Central Bank of Nigeria Communiqué No. 95 of the Monetary Policy Committee Meeting of May 19 and 20, 2014

The Monetary Policy Committee (MPC) met on 19th and 20th May, 2014 against the backdrop of continuing modest recovery in the US economy, lingering fragile recovery in Europe, slowing output growth in the emerging market economies and possible risks to domestic price stability. In attendance were 9 members including Mr. Adebayo Adelabu, the new Deputy Governor, Financial System Stability. The Committee considered major developments in both the global and domestic economies up to May 2014, and the outlook for the rest of the year.

International Economic Developments

The Committee noted the prospects of improved global growth in 2014 predicated on expectations of sustained favorable developments in the US and the euro area. Driven by the recovery in the advanced economies, global growth strengthened in the second half of 2013, averaging 3.6 per cent from the 2.6 per cent recorded during the first half. In the United States, improved domestic demand continues to strengthen growth outlook. In Europe, a pickup in growth in the core states continued to compensate for the decline in most of the peripheral states even as debt, low inflation, financial fragmentation and unemployment persisted as threats to sustainable long term economic recovery in the region. Growth in the emerging markets and developing economies is projected to rise from 4.7 per cent in 2013 to 4.9 per cent in 2014. The effects of tighter financial conditions in these economies are expected to be moderated by improved external demand from the advanced economies.

Global inflation is generally expected to remain subdued in 2014 with sustained sizable negative output gaps in the advanced economies, weaker domestic demand in several emerging economies, and falling commodity prices. In the euro area and the United States, headline inflation at about 1.5 per cent is projected to remain below the long-term inflation expectations. Lower world commodity prices in U.S. dollar terms would help reduce price pressures, although in some economies, exchange rate depreciation continues to pose a threat to consumer price stability.

The Committee noted that monetary policy stance across the advanced economies could begin to diverge in 2014/15. In the United States, the Federal Open Market Committee (FOMC) rate is expected to increase, post-tapering, in 2015. On the contrary, markets continue to expect a prolonged period of low interest rates and supportive monetary policy in the euro area and Japan. In the emerging market economies, there has been a tightening of monetary and financial conditions since mid-2013, owing to the combined effect of spillovers from rising bond rates and better economic prospects in the advanced economies based on the markets' reassessment of medium-term growth prospects. The risks posed to the emerging economies by capital reversals in the post-tapering era remain a major challenge to the outlook.

Overall, global economic outlook remains benign with prospects of steady and gradual improvements in the major economies, as well as slowing but sustained healthy growth in the emerging markets and developing economies.

Domestic Economic and Financial Developments

Output

The Committee noted that real Gross Domestic Product (GDP) growth remains robust. The recently rebased GDP figures released by the National Bureau of Statistics (NBS) indicated that real GDP grew by 7.41 per cent in 2013, compared with the 5.09 and 6.66 per cent recorded in 2011 and 2012, respectively. From the rebased GDP, the new major sectors of the economy in 2013 in terms of their share in GDP were: Services (36.08%); Industry (21.73%); Agriculture (21.50%) and Trade (17.06%). Figures for the first quarter of 2014 based on the rebased GDP are yet to be released by the NBS. The non-oil sector remained the main source of overall growth performance (7.77%), driven largely by: agriculture (0.43%), industry (1.28%) of which manufacturing was 1.26% and construction (0.62%); trade (1.54%) and services (3.89%).

Prices

Inflation has remained within the indicative benchmark target range of 6.0-9.0 per cent during the first four months of 2014. On a year-on-year basis, however, headline inflation inched up to 7.9 per cent in April from 7.8 per cent in March 2014. Food inflation, which was 9.3 per cent in January, declined to 9.2 per cent in February and slightly increased to 9.3 and 9.4 per cent in March and April, 2014, respectively. Core inflation, which declined to 6.6 per cent in January, increased to 7.2 per cent in February, and rose further to 7.5 per cent in April, 2014. The Committee noted that headline inflation has remained within single digit in the last sixteen months and stressed its commitment to sustain price stability; defined by the Bank's indicative benchmark range.

Monetary, Credit and Financial Markets' Developments

Broad money supply (M2) increased by 1.94 per cent in April, over the level at end-December 2013. When annualized, M2 increased by 5.83 per cent. M2 was however, below the growth benchmark of 15.52 per cent for 2014. The increase in money supply reflected the growth in the net domestic credit (NDC) of 1.62 per cent in April. Annualized, NDC grew by 4.85 per cent over the end-December, 2013 level. It is, however, below the provisional benchmark of 28.5 per cent for 2014. The slow growth in aggregate credit was traced mainly to Federal Government borrowing which contracted by 18.06 per cent in April 2014 or 54.18 per cent on annualized basis. In the period under review, money market interest rates remained within the MPR corridor of +/- 200 basis points; oscillating in tandem with the level of liquidity in the banking system. The inter-bank call and OBB rates averaged 10.5 and 10.59 per cent, respectively, in April. As at mid-May, the inter-bank call rate stood at 10.57 per cent while the OBB rate was 10.32 per cent.

The Committee noted the modest improvement in the equities segment of the capital market in the review period. The All-Share Index (ASI) rose by 0.7 per cent from 38,748.01 on March 31, 2014 to 39,018.34 on May 16. Similarly, Market Capitalization (MC) increased by 3.3 per cent from N12.45 trillion to N12.85 trillion in the same period. However, relative to end-December 2013, the indices declined by 5.6 and 2.8 per cent, respectively. This was traced partly to the impact of the response of global financial markets to Q.E. tapering by the US Fed, weak economic performance in the emerging markets and fragile recovery in the Eurozone.

