Central Bank of Nigeria Communique No 108 of the Monetary Policy Committee Meeting of Monday and Tuesday 25th and 26th July 2016

The Monetary Policy Committee met on 25th and 26th July 2016 against the backdrop of fragile global and domestic economic and financial conditions. The Committee evaluated the global and domestic macroeconomic and financial developments in the first six months of 2016 and the outlook for the rest of the year. In attendance were 8 members.

International Economic Developments

The Committee noted the continued sluggish growth in global output, being underpinned by weak demand and slowing productivity. In addition to existing risks, rising debt levels in the Emerging Market Economies (EMEs), volatile financial markets and the vote of the United Kingdom to exit the European Union "BREXIT" have lessened the prospects for a more prosperous global economy in 2016. Consequently, the International Monetary Fund (IMF), in July 2016, further downgraded its baseline forecast for global growth to 3.1 per cent from 3.2 in April. The Organisation of Economic Cooperation and Development (OECD) forecast for global output in 2016 is even less optimistic at 3.0 per cent. Slower global growth prospects is traced to weak trade, sluggish investment, protracted weak aggregate demand and low commodity

prices; which have translated to output declines in the Emerging Market and Developing Economies (EMDEs). The Brexit vote has created widespread uncertainty and elevated volatility in the global financial markets.

The United States (US) economy grew by 0.8 per cent in Q1 of 2016, though, much lower than the 1.4 per cent growth recorded in the last quarter of 2015. The tapered growth was attributed to the goods sector which continues to struggle under the weight of declining factory activity; the hitherto resilient service sector is now losing steam while trade remains under pressure from a strong dollar and weak domestic demand.

The Japan economy grew at an annualized rate of 1.7 per cent in Q1 of 2016, a reversal of the negative growth recorded in Q4 of 2015. The Bank of Japan (BoJ) at its 15th-16th July meeting of the Monetary Policy Committee, maintained its monthly asset purchase at ¥6.7 trillion (US$63.93 billion), leaving the policy rate also unchanged at negative 0.1 per cent.

The Euro Area grew by 0.6 per cent in first quarter, 2016, up from 0.3 per cent, recorded in fourth quarter of 2015. Downside risks to the growth outlook have, however, risen following the Brexit vote. The Governing Council of the European Central Bank (ECB), at its meeting of July 21st, 2016, retained its key interest rates on the main refinancing operations, the marginal lending facility and the deposit facility at 0.00, 0.25 and -0.40 per cent, respectively, with the expectation that they would remain at present

or lower levels for an extended period of time. The ECB also sustained its monthly asset purchases of €80 billion (US$87.91) until March 2017, with possibility of extension.

In anticipation of and to mitigate the impact of the Brexit vote, the Bank of England (BoE) voted to continue its ₤375 billion (US$495 billion) monthly assets purchase program, financed through the issuance of reserves and possible increase in the quantum should the need arise. The Bank also retained its policy rate at 0.5 per cent, with a commitment to stimulate inflationary growth towards its 2.0 per cent long run path. The Bank also hinted at a possible further easing of monetary policy in August, 2016.

Major EMDEs continued to face declining capital inflows, rising financing costs and geo-political tensions, all of which pose constrain to growth. Depressed commodity prices continued to tilt the balance of risk towards the downside, thus, dampening prospects for near term economic and financial recovery in the EMDEs. Consequently, the IMF (WEO July 2016 Update) downgraded the 2016 growth forecast for this group of countries to 4.1 from 4.3 per cent in the April projection.

In July, oil and other commodity prices rallied against the backdrop of better-than-expected economic data on China in the second quarter, sustained attacks on oil production facilities in Nigeria, and continued unrest in Libya. Nonetheless, global inflation remained subdued despite widespread easing of monetary policy. In the advanced economies, recent developments such as BREXIT has increased the

uncertainty surrounding the future of the Euro zone thus further weakening demand and suppressing inflation. Consequently, while the stance of monetary policy in most advanced economies is expected to remain accomodative through fiscal 2016 in the EMDEs, it is expected to remain mixed, reflecting diversity and multiplicity of shocks confronting them.

Domestic Economic and Financial Developments

Output

The Nigerian economy is still saddled with the effects of the shocks of the first quarter of 2016; which led to a contraction in output arising from energy shortages, high electricity tariffs, price hikes, scarcity of foreign exchange and depressed consumer demand, among others. Whereas the influence and persistence of some of the factors waned in the second quarter, it is unlikely that the economy rebounded strongly in the quarter as setbacks in the energy sector continued owing mainly to vandalism of oil installations. In addition, the implementation of the 2016 budget in the second quarter remained slower than expected in the second quarter. The Committee noted that most of the conditions undermining domestic output growth were outside the direct purview of monetary policy. It nonetheless, hopes that the deregulation in the downstream petroleum sector and the liberalization of the foreign exchange market would help bring about the much needed relief to the economy.

Data from the National Bureau of Statistics (NBS) indicate that domestic output in the first quarter of 2016 contracted by 0.36 per cent, the first negative growth in many

years. This represented a decline of 2.47 percentage points in output from the 2.11 per cent reported in the fourth 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 virtually all sectors of the economy, with the non-oil sector recording a decline of about 0.18 per cent, compared with the 3.14 per cent expansion in the preceding quarter. Agriculture and Trade were the only sectors with positive growth at 0.68 per cent and 0.40 per cent, respectively, Industry, Construction and Services contracted by 0.93, 0.26 and 0.08 percentage point, respectively.

Prices

The Committee noted a further rise in year-on-year headline inflation to 16.48 per cent in June 2016, from 15