



CENTRAL BANK OF NIGERIA COMMUNIQUÉ NO 115 OF THE MONETARY POLICY COMMITTEE MEETING OF 25th AND 26th SEPTEMBER, 2017

Background

The Monetary Policy Committee met on the 25th and 26th of September, 2017 against the backdrop of a relatively optimistic global economy. The Committee examined the global and domestic economic and financial environments up to the third quarter of 2017, and the outlook for the rest of the year. The recent spate of flooding and hurricanes in some parts of the globe; the flooding in Nigeria; the increasing tension between the US and North Korea, and the perception of hostilities on the Korean Peninsula as well as the associated geo-political tensions, were identified as key risks to global output growth.

On the domestic front, the economy exited recession (which began in the first quarter of 2016) in the second half of 2017, with a modest positive short to medium-term outlook, resulting largely from deliberate macroeconomic stimulus and a stable naira exchange rate. Inflation expectations also appeared anchored on the strength of prevailing tight monetary policy stance.

Seven (7) members of the MPC were present at the meeting.

External Developments

Global output is projected to improve further in 2017, as growth forecast by the IMF in its July World Economic Outlook (WEO) was projected at 3.5 per cent, up from 3.2 per cent in 2016. Output growth in some advanced economies, including Japan, the Euro-area as well as some emerging market and developing economies is expected to improve in 2017. Nigeria, Brazil and South Africa, all exited recession, while Russia is likely to exit recession in the fourth quarter of 2017, after a mild contraction of 0.57 per cent in the second quarter. Growth forecast for the US was revised downwards from 2.3 per cent to 2.1 per cent in 2017, as a result of the weak growth observed in the first quarter of the year.

The MPC, however, noted some headwinds confronting the optimistic global growth prospects to include: recent developments on the Korean peninsula; the damage to infrastructure caused by hurricanes - Harvey, Irma and Maria; the lull in BREXIT negotiations and the normalization of monetary policy by the US Fed, which is expected to instigate global capital flow reversal. Other challenges include the continued slow pace of recovery in global oil and other commodity prices and China's reduction in uptake of global commodities. In addition, the

Committee noted the tepid global inflation momentum, implying that continued monetary policy normalization could be injurious to global growth prospects.

The uptick in global inflation persisted, but moderated, in response to rising oil prices, continued accommodative monetary policy in the advanced economies; and currency appreciation in some emerging markets and developing countries. Average inflation for the developed economies is projected at 1.9 per cent in 2017, while it is forecast to average 4.5 per cent in the emerging and developing economies, as prices are expected to moderate due to seasonal effects. The Committee observed that the outlook for global monetary policy remains predominantly accommodative, in support of recovery and growth.

Domestic Output Developments

Data from the National Bureau of Statistics (NBS) showed that real Gross Domestic Product (GDP) grew by 0.55 per cent in the second quarter of 2017, against the contractions of 0.91 and 1.49 per cent in the previous quarter of 2017, and the corresponding quarter of 2016, respectively, marking the technical exit of the Nigerian economy from recession. Non-oil real GDP grew by 0.45 per cent in Q2, 2017, driven largely by agriculture (3.0%), industry (1.1%), and construction (0.1%). The modest growth was attributed to fiscal injections from the implementation of the Economic Recovery and Growth Plan (ERGP), and enhanced supply of

foreign exchange arising from improved crude oil prices. The Committee also noted the positive outlook from the Purchasing Managers Index (PMI) for manufacturing and non-manufacturing activities, which stood at 53.6 and 54.1 index points in August 2017, respectively, above the 50 index points benchmark, indicating moderate signs of recovery. The Committee further noted that, although the recovery was weak, it was hopeful that the active implementation of the 2017 budget could boost aggregate demand and employment.

Developments in Money and Prices

The Committee noted that money supply (M2) contracted by 11.06 per cent in August 2017 (annualised), in contrast to the provisional growth benchmark of 10.29 per cent for 2017. The development in M2 is largely due to the contraction of 18.42 per cent in other assets net (OAN) in August 2017. Similarly, M1 contracted by 12.25 per cent in August 2017, (annualised to -18.37 per cent). Net domestic credit (NDC) contracted by 0.14 per cent, annualized at -0.20 per cent, driven majorly by net credit to government, which also contracted by 1.05 per cent against the programmed growth of 33.12 per cent. Credit to the private sector, however, grew marginally by 0.07 per cent in August 2017, compared with the provisional benchmark of 14.88 per cent. The MPC also noted the policy constraints in ensuring the flow of credit to the real sector in the face of weak and underperforming monetary aggregates.