External Sector Developments

The naira exchange rate remained stable at the rDAS window but appreciated at the interbank and the BDC segments of the market. The exchange rate at the rDAS-SPT during the review period (March 26,-May 16, 2014) strengthened to N157.29/US$ from N157.30/US$, representing an appreciation of N0.01k or 0.01 per cent. At the Interbank foreign exchange market, the selling rate opened at N164.65/US$ and closed at N162.33/US$, representing an appreciation of 1.41 per cent or N2.32k in the same period. At the BDC segment of the foreign exchange market, the naira which sold at N172.00/US$ on March 26, closed at N167.00/US$ on May 16; indicating an appreciation of 2.91 per cent.

Gross official reserves as at May 15, 2014 stood at US$38.30 billion compared with US$37.40 billion at end-March and US$42.85 billion at end-December 2013. The current level of the country's external reserves could provide approximately 9 months of imports cover.

The Committee's Considerations

The MPC noted the mixed signals over the global growth prospects in the advanced, emerging markets and developing economies. From the United States, the continued gains in employment, rising inflation and growth stability could soon pave way for policy tightening. On the contrary, the outlook for monetary policy appears biased towards sustaining easy monetary stance in the euro area and Japan against the backdrop of slow and uneven recovery in the region. For the emerging markets and developing countries, the Committee was concerned that the current underlying pressures on their currencies arising from capital flow reversals, increases in consumer prices and declining inflows, which preclude the use of expansionary monetary policy to stabilize domestic output and employment in the short run, could dampen growth prospects.

The Committee noted with satisfaction Nigeria's overall domestic economic environment which has remained stable with inflation contained within the target range, the recent stability in the foreign exchange market, stable interbank rates and strong growth outlook. The key challenge for policy, in the Committee's view, was that of sustaining and deepening the outcomes of existing policies. It noted, also, that over the medium term, the major risks to price stability appeared to be emanating from both external and internal sources.

From the external environment, risks to the domestic economy include the prospects for increased yields and interest rates in the US and the rather low level of economic activity in the emerging markets; both of which could have repercussions for foreign exchange inflows (private and official) and stability of the naira exchange rate. Internally, the key risk factors include the high systemic banking system liquidity, elevated security concerns and anticipated high election-related spending in the run-up to the 2015 general elections. High domestic liquidity could exert sustained pressure on both the exchange rate and consumer prices, as well as accentuate the already high demand for foreign exchange, further depleting the country's external reserves. In addition, core inflation has continued to send conflicting signals since January 2014. If the upward trend continues as observed in April 2014, it could be a major factor in the upward trend in prices.

The Committee also expressed concern over the eroded fiscal buffers which have exposed the economy to vulnerabilities arising from both domestic and external shocks. The erosion has accentuated the regime of persistently high interest rates, elevated demand for foreign exchange and declining reserves accretion. The Committee enjoined the Management of the Bank to continue to monitor developments in the fiscal space with a view to taking appropriate monetary policy actions.

In the light of the foregoing, the Committee acknowledged the success of monetary policy measures in attaining price and exchange rate stability and considered: the potential headwinds in 2014, the ultimate goal of transiting to a truly low-inflation environment; and the need to retain portfolio flows. The Committee unanimously voted to retain the current stance of monetary policy. In addition, one member voted for an asymmetric corridor around the MPR.

Consequently, the Committee voted to:

- hold the MPR at 12%;
- keep the CRR on public sector deposits at 75% and CRR on private sector deposits at 15%;
- retain the MPR corridor at +/-200 basis points.

Thank you

Sarah O. Alade
Acting Governor
Central Bank of Nigeria
20th May, 2014

PERSONAL STATEMENTS BY MEMBERS OF THE MONETARY POLICY COMMITTEE

1.0 ADELABU, ADEBAYO

Macroeconomic outcomes have remained relatively good since the beginning of FY 2014. Headline inflation, though inched up to 7.9 per cent in April 2014, is still within the long term target of the Bank while real output growth at 7.94 per cent in 2013 is higher than the last 5-year average of 6.93 per cent. Besides, real output growth in FY 2013 confirms that the economy is firmly on recovery path, following the slowdown of 2011. The exchange rate at the rDAS market has remained within the Bank's target of +/-3.0 per cent while a modest appreciation has been observed in the interbank and BDC markets. Furthermore, volatility in the money market rates has largely been subdued. These outcomes reflect the proactive nature of the monetary policy of the Bank, which should be consolidated.

The sustainability of these gains, however, is confronted with a number of challenges. With respect to the consumer price level, although the various measures of inflation are still within the single digit target, an upward trend appears to be firming up for the core component since the beginning of FY 2014. The elevated banking system liquidity, evidenced by an average of N400 billion in daily SDF since January and aggregate spending in the run-up to the 2015 general elections may pose significant risk to inflation. To underscore this point, staff forecasts indicate that headline inflation could rise to around the border of single digit as early as June. Consequently, policy response to rein in inflation expectation could not be completely ignored at this point in time.

