Central Bank of Nigeria (CBN) Communiqué No. 100 of the Monetary Policy Committee Meeting of Monday 23rd and Tuesday 24th March, 2015

The Monetary Policy Committee (MPC) met on 23rd and 24th March, 2015, against the backdrop of harsh external economic environment and significant risks in the domestic economy. In attendance were eleven (11) out of the twelve (12) members, including Dr. O. J. Nnanna, who assumed duty as Deputy Governor (Financial System Stability) at the end of January 2015. The Committee analyzed key developments in the global and domestic economic and financial conditions as well as the outlook for the rest of 2015.

International Economic Developments

The Committee noted that the pace of global economic recovery had remained moderate and uneven. In particular, the Committee noted that lower commodity prices were weighing heavily on output growth, especially in the oil exporting countries. In addition, expectations of a rise in US short-term interest rates continue to fuel capital outflows and currency weaknesses in the emerging markets and developing countries. Against the backdrop of sustained weakness in the Euro zone and softening growth in the emerging markets, global output has remained largely tapered.

During the first quarter of 2015, the United States led the global impetus to output growth as consumer demand strengthened on the heels of falling oil prices, lower US oil imports and accommodative monetary policy. In contrast, in the Euro area, continued output decline, in the face of positive oil price shocks, made the European Central Bank (ECB) to introduce a massive €1.1 trillion asset purchase programme, commencing in March 2015, involving a €60 billion monthly asset purchase. The programme, although open-ended, is expected to last at least until September 2016 by which time inflation may have gained reasonable traction.

The Committee, however, noted a number of important downside risks to global outlook in 2015 including geopolitical tensions and conflicts; the negative impact of commodity price declines; weak external demand and the possibility of Monetary Policy normalization in the US. Growth could, however, remain subdued in most of the Euro Area and Japan, in the short-to-medium term. Growth in the emerging markets may exhibit wide variations with sharp deceleration in most of the large emerging market economies, especially in Latin America and Eastern Europe, due to the headwinds from softening commodity prices and slowdown in external demand from the advanced economies. In addition, country specific risks, such as political crisis, structural factors, adverse weather conditions, and large swings in currencies may continue to slow aggregate demand in a number of countries.

Global inflation continues to be low due to declining oil prices and continuing slack in global output. Core inflation has continued to sag due amongst other things to the dampening effect of low oil prices and lack of appreciable wage gains. Average inflation for the developed economies is projected to remain flat at 1.5 per cent in 2015 due to the increasing output gap, weak recovery, and strong regional currencies. This development appears to be offsetting the risk of imported inflation in the emerging and developing countries, most of which have experienced moderate to severe depreciation in their local currencies. Developing economies are thus expected to have moderate inflation in the medium term.

The Committee observed that the outlook for global monetary policy suggested a predominantly easy stance. The Euro Area and Japan are expected to remain in the accommodative mode. Even in countries where growth appears to be strengthening like the US, UK and Canada, there are indications of delayed switch to tight monetary policy stance. Owing to currency concerns, however, the Committee further noted that some emerging and developing economies may experience moderate tightening in the short to medium term. Growth in sub-Saharan Africa is projected to average 4.9 per cent in 2015.

Domestic Economic and Financial Development

Output

The National Bureau of Statistics (NBS) estimated real Gross Domestic Product (GDP) growth rate at 5.94 per cent in Q4 of 2014 lower than the 6.77 per cent recorded in the corresponding period of 2013 and the 6.23 per cent recorded in Q3 2014. The Committee noted that the slowdown in growth resulted mainly from the non-oil sector, which grew by 6.44 per cent in Q4, 2014 compared with 8.78 per cent in Q3 2014. Agriculture, industry, construction, trade and services contributed, 0.89, 1.30, 3.64, 0.87 and 2.45 percentage points, compared with 1.21, 1.04, 0.36, 1.08 and 2.53 percentage points, respectively, in Q3 2014. The softening non-oil GDP was partly traced to the spill over effects of low oil prices which negatively impacted agricultural output, trade and services.

Oil-GDP on the other hand, grew by 1.18 per cent in Q4, 2014 compared with a decline of 3.60 per cent in the preceding quarter. The growth in oil-GDP is particularly noteworthy because it came at a time when the sector was experiencing external negative price shocks.

Prices

Headline inflation remained within the 6.0—9.0 per cent band established by the CBN. However, the Committee noted with concern, the gradual increase in the year on year headline inflation during the first two months of the year from 8.0 per cent in December 2014 to 8.2 per cent in January and further to 8.4 per cent in February 2015. The underlying inflationary pressures came largely from food (particularly imported food) and the core components. Food inflation rose from 9.2 per cent in December 2014 to 9.4 per cent in February 2015 while core inflation increased from 6.2 to 7.0 per cent during the same period. The major risks to inflation, the Committee noted, include elevated aggregate spending in the run-up to the 2015 general elections, the likely higher import prices on the strength of an appreciating dollar and possible food supply shocks linked to insurgency and insecurity in some major agricultural zones of the country.