Inflationary pressure in the economy continued to moderate with headline inflation (year-on-year) receding for the seventh consecutive month to 16.01 per cent in August 2017, from 16.05 per cent in July 2017. Food inflation declined slightly to 20.25 per cent in August 2017 from 20.28 per cent in July 2017, while core inflation increased to 12.30 per cent in August 2017 from 12.21 per cent in July 2017. This development was attributed to the contraction in money supply, decline in imported food and non-food prices, favourable base effects, and the moderating effects of stable exchange rates. The Committee, however, noted that the high food inflation was traceable to rising prices of farm inputs and supply shortages, intermittent clashes between farmers and herdsmen, as well as weak harvest, due to increased flooding of farmlands.

Money market interest rates oscillated in tandem with the level of liquidity in the banking system as the average inter-bank call rate which opened at 18.00 per cent on July 26, 2017, closed at 7.00 per cent on August 31, 2017. The OBB rate opened at 15.03 per cent and closed lower at 7.83 per cent in the same period. However, the average inter-bank call and OBB rates for the period stood at 22.63 and 39.66 per cent, respectively. The movement in net liquidity positions and flows reflected the effects of OMO sales; foreign exchange interventions; statutory revenue payments to states and local governments; remittances by Nigerian Customs

and Federal Inland Revenue Services for FAAC meetings; and the maturity of CBN Bills.

The Committee noted the continuing improvement in the external reserves position and the equities segment of the capital market. External reserves position grew to US\$32.9 billion at close of business on 25th September, 2017 while the All-Share Index (ASI) rose by 7.20 per cent from 33,117.48 on June 30, 2017 to 35,504.62 on August 31, 2017. Market Capitalization (MC) improved by 6.90 per cent to N12.24 trillion from N11.45 trillion during the same period. Relative to end-December 2016, capital market indices rose by 32.10 and 32.30 per cent, respectively, reflecting growing investor confidence, due to improvements in foreign exchange management.

Total foreign exchange inflows through the Central Bank of Nigeria (CBN) rose by 1.98 per cent in August 2017, compared with the previous month. Similarly, total outflow increased by 7.03 per cent during the same period, as a result of increased international remittances, inclusive of public sector and JVC payments; which rose by 58.59 per cent in the period under review.

The Committee noted the trend towards convergence between the rates at the bureau-de-change (BDC) and the Nigeria Autonomous Foreign Exchange (NAFEX) segments, as well as the stability of the exchange rate at the inter-bank segment of the

foreign exchange market during the review period. Similarly, the Committee noted the success of the Investor and Exporters' window (I &E) of the foreign exchange market and traced this not only to foreign investor confidence but also to the zeal and commitment of Nigerian exporters who have demonstrated preference for the window to the parallel market. The Committee observed that the I&E window has increased liquidity and boosted confidence in the market with over US\$7.0 billion inflow in the last five months. The Committee will continue to introduce policies that will improve the confidence of foreign investors in the country's macroeconomic management regime.

2.0. Overall Outlook and Risks

Available data and forecast of key macroeconomic variables indicate a relatively positive outlook, predicated on existing policy initiatives including the ERGP. Other potential drivers of economic recovery are; the expected increase in government revenue arising from favourable crude oil prices, stable output, and general improvements in the non-oil sector, especially, agriculture, industry and construction. The intervention by the CBN in the real sector is expected to continue to yield positive results in terms of output and lower consumer prices.

The Committee, however, noted some downside risks to the overall short- to medium-term positive outlook for the economy. These include; flooding which displaced farming communities and

political agitations. On the external front, the hawkish policy stance in the United States, rising geo-political tensions and sluggish output recovery in the Euro-area and Japan, could slow-down the momentum of global output growth, with significant spillovers to emerging markets and developing countries, including Nigeria.

3.0. The Considerations of the Committee

The Committee applauded the exit of the Nigerian economy from recession but observed that the growth remains fragile and, therefore, hopes that complementary fiscal and monetary policies would sustain the growth momentum. The Committee further expressed satisfaction with the gradual, but consistent decline in inflation, noting, however, the substantial base effect in addition to the continuous improvement in the naira exchange rate across all segments of the foreign exchange market; and considerable improvement in foreign capital inflow. The Committee welcomed the steady implementation of the 2017 Budget, especially, the capital component of the budget, and urged increased momentum in expenditure directed at the growth-stimulating sectors of the economy in order to reduce youth unemployment and restiveness.