Closely related to this is the declining external reserve and implication for exchange rate stability, which is a major challenge to nearly all developing economies at the moment. For us, the pressure is from both supply and demand sides. The recent upward adjustment of Cash Reserve Requirement (CRR) on both the public and private sector deposit has largely curtailed the demand pressure in the foreign exchange market by modifying the behavior of the DMBs. This notwithstanding, a slight degree of volatility was still noticeable in the interbank market particularly in May 2014. Further increase on CRR may pose some risks to the stability of the banking system as threats to the system are gradually seen in the reduction of interbank transactions since the beginning of the year. This suggests that the supply side of the foreign exchange market deserves further policy attention.

There are two major issues on the supply side of the foreign exchange market. Accretion to the external reserves from oil has not been significant in the recent past though data in the last few months showed that oil production volumes has started to recover. With increased global demand for oil due to recovery in the advanced economies, oil price would likely remain firm over the medium term. In effect, accretion to reserves is expected to improve. The other major issue is the ongoing tapering of the QE3 by the Federal Reserve which has revised investors' sentiment against emerging and developing economies in general. Besides, I am also of the view that developing economies including Nigeria should be preparing for the post tapering era in the US and other developed economies. With unemployment in the US inching towards the long term trend a switch to a tightening mode appears very likely in the medium term. The cumulative effect of this development is that capital outflow from emerging economies could continue for some time to come.

In a nutshell, the foregoing analysis presents the need to continue to maintain a tight monetary stance either by holding steady the current measures or by strengthening them. The impact of the tightening measures on growth, however, could not be completely discounted, particularly when consideration is given to rising lending rates to small and medium scale borrowers. This notwithstanding, the position of the monetary authority must be without ambiguity whenever there is the delicate tradeoff between price stability and other goals.

In sum, on the basis of the need to manage inflation expectation, address the vulnerability of the economy to capital flow, build up external reserves without undermining the stability of the banking system, the subsisting monetary policy measures should be maintained.

Consequently, I vote for retention of the current monetary policy measures: MPR at 12 per cent with a symmetry corridor of 2 per cent, Private Sector CRR at 15 per cent, and Public sector CRR at 75 per cent.

2.0 ALADE, O. SARAH

Global economic growth is projected broadly to strengthen to 3.6 percent in 2014 from 3.0 percent recorded in 2013, with much of the momentum coming from advanced economies according to the April 2014, World Economic Outlook (WEO). In emerging markets, while earlier projected risks have diminished, new ones have emerged as a result of lower than expected inflation in the advanced countries, which will impact output demand and prices, and geopolitical risks. In the domestic environment, although stability have returned to the foreign exchange market after some periods of turbulence, increased political risk and uptick in inflation due to seasonal planting period calls for a hold on monetary policy rate to safeguard the gains made. Based on the above, I support a hold in Monetary Policy Rate (MPC), maintenance of a 75 percent increase in public sector deposits Cash Reserve Requirement (CRR) and a 15 percent increase in private sector deposits.

Global economic growth has improved albeit with some downside risks. Outlook to global growth has turned positive on the recovery from the advanced countries led by United States, United Kingdom and Germany. In the United States, there is a pickup in momentum as disposable income adjusted for inflation grew by a strong 3.8 percent in January through March with strong consumer confidence index. The April surge in job growth to 288,000 confirms a pickup in the economy as monthly job growth so far this year averaged 214,000 a month, above analysts' estimate of 200,000 per month. In the Euro zone, growth is positive but subdued at 0.2 percent in the first quarter with Germany pushing the growth in the region at 0.8 percent. The high growth in Germany was bolstered by industrial expansion and construction activity which benefited from a mild winter. In emerging market and developing economies, growth is projected to pick up to 4.9 percent in 2014. Growth will be helped by stronger external demand from advanced economies, but tighter financial conditions from tapering could have a dampening effect on domestic demand growth if not handled well. Therefore care must be taken in balancing the dual objective of stability and growth.

Headline inflation increased to 7.9 percent in April compared to 7.8 percent recorded in March 2014. Headline inflation increased to 7.9 percent in April, suggesting that inflation may be expected to stay elevated in the coming months, as local food supply dwindle at the start of the planting season. Although a slight increase, it is still within the Central Bank target of between 6- 9 percent and the overall goal of single digit inflation. Core inflation rose slightly to 7.9 percent in April from 6.8 percent recorded in March, 2014, while food inflation increased slightly to 9.4 percent from 9.3 percent recorded in the previous month. The increase in food index is driven mainly by dwindling local food stocks as planting season commence, suggesting that future increase in inflation is to be expected in the coming months. Aside from the seasonal factors, there is still fiscal risk as a result of pre-election and increased security spending. Based on this, monetary policy should remain restrictive to forestall the anticipated impact of fiscal risks and food supply seasonality.

Stability has returned to the domestic market. Foreign exchange reserves increased to $38.30 billion as at May 15, 2014, after declining in February and March as investors react to the perceived uncertainty in the market. This is as a result of increase revenue from oil and an attempt to strengthen the fiscal buffer by the government. Excess Crude Account (ECA) increased to $4.1 billion as at May 16, 2014 from $2.5 billion at the end of 2013, as government intensifies effort at rebuilding the fiscal buffers to forestall the downside risk to the domestic economy through foreign reserve depletion. The projection is that reserves build-up in the coming months will be sustained if prices stay steady on the back of high production and stable prices. The Naira has strengthened by 2% in the past 3 months to reach NGN/USD162.4 as foreign investors return to the local bond market. Proper coordination between the fiscal and monetary authority have helped stir the economy safely out of the temporary macroeconomic shock it experienced earlier on the year.

