by a tapering near-term outlook.

In Nigeria, recent data from the National Bureau of Statistics shows that economic activities tightened in 2016Q1 as the domestic economy grew by -0.36 percent. This is significantly less than the 2.1 percent recorded in 2015Q4 and the 4.0 percent growth rate in the corresponding quarter of 2015. Analysis indicates that the outcome was due to contractions in both the oil and non-oil sectors which grew by -1.89 percent and -0.18 percent, respectively; with the non-oil sector contributing about 89.7 percent to aggregate GDP. The contraction suffered during the quarter was due essentially to severe and adverse shocks in the energy sector as price hikes and poor availability basically

fettered the consumption of power and fuel in the country. The effect of the energy crisis on the economy was enflamed by low crude oil prices, ebbing net capital flows, foreign exchange scarcity, weak domestic demand and plunging domestic investments. The uncertainty surrounding the belated ratification of the 2016 budget also affected private sector investment decisions detrimentally and further harmed the already fragile supply capacity of the economy. I note that while the shocks to the economy had a bit of demand elements, they were principally structural and supply-sided; hence, beyond the immediate jurisdiction of monetary policy.

Consumer Price Index Report of the NBS for April 2016 indicated a sustained rise in the year-on-year rate of domestic inflation. From a rate of 9.6 percent in January, inflation, which at 11.4 percent breached the single-digit frontier in February, remained double-digit in March and April at 12.8 percent and 13.7 percent, respectively. A breakdown of the inflation dynamics indicates that the underlying pressure derives largely from the lingering effects of unfavourable energy prices and exchange rate pass-through, which was aggravated by debilitated harvests (due to

devastating blights that affected some farm produce) and other structural misalignments that underpin domestic supply constraints. Accordingly, both the food and the core components of inflation rose, respectively, from 12.7 percent and 12.2 percent in March to 13.2 percent and 13.4 percent in April. I note that the drivers of the current inflationary are broadly structural and supply-side factors. Nonetheless, the monetary policy committee remains committed to deploying all tools within its armoury to check the long-run trend of future inflation.

On monetary and credit conditions, available data indicated that broad money supply (M2) grew by 3.5 percent in April 2016 vis-à-vis the December 2015 level. This implied an annualized growth rate of 10.5 percent compared with the provisional growth benchmark of 10.9 percent set for 2016. Over the same period, net domestic credit (NDC) grew by 7.9 percent; an annualized growth of 23.6 percent. At this rate, the annualized growth rate of NDC exceeded the provisional benchmark of 17.9 percent for 2016. The development in NDC reflected the significant 35.9 percent expansion in credit to government during the month which implies an annualized growth of 107.9 percent.

Credit to the private sector, however, grew by 3.5 percent in April 2016, which at an annualized rate of 10.6 percent lagged behind the programmed target of 13.3 percent. I once again note that this austere outcome reflected the continued apathy of the banking system to adequately provide the essential lifeline to the core private sector to stimulate and re-inflate the economy.

In the money market, the chronic liquidity surfeit especially in the banking system translated to recurring low interest rates. The liquidity profile of the financial markets during the review period was escalated by the distribution of the FAAC allocation and the maturity of some securities, which consequently doused interbank transactions. Correspondingly, inter-bank call rate, which stood at 4.5 percent on 21 March 2016, recorded an average of 2.0 percent between 25 March and 14 April 2016. At the capital market, available data signalled a further rebound in equity transactions since the last MPC. Starting at 25,899.91 points on 24 March 2016, the All-Share Index of the Nigerian Stock Exchange rose by 3.3 percent to 26,763.86 points as at 18 May 2016. Over the same period, Market Capitalisation showed a 3.1 percent increase from ~~N~~8.9 trillion to ~~N~~9.2 trillion. In spite of this, the indices

shrank by 6.6 percent and 6.7 percent, respectively, relative to their values as at end-December 2015.

During the review period, the daily average exchange rate of the Naira to the US dollar at the interbank market remained steady around ₦197.00/US\$. The sustained firmness of the naira at the foreign exchange market is attributable to the CBN's effort at safeguarding the value of the domestic currency using a combination of alternative policy measures. In view of the prolonged demand pressure at the market in the face of thinning supply and its effect on our gross official reserves, I note the expediency of reforming the foreign exchange market to accommodate more flexibility in its dynamics. This has become imperative due to the elevated focus on autonomous and interbank foreign exchange transactions that heralded the deregulation of PMS pricing and the attendant extra pressure it puts forth on the exchange rate. The market reform is likewise necessary to boost foreign exchange supply and dampen the encumbrances on reserves. Available data on gross official reserves indicated a 4.6 percent decline in the 30-day moving

average position from US\$27.9 billion as at end-March 2016 to US\$26.6 billion on 20 May 2016.