The Committee, however, expressed concern on the sustained pressure on food prices, noting risks posed by floods, strikes and insurgencies in various parts of the country to food production and

distribution. Regarding the tepid turnaround in economic activities in the second quarter of 2017, the Committee emphasized that the employment gains of recovery were still minimal, noting that a number of important job elastic sub-sectors were still weak and may require more fiscal support to regain traction. The Committee, however, commended the Federal Government for issuing the Executive Order aimed at improving the ease of doing business in the country. It also noted the efforts of the government to create jobs in the agricultural sector with the inauguration of the Presidential Committee on job creation, targeting at least ten thousand jobs in each state of the Federation, over the next six months through a boost in agricultural support and funding. The Committee enjoins the state governments to work with the Presidential Committee to actualise this plan without further delay.

The MPC also noted with satisfaction, the directive of the Federal Government to all states to promptly pay outstanding salary arrears, in order to boost aggregate demand. It commended efforts to clear outstanding contractor arrears; prompt settlement of trade disputes with certain Unions of organised labour, including the Academic Staff Union of Universities (ASUU) and Health Workers; as well as the release of money to settle outstanding entitlements of the erstwhile workers of the defunct Nigeria Airways. These efforts, the Committee reasoned would improve aggregate demand and strengthen the weak recovery.

The Committee restated its commitment to maintaining stability in prices, without which meaningful recovery cannot be achieved. In this regard, members welcomed the gradual narrowing of rate spreads in the foreign exchange market and urged the Bank to continue to monitor and respond proactively to threats and vulnerabilities in the foreign exchange market.

On the outlook for financial stability, the Committee noted that, in spite of the banking sub-sector's resilience, the weak macroeconomic environment has continued to impact negatively on the stability of the sub-sector. The Committee reiterated its call on the Bank to sustain its surveillance of deposit money banks (DMBs) activities for the purpose of prompt identification and mitigation of potential vulnerabilities. The Committee also called on the DMBs to support the quest to move the economy forward by extending reasonably low priced credit to the private sector.

4.0. The Committee's Decisions

In arriving at its decision, the Committee took note of the gains so far achieved as a result of its earlier decisions; including the stability in the foreign exchange market and the moderate reduction in inflation. The option was whether to hold, tighten or ease. These were subjected to extensive debate. As in previous meetings, although tightening would help rein in inflation expectations and strengthen the stability in the foreign exchange

market, the Committee felt that it would further widen the income gap, depress aggregate demand and adversely affect credit delivery to the private sector. The Committee also noted that tightening may result in the deposit money banks re-pricing their assets and loans, thus raising the cost of borrowing and therefore heightening the already weak investment climate and non-performing loans.

With respect to loosening, the Committee believed that although while it would make it more attractive for Nigerians to acquire assets at cheaper prices, thus increasing their net wealth, and therefore stimulate spending as confidence rises, it nevertheless, felt constrained that loosening at this time would exacerbate inflationary pressures and worsen the exchange rate and inflationary conditions. The Committee also felt that loosening will further pull the real rate deeper into negative territory as the gap between the nominal interest rate and inflation widens.

On the argument to hold, the Committee believes that the effects of fiscal policy actions towards stimulating the economy have begun to manifest as evident in the exit of the economy from the fifteen-month recession. Although still fragile, the fragility of the growth makes it imperative to allow more time to make appropriate complementary policy decisions to strengthen the recovery. Secondly, the Committee was of the view that economic activity would become clearer between now and the

first quarter of 2018, when growth is expected to have sufficiently strengthened and gains in receding inflation, very obvious. The most compelling argument for a hold was to achieve more clarity in the evolution of key macroeconomic indicators including budget implementation, economic recovery, exchange rate, inflation and employment generation.

In consideration of the headwinds confronting the domestic economy and the uncertainties in the global environment, the Committee decided by a vote of 6 to 1 to retain the Monetary Policy Rate (MPR) at 14.0 per cent alongside all other policy parameters. In arriving at this HOLD decision, the MPC commits to employing maximum flexibility to guide the economy on the path to optimal growth. Consequently, 6 members voted to retain the MPR and all other parameters at their current levels, while one member voted to lower the MPR to signal an ease to the current stance of tight monetary policy. However, overall, majority of the members expressed a strong commitment to policy flexibility that would allow the Committee to promptly take the necessary actions that would promote overall macroeconomic stability and engender sustainable growth.

In summary, the MPC voted to:

- (i) Retain the MPR at 14.0 per cent;
- (ii) Retain the CRR at 22.5 per cent;

- (iii) Retain the Liquidity Ratio at 30.0 per cent; and
- (iv) Retain the Asymmetric corridor at +200 and -500 basis points around the MPR.

Thank you for listening.

Godwin I. Emefiele

Governor, Central Bank of Nigeria

26th September, 2017