Domestic growth has remained robust but downside risks remain. The forecast for 2014 GDP growth ranged from 6.75 percent to 7.41 percent but there are risk to this projection. While the rebased GDP suggest that the economy is now more diversified and broad-based, sustaining the momentum and creating inclusive growth is the task all policy makers should take seriously. This will require creating an environment that is competitive and attractive to both foreign and domestic investors. The security challenges in the country could impact growth negatively, although the effort at dealing with the issue with international help is a welcome development with the potential of achieving positive results.

Pressure in the foreign exchange market has eased and some level of stability has returned. Pressure at the foreign exchange market window has eased as the diligent and coordinated efforts by the Central Bank to restore stability paid off. This has been helped by the foreign exchange inflows by foreign investors who are now returning to the country in the local bond market and other portfolio flows. Rates at the Interbank and Open Buy Back (OBB) rate have remained within the band at 10.55 and 10.29 percent respectively as at May 16, 2014. These indicate excess liquidity in the system as banks accessed the Standing Deposit facility (SDF), but were rarely at the Standing Lending Facility (SLF) window since the last MPC in March. In addition, lending rates eased to 21 percent, suggesting that care must be taken to manage the structural liquidity and the structural impediments to credit growth in the economy.

Although pressure on the foreign exchange has eased, there are some downside risks to the growth and stability prospects, and now is not the time to start easing. Base on this, I vote for a hold on Monetary Policy Rate, the maintenance of 75 percent increase in public sector deposits Cash Reserve Requirement (CRR) and a 15 percent increase in private sector Cash Reserve Requirement.

3.0 BARAU, SULEIMAN

The current MPC meeting is taking place at a time of relative stability in the local environment and when there is no significant development in the global economy to elicit a change in policy.

Review of Developments

1.1 **The global economy sustained the momentum towards recovery since the last MPC meeting, with global output estimated at 2.8% in the first quarter (Q1).** The sustained accommodative monetary policy in the Euro area, Japan and the United States of America inspite of 'tapering' is largely responsible for this. It is this and other significant measures implemented particularly in the Euro area that ensured a more optimistic global growth forecast. Consequently, global output growth is projected at 3.6% by the International Monetary Fund (IMF) as against 3.0% achieved in 2013. The projected output growth in the Euro area of 1.2% for 2014 is similarly optimistic, up from minus 0.4% in 2013. Unemployment in the US dropped to 6.3% in April, thus supporting the strong forecast growth numbers. The Federal Open Market Committee (FOMC) has further reduced the monthly asset purchase programme to $45 billion effective May, 2013 in the USA. Overall, growth is expected to increase to 2.8% in 2014 compared with 1.9% in

2013. China's Q1 GDP growth reduced to 7.4% compared to 7.7% in Q3. It is however slightly below the 7.5% forecast in 2013 indicating that growth is within forecast. Output in Sub-Saharan Africa is expected to increase to 5.5% in 2014, a stronger prospect when compared with 4.9% in 2013. Overall the global economy is expected to moderately grow in 2014.

1.2 **The Nigeria economy, after the recent rebasing of GDP, witnessed substantial growth of 7.94% in 2013 when compared with 6.66% in 2012.** The rebasing of the GDP indicates the fact that our economy is more diversified than we thought it was. Industry and services now accounts for over 57% of GDP up from 39%. The rebasing has however, also thrown up other challenges in terms of strengthening taxes and revenue base to reflect the level of the rebased GDP. Overall, growth outlook remains strong at over 7% for 2014 inspite of the GDP rebasing.

1.3 **Headline Inflation (HI) though largely stable inched up marginally from 7.8% to 7.9% in April, 2014, largely accounted by the surge in Food/Non Alcoholic Beverage and Housing/Water/Electricity/Other Fuels components of that measure.** The Core measure (CI) showed a stronger surge from 6.8% in March to 7.5% in April, 2014. While inflation has largely been subdued, the outlook for the Headline and Core measures indicate a disturbing upside risk. In all, the Headline measure of inflation is expected to remain within single digit level for a large part of 2014 based on staff estimates. However, real interest rate is expected to continue to be positive.

1.4 **Interest rates remained largely stable. Market rates, remained within the corridor.** It is however, disturbing that active traders have not resumed in the interbank clean (unsecured) segment of the money market, indicating that inspite of evidence of good liquidity, confidence has not returned. The spread between the consolidated deposit and lending rates also remain a concern. It is hoped that the effect of the shared services initiatives when fully implemented would help to narrow the spreads through the reduction of cost of doing business of banks and ultimately, lending rates. The more strategic solution to this problem remains the development of a vibrant fixed income segment of the capital market that should radically alter the demand and supply balance for credits in the banking system and favourably lower lending rates.

1.5 **Exchange Rate witnessed substantial appreciation in the Interbank and Bureau De Change segments.** Interbank Rate appreciated by 1.41% (N2.32) from 164.65 to N162.33 from March 26th to May 16th respectively. The BDC rate also appreciated by 2.91% (N5.00) from 172.00 to N167.00 respectively over the same period. The rDAS rate remained stable at around N157.29 over the same period. The stability and appreciation witnessed in the respective segments was largely as a result of the tight stance in policy, reversal in market sentiment and reversal of portfolio outflows.