Monetary, Credit and Financial Markets' Developments

Broad money supply (M2) declined by 1.70 per cent in February 2014 over the level at end-December 2014. This translated to an annualized decline of 10.23 per cent compared with the provisional growth benchmark of 15.24 for fiscal 2015. The decline in M2 primarily reflected the contraction of 18.14 and 8.22 per cent in net foreign assets (NFA) and other assets (net), respectively, during the period.

The fall in NFA is attributed to the combined effects of weakening oil price and reversal of portfolio capital flows. During the period, net domestic credit (NDC) grew by 9.89 per cent in February 2015, annualized to a growth rate of 59.31 per cent, compared with a growth rate 7.89 per cent recorded in the corresponding period of 2014 and an indicative benchmark of 29.3 per cent for 2015. The credit-to-government (net) component grew sharply by 54.69 per cent relative to a decline of 21.81per cent at end-December 2014.

The Committee noted that money market interest rates were relatively volatile in the intervening period but stabilized on average during the first two months of 2015, as banking system liquidity fluctuated. Thus, average inter-bank call and OBB rates, which opened at 10.58 and 10.52 per cent on 5th and 6th January 2015, closed at 11.00 and 9.23 per cent, respectively, on February 27, 2015. Average inter-bank call and OBB rates for the period were 15.21 and 18.36 per cent, respectively.

The Committee observed that the bearish conditions in the capital market continued in the review period. The All-Share Index (ASI) decreased by 13.1 per cent from 34,657.15 at end-December 2014 to 30,103.81 by February 27, 2015. Market capitalization also moved in the same direction, falling by 12.5 per cent from N11.48 trillion to N10.04 trillion during the period. The Committee noted that the situation, though reflecting current trends globally, needed to be monitored closely.

External Sector Developments

Following the closure of the Retail Dutch Auction System (rDAS) window of the foreign exchange market on 18th February 2015, the foreign exchange market is now unified. Consequently, the naira exchange rate opened at N180.1/US$ and closed at N198.0/US$, with a daily average rate of N198.0/US$. This represented a depreciation of N17.9k or 9.04 per cent for the period.

Considerations

The Committee expressed satisfaction with the impact of the decisions taken to harmonise the foreign exchange market. As a consequence of those actions, the interbank exchange rate has stabilized after an initial adjustment. The Committee, however, expressed concern about the wide divergence between the interbank and the bureau-de-change exchange rates, which provides an avenue for arbitrage and speculative activities in the market. The Committee noted with concern the phenomenon of currency substitution and partial dollarization in the economy, a development which may have significantly fuelled the high demand for foreign exchange. The Committee, therefore, reiterated that the naira remained the currency of transaction in the economy and advised the Bank to take all possible measures to address this development. The Committee also expressed concern about the outlook for growth, which had moderated partly due to the effects of low oil prices, naira exchange rate depreciation, and election-related concerns. The Committee was however, optimistic that the situation would improve once elections were successfully conducted with the expected improvement in business confidence.

The Committee took note that while adverse developments in international oil prices had affected government revenues and reserves accretion and impacted negatively on capital flows, the financial system remained stable with key banking stability indicators showing robustness. In the light of this, the Committee directed the Bank to take all necessary measures to improve the resilience of the financial system as well as the overall economic environment and functioning of the financial markets.

The Committee also took note of the administrative measures implemented by the Bank since the last meeting of the MPC to achieve stability in the foreign exchange market. The Bank had on 18th February 2015 taken the bold supply management measures to close the official window of the foreign exchange market in order to create transparency and minimize arbitrage opportunities in the foreign exchange market. Furthermore, to deepen the market and enhance the efficacy of the demand management measures, the Bank gave specific directives on the effective monitoring and repatriation of both oil and non-oil export proceeds. In addition, the utilization of export proceeds has been restricted to eligible transactions only, to minimize leakages. The Committee enjoined the Bank to continue to fine-tune demand management measures as well as implement appropriate supply-enhancing strategies to ensure effective demand and utilization of foreign exchange in the country.

The Committee noted the gradual rise in headline inflation, driven mainly by exchange rate-induced high prices of imported (processed) food and output supply shocks. However, the Committee was of the view that the prevailing tight monetary policy stance and some of the recent administrative measures would among others help to lock-in inflation expectations and further stabilize the naira exchange rate.

Decision

In the light of the above considerations, the Committee observed that its previous decisions needed time for their effects to fully permeate the economy and therefore, voted to maintain the current position. Consequently, the Committee decided as follows:

All eleven members unanimously voted to retain the MPR at 13 per cent; retain the CRR on Private Sector deposits at 20 per cent; retain CRR on Public Sector deposits at 75 per cent; and retain the liquidity ratio at 30 per cent.

I thank you all for Listening

Godwin I. Emefiele, *CON*

Governor

Central Bank of Nigeria

24th March, 2015