In general, I note the sliding fortunes of the Nigerian economy as harsh impulses continue to batter the domestic economy. Year-to-date, the economy has been hit by extensive shockwaves particularly from the energy markets as the price of power and PMS soar while the availability remained constrained. The energy crisis resulting from the effects of widespread inadequacy of energy supply thinned economic activities severely in the first quarter and led to a contracting economic growth and rising inflation. This situation, which is reinforced by the fall in crude oil prices, further exposed the cracks in the structural fabric of the Nigerian economy. In addition to the problem of stagflation, we observed a concomitant prevalence of excess liquidity in the banking system, low credit to the productive private sector, surging exchange market pressure, inadequate foreign exchange supply, structural vulnerabilities and a constrained fiscal space.

The underlying cause of the current macroeconomic crisis is the fall in oil prices. Unfortunately, the continued apathy of banks to lend to the productive sector hindered the ability of the economy to absorb the resultant shocks. As I noted some time ago, recent MPC decisions have been mainly accommodative with the aim of supporting economic expansion. Though the level of banking system liquidity was accordingly grown, the impact is yet to reach the real private sector where it is mainly needed. Most of the released liquidity found its way into the foreign exchange market where speculative demand continued to be high amidst dwindling supply. As a result, the impact of the policy decision was muted while the unrelenting exchange market pressure buoyed spiralling inflation.

On the fundamental driver of inflation, data on macroeconomic conditions showed that money supply growth was congruent with programmed target, while aggregate demand was reducing. The fall in household spending, private investment, and public expenditure rationalize the declining domestic demand. Yet inflation is rising. Theoretically, inflation and output growth are expected to co-vary positively for conventional monetary policy

to be effective. A situation, as we have observed in Nigeria, where rising inflation is accompanied by declining growth is atypical. It connotes that the current inflationary pressure is neither a monetary phenomenon nor an aggregate demand phenomenon. Rather it is an aggregate supply phenomenon. Conventional monetary policy approaches may worsen rather than ease the problem if applied wrongly in this instance.

All these are of great concern to policy makers. At this point, however, I believe that the most critical and urgent concern should be to return the economy on the path of growth. I reiterate once again that the structural imbalances and the fundamental misalignment inherent in the Nigerian economy, which were manifested vividly in the recently released macroeconomic indicators, reflects the protracted weak aggregate supply problem and the disproportionate vulnerability of the economy to supply shocks. Nigeria needs to learn from the lessons of past episodes of low oil prices and the experiences of comparable emerging Asian countries that are performing exceptionally well at this time. We should see this as an opportunity to diversify the economy permanently. To this end,

the CBN will not relent in its efforts at supporting the broad diversification of the economy and the build-up of our domestic productive capacity. However, the Bank alone cannot do this. Traditional monetary policy is simply not equipped to deal with the kind of problem currently facing the Nigerian economy.

In this light, I warmly acknowledge the importance of the recently ratified 2016 fiscal budget in easing macroeconomic uncertainties that pervades our economy. I also note the significant weight accorded to capital expenditure in that budget. I am of the view that a judicious implementation of the budget would allay some of the infrastructural challenges which complicate the vulnerabilities of the Nigerian economy. I thus posit that overcoming the infrastructural problems as well as an effective industrial and trade policy would considerably correct much the misalignment seen in the Nigerian economy. I strongly believe that, in the medium term, this will not only boost productivity and domestic supply capacity to ensure that jobs and goods are in abundant supply it would also ease the exchange market pressure.

On its part, the CBN will sustain and strengthen its development finance efforts to ensure that affordable credits are directed to strategic and high impact real sector initiatives. In the near-term, it is essential to ensure that the effects of previous policies decision gradually permeate the system and also delay further policy shocks to avoid system seizures. However, the un-abating pressure in the foreign exchange market needs to be tamed permanently. I am aware of the widespread clamour for further devaluation of the Naira. While pricing may be an issue at the foreign exchange market, the bigger problem is that of supply shortages. We need to take actions that will boost foreign exchange supply and simultaneously eliminate speculative demand from the market. It is in this regard that the creation and adoption a more robust framework of exchange pricing and allocation becomes imperative.

Based on the foregoing, I vote to:

1. Retain the MPR at 12.0 percent;
2. Retain the CRR at 22.5 percent;
3. Retain the asymmetric corridor at +200/–500 basis points;

4. Retain Liquidity Ratio at 30 percent; and
5. Introduce a flexible inter-bank foreign exchange market structure and to retain a small window for critical transactions.

GODWIN I. EMEFIELE, CON

Governor

May 2016