1.6 **Foreign Reserves level became stable at $37 billion.** External reserves at $38.30 billion as at May 15th is equivalent to approximately 9 months of import cover. There are a few reasons for this. First, the production level of crude has been largely stable at about 1.876 bpd. Secondly, oil price has maintained a floor above $100/b. Thirdly, portfolio outflows have reversed and inflows are at pre-February 21 level. Fourthly, and closely related, market sentiments have reversed. Finally, with tax holiday given to the Nigerian Liquefied Natural Gas Company just expiring, inflows from the petroleum sector would be diversified and enhanced. We see overall stability in the level of foreign reserves in the short run given the above demand and supply scenario for foreign exchange.

Pressure points/challenges

Fiscal scenario remains a source of concern from a Monetary Policy standpoint. Inspite of efforts towards fiscal consolidation, with impressive outcome, fiscal buffers from the low balances in the Excess Crude Account at a period of high oil price and stable production levels gives me concern. Besides, the budget is yet to be signed into law by the President/C in C as a result of reported issues with respect to the package passed by the National Assembly. It may be true that recurrent spending is being made at current levels but capital expenditure is said to be at 50% of previous year's numbers. I cannot therefore rule out the possibility of increase/sudden injection of liquidity from spending as the Appropriation Act is signed, due to what one may loosely call 'money illusion'.

Portfolio inflow trends have favourably reversed recently. Future trend will depend on FOMC decisions on tapering going forward and indeed on the reversal of quantitative easing in Japan and across the globe. This is an external variable that could potentially impact the success of policy in Nigeria.

Slow levels of structural reforms due to the known limitations of monetary. Monetary Policy can only deliver stable prices and monetary variables that are conducive to growth. Growth should ultimately be driven by fundamental and complementary reforms coming from the real sectors. With the recent privatization of the power sector and significant reforms in the agricultural sector, we are heading in the right direction. However, we need to extend these reforms to other sectors and drive them faster as well. It is well known that financial sector and real sector reforms produce best results if they are pursued concurrently.

Current security challenge is a significant exogenous variable that may hamper the effectiveness of monetary policy if not contained. Besides, I have not been able to de couple the security challenge that we have today with significant issues of the current human development indices in Nigeria. In plain terms, significant success in monetary policy, financial and real sector reforms are best delivered in an environment where security of lives and property is guaranteed.

Recommendation

In the light of the fact that the above challenges are already receiving varying levels of attention from Government, the demonstrated global and domestic macroeconomic stability since the last MPC as well as successes recorded by the MPC, I have no doubt that the sensible course for the current MPC is to hold stance of policy and various measures already in place to support this stance. I therefore voted as follows:

- Keep MPR at 12%;
- Keep Private Sector CRR at 15%;
- Keep Public Sector CRR at 75%;
- Keep the systemic corridor at plus and minus 2% around the MPR; and
- Keep Net Open Position at 1% of Shareholders Funds

4.0 DANIEL-NWAOBIA, ANASTASIA

Developments in 2013 indicated that the economy recorded a rebased growth of 7.94 per cent, which was higher than 5.09 and 6.6 per cent recorded in 2011 and 2012, respectively despite continuing security challenges, and weak external environment. The improved growth outlook was based on sustained implementation of the on-going reforms and the Federal Government's transformation agenda, especially in Agriculture; Energy and Transportation. Government's increased efforts aimed at curbing crude oil theft; critical infrastructure vandalization such as gas and oil pipelines, as well as the general sanitization of the petroleum industry cannot be overlooked.

Headline inflation continued its moderation to single digits, indicating the effectiveness of sustained tight monetary policy of the Bank. Though it rose marginally to 7.8 and 7.9 per cent in March and April, 2014, respectively from 7.7 per cent in February 2014, projections of inflation performance in the next six months indicate that the year-on-year headline inflation would remain within the single digit target.

Stability in the foreign exchange market, as evidenced by the modest appreciation recorded in the three segments of the market during the period under review (March, 26 – April 30 2014) is also worthy of note. The appreciation witnessed in the three segments of the market could be attributed to improved supply following the gradual return of foreign investors to the Nigerian market as a result of the confidence reposed in the economy.

A key challenge to monetary policy in 2014 in the wake of the tapering by the Federal Reserve which is proceeding faster than anticipated with consequences for capital flow reversals relates to a possible instability in our financial markets. However, the recently concluded 24th edition of the World Economic Forum Africa (WEFA) is expected to help stimulate investment in the economy, thereby creating job opportunities and reducing unemployment. The result of this is expected soon as understanding and commitments were made during the meeting by several investors, especially in the area of Power, Housing, Education, Agriculture, etc. This is likely to reduce the vulnerability of the economy to shocks, particularly through the diversification of the funding sources away from oil. Attraction of capital will reduce pressure on the exchange rate and also help in external reserves build-up. However, there is need to continue to keep an eye on the areas of vulnerability and intervene when necessary.

In view of the effectiveness of the current tight monetary policy stance in keeping inflation within single digits as well as maintaining stability in the foreign exchange market, it is advisable to sustain the current policy stance.

Consequently, I vote as follows:

i. The Monetary Policy Rate (MPR) to be retained at the current level of 12% and corridor of +/- 2% for the inter-meeting period.

ii. The Private sector CRR which was increased from 12 to 15 per cent in March, 2014 should also be sustained to enable the market adjust to the new policy.

iii. The current policy on foreign exchange (mid-point and exchange rate band of N155/US$1 +/- 3%) should be retained for the next two months when another review will be due for consideration, while effort to rebuild the fiscal buffers is being sustained to further engender stability in the foreign exchange market and build investor confidence.

5.0 GARBA, ABDUL-GANIYU

At the third MPC meeting for 2014 (May 19-20), my decision took account of (1) my previous decisions and the majority decisions, (2) action lag and policy performance, (3) the revealed and expected responses of key players to policy, action lag and policy options, (4) regulatory effectiveness, (5) underlying vulnerabilities in the national and global economy, (6) short-term stability of key variables in March and April and the associated costs and risks, (6) transition issues and (6) underlying trends and fundamental structural changes in the economy. After due analysis of the underlying evidence and contemplations about the outlook (national and global), I am convinced that it is wise to keep MPR, CRR on private sector deposit and CRR on public sector deposit and the SLF rate unchanged in the short term. This implies the following: MPR (12%), CRR on private sector deposit (15%), CRR on public sector deposit (75%) and SLF rate (14%).

However, I remain convinced of the need for (1) short term responses to the slow-down in the activities in the interbank lending market and (2) medium term planned adaptations to a post- QE world.

In the short term, I am convinced that there is a need for an asymmetric corridor to gradually reduce the incentive for the rapidly expanding activities in the Standing Deposit Facility (SDF) window. It is axiomatic that an active interbank lending market (ILM) is necessary for the efficient pricing of risks and financial assets, for allocative efficiency as well as for the effectiveness of monetary policy to stimulate the growth in investments, employment and economic development. I do not subscribe to the idea of classical dichotomy that is, the idea that monetary policy variables impact only monetary variables in the short run or the idea that monetary policy variables do not generate hysteresis that is, long lasting impacts.

Indeed, both the interbank lending market and Open Buy Back are pivotal to the transmission mechanism of the monetary policy regime guiding the MPC decisions. Since the interbank call rate became the operating target for monetary policy, the call rate also became the benchmark for short-term rates (prime and maximum lending rates). Until recently, strong linkages were successfully established between MPR, call rate and the short term rates in the tightening regime that began with the September 2010 MPC meeting. When the interbank lending market becomes significantly less active for whatever reason (s), the call rate becomes a less effective benchmark for the pricing of short-term risks and rates and for the efficient allocation of financial assets.

I am convinced based on analysis of available data and from institutional perspectives that (1) the AMCON effects on the interbank market are exaggerated; (2) a 10% rate on SDF has been a consistently strong incentive for inverted intermediation and by corollary, a strong disincentive against the intermediation effectiveness of DMBs and (3) a reduction in the SDF rate along with game changing administrative options will incentivize DMBs away from the highly profitable games of inverted intermediation.

I therefore, vote for a reduction in SDF by 300 basis points that is from 10% to 7%. The risk of a portfolio readjustment into the forex market may exist. However, effective administrative actions including (a) mechanism re-design and (b) more effective surveillance would considerably reduce such risks. The inverted intermediation is a strong vulnerability in the Nigerian economy that must be inverted if monetary policy is to stand a strong chance of sustaining price stability and lowering the sacrifice ratio (employment and growth forgone in disinflation regimes). Besides, analysis of available data convinces me on a sustained basis that the ***<u>pressure on the Naira is not driven by fundamentals</u>*** (net exports, current account balances and net financial flows have been positive from 2011). For instance, in the first quarter of 2014, the average monthly trade balance and net financial are respectively \$3.34 billion and \$4.6 billion respectively. It is clear to me that ***<u>"unwise rational greed"</u>*** (destructive rationalism) and ***<u>asymmetries</u>*** (financial power and information) undermine the pricing and allocation of financial assets with adverse effects on employment, investment, development and security. The challenge for MPC and the CBN in collaborations with fiscal authorities is to develop a right mix of policy, administrative effectiveness and institutional changes to tame such behaviors, address the vulnerabilities in the economy that are being exploited and; to be build resilience into the economy to sustain stability in a post-QE world.

I have always favored a forward-looking monetary policy regime anchored in (1) a creative mix of policies and institutional changes; (2) effective coordination and (3) sound prudential oversights. These ought to be at the core of the conversations and decisions for the post-QE era macroeconomic management of the Nigerian economy.

6.0 MOGHALU, C. KINGSLEY

Considerations

Taking into consideration a combination of monetary conditions and the economic environment, my vote in this MPC meeting appears obvious to me.

At the last MPC meeting there were concerns generated by the leadership transition in the Central Bank of Nigeria. Between then and now, stability has been firmly anchored, and the naira has been stable and even recorded gains vis-à-vis the dollar. But this has been at significant cost to our external reserves owing to the resolute interventions by the CBN in the forex market. Nigeria has had net inflows of foreign capital since April 2014. And with reserves at US$38.30 as at May 15, 2014, this provides approximately 9 months of import cover.

Against this background, we have a present context in which the economy's growth rate is satisfactory at 7.41 per cent in 2013 driven by non-oil sectors; inflation, though ticking up to 7.9 per cent in April 2014 on a year-on-year basis, remained within the single digit indicative target. Broad money supply (M2) increased by 5.83 per cent on an annualized basis but remained below the growth benchmark of 15.52 per cent for 2014, and net domestic credit increased by 1.62 per cent in April. The interbank market has remained stable. Oil output increased.

On the other hand, two factors suggest the MPC cannot be complacent in the present state of things. The first is that liquidity remains high and inflationary threats remain. The second is that the United States Federal Reserve Bank appears set to increase the pace of tapering and is expected to increase its monetary policy rate in 2015. U.S. interest rate rises, combined with the prospect of increased spending in the Nigerian election period, could place serious pressures on the naira as foreign investors seek what they may perceive to be relative safety, and inflationary pressure may increase.

No matter, the situation at present and the immediate future clearly argues for the maintenance of stability and leaving monetary aggregates as they are at present.

The threat at the last MPC having passed, this is not a time to make changes to the monetary stance of this Committee. Until the structure of the Nigerian economy changes in a fundamental manner, or fiscal buffers increase markedly (or, preferably, both outcomes occur), monetary policy must remain tight. It is a hopeful sign that recent growth has been driven largely by non-oil sectors, and the recent GDP rebasing exercise indicates an increasing diversification of the economy. But, until we achieve economic complexity and import far less than we do today, monetary policy will have to continue to bear a heavy burden. That is the Faustian dilemma – and eradicating that dilemma is a largely fiscal responsibility.

Vote

I therefore vote to:

- Maintain the MPR at 12%
- Hold the CRR on public sector at 75% and CRR on private sector deposits at 15%
- Retain the MPR corridor at plus or minus 200 basis points.

7.0 ORONSAYE O. STEPHEN

From the statistics released by the National Bureau of Statistics (NBS), our real Gross Domestic Product (GDP) indicates that our economy is healthy. Specifically, the NBS figures show that the rebased GDP grew by 7.41 per cent in 2013, compared to what the economy witnessed in the corresponding period of last year.

The Year-on-Year (Y-O-Y) headline inflation rose to 7.9 per cent in April, while food inflation stood at 9.4 per cent for the months of March and April 2014, up 0.1 per cent from the figure in February 2014. Core inflation rose from 7.2 per cent in February 2014 to 7.5 per cent. Despite the percentage increases, it is gratifying to note that inflation has remained within the single digit benchmark in the first quarter of 2014. It is also noteworthy that the Naira has remained quite stable in the face of extreme internal and external pressures.

The Committee, in considering the performance of the Nigerian economy in the last three months, equally noted that the country's overall domestic economic environment has remained stable, backed with single digit inflation, as well as stability in the foreign exchange market and interbank rates. These, however, need to be sustained.

Considering the success of monetary policy measures in attaining price and exchange rate stability and the fact that the conditions for maintaining MPR at 12% are still unchanged; there is therefore no justifiable reason to tamper with the present rate.

On the Cash Reserve Requirement (CRR) on deposits from the Public Sector, I do not see the reason for any increase at this time considering the gains achieved from imposing 75 per cent CRR on the funds.

Votes

The arguments canvassed for holding the MPR at 12% in March 2014 remain largely unchanged. Given the stability all-round, I do not see reasons why the parameters should be altered at this time.

Based on the foregoing, I voted for the following:

a) Holding the MPR at 12%;
b) Retaining the symmetric corridor of 200 basis point around the MPR;
c) Retaining the Cash Reserve Requirement (CRR) at 15% for deposits from the private sector; and
d) Retaining the 75% Cash Reserve Requirement (CRR) on deposits from the Public Sector.

8.0 SALAMI, R. ADEDOYON

Despite the marginal increase in Headline Inflation to 7.9percent in April, prices, in the opening four months of the year rose on average by 7.85percent. This places inflation within the 6-9percent target for 2014. Unlike the opening months of 2013 when Core inflation trended lower, there is no immediately discernible trend in the data for Non-food inflation for the 1st four months of 2014. However, the average rate of Core inflation is, thus far, approximately 200bps lower than it had been for the same period last year. While Food inflation is similarly lower than it had been between January-April 2013, at an average of 9.4 percent, it however continues to rise faster than Core Inflation.

With stability of the exchange rate across segments – indeed, an appreciation in the Bureau de Change market, the background to this meeting of the MPC was devoid of the anxiety which had framed the run-up to recent meetings. The stability which formed the background to this meeting is in no small measure the result of improvement in confidence as the turbulence generated by the transition of leadership at the Central Bank subsided. The slight rise in the stock of Forex Reserves – rising by approximately US$0.5bn to US$38.3bn - since our meeting in March, also reduced uncertainty. The recovery in confidence saw a sharp rise in portfolio inflow of

US$2.152bn in April 2014 – an increase of almost US$1.2bn over the inflow the previous month.

Given the significance of international developments to our economy, the announcement of further tapering in Quantitative Easing by the Federal Open Markets Committee (FOMC) of the US Federal Reserve was perhaps the most significant non-domestic issue to reflect on. With FOMC Asset purchases further reduced by US$10bn/month from May coupled with easing short and long term yields in the US the impact on Capital flows continues to be an issue of importance for domestic policy making.

In the absence of data to indicate how the output and expenditure sides of the economy, in aggregate, have fared in the opening months of the year, it is near impossible to authoritatively describe, or indeed assess, domestic non-financial economic conditions. It is thus near impossible to situate developments in the rest of economy in the context of the Monetary Policy Committee's (MPC) primary mandate of ensuring currency and price stability.

Bearing in mind the caveat in the preceding paragraph, liquidity – irrespective of definition – continues to contract when adjusted for increases in prices. In contrast, there appears to be a sharp improvement in credit to the private sector. Not only does its growth rate exceed inflation, industry loan book seems to be growing faster than liabilities. The sharp reduction in both volume and value of transactions at the interbank window continues.

With regard to the MPC's principal mandate of price stability, the six-month ahead outlook for inflation, provided by Bank Staff, shows some improvement relative to the position at our meeting in March. Notwithstanding this, the Outlook is for Headline to worsen slightly from the current position. Headline Inflation, projected to average 8.7percent between May and October, is expected to show a continuous rise. Over the next six months, Core Inflation is expected to peak at 7.9percent in May/June before decelerating to 6.1percent in Sept. In the same six months, Food price inflation is expected to worsen – averaging 10.6percent, with a peak of 11.1percent.

Staff Outlook for economic conditions hasn't changed materially – characterized by lower oil prices, faster tapering of Quantitative Easing, prospect of rising deficit as revenues continue to slip, and worsening inflationary pressure. Perhaps to these we should add the formal commencement of activities towards the 2015 General Elections. On the positive side, the leadership transition at the Central Bank, a source of very expensive turbulence, should be concluded shortly.

Leaving all monetary policy parameters unchanged, for which I vote, is not to suggest that there are no challenges ahead. The lull currently being experienced simply offers an opportunity to emplace a contingency plan to proactively respond when the next wave comes in.

9.0 UCHE, U. CHIBIUKE

For some time now I have consistently voiced my concern about the impact of fiscal policy (mis)management on monetary policy. Although the promotion of price stability is a key mandate of MPC, this is not an end in itself. If it were so it will, in my opinion, be very easy to achieve. The essence of price stability is to help create the enabling environment for economic growth and development to take place. This perhaps explains why it is also the mandate of MPC to determine credit policy. As a consequence of this, we have in the past tried to use monetary policy to force changes in government fiscal behavior which is also critical to economic development and the credit system. A clear example of such monetary policy strategy is the use of CRR to force government to adopt the Treasury Single Account (TSA). Specifically, the CRR on government deposits has since been raised to 75 percent, as against 15 percent for private sector deposits, all in the attempt to promote government fiscal prudence which facilitates the operationalisation of monetary policy.

Although I am pleased with the results thus far from the above policy initiative, available data suggests that some government agencies and banks may be circumventing this strategy by exploiting the arbitrage opportunities that have arisen as a consequence of the fact that there is currently no requirement for CRR to be applied to domiciliary account deposits in commercial banks. The above example clearly shows the limitations of using monetary policy as a tool to force prudent fiscal behavior on the part of government and its agencies. The fact that there are few viable monetary policy instruments left in a fiscally dominant environment explains my minority vote to extend CRR to public sector domiciliary accounts at the last MPC meeting. To be able to appreciate the difficulties we face in formulating effective monetary policy, it is important to note that the placement of government deposits in commercial banks contravenes the CBN Act which makes it explicit that the CBN is the banker to the government. Placement of government deposits in commercial banks also facilitates poor fiscal management by government and its agencies which in turn complicate monetary policy formulation. Based on the above, I was pleased to learn that the government is now taking the issue of TSA seriously and has indeed given a deadline of May 2014 to all government agencies to comply or face severe sanctions. Once the TSA is achieved, the abnormal practice of applying CRR on public sector deposits will cease to exist.

Another policy development, although considered contentious in some circles, that has positively impacted on monetary policy is the rebasing of the Nigerian GDP. The above exercise has demonstrated that the Nigerian economy is more diversified than previously believed. It is for instance now known that the manufacturing and service sectors are the leading sectors in the

Nigerian economy, not agriculture as previously believed. The implication of the above is that MPC must now do more to encourage the delivery of credit to these important sectors. After all the design of credit policy is also a key mandate of MPC. The argument that the dominant subsistence practice in the agricultural sector, coupled with its dependence on uncontrollable natural forces like the weather, makes it less responsive to monetary policy manipulation clearly cannot be transferred to the service and manufacturing sectors of our economy. Since the excessive interest rates charged by banks has consistently been a primary concern of both the service and manufacturing sectors, I am of the view that we should do more to bring down the cost of credit to these important sectors of our economy. Using market forces to explain away the widening gap between deposit and lending rates in the country is no longer useful.

Despite the above positive policy anticipations and/or developments, the monetary policy environment in the country remains challenging. This was no doubt brought to a head early in the year by the leadership crisis in the CBN. The subsequent outflow of foreign portfolio investments put pressure on both our external reserves and the value of our currency. Although these pressures have started to ease, difficulties remain. While the variance between the w/r/DAS, interbank and BDC exchange rates narrowed in the recent past, it remains material. I am also aware that there are concerns about the fact that the 2014 budget has not been signed into law, growing insecurity in some parts of the country and the dwindling government revenues especially in the run up to an election year. Despite these, I am reluctant to vote for further tightening of monetary policy at this point. This is in part because if the planned total implementation of the TSA happens at the end of this month, this will in itself represent an implicit tightening of monetary policy. Furthermore I am convinced that a lot of the portfolio outflows that negatively impacted on our foreign reserves had more to do with the perceived uncertainties that arose from the recent leadership crisis in the Central Bank and less with the inability of the Central Bank to tighten monetary policy and offer investors better rates of return, The fact that such portfolio outflows have tapered provide support for this view. More important however is the fact that there will be another change in the leadership of the CBN in a couple of weeks. I am of the view that policy changes should be undertaken at the present time only if absolutely necessary. From the above analysis, this is certainly not the case at this point.

In the light of the above factors, I hereby vote as follows: (1) to retain MPR at 12 percent with interest rate corridor of + 200/- 200 basis points; (2) to retain CRR at on private sector and government deposits at 15 percent and 75 percent respectively, and; (3) to retain Liquidity Ratio at 30 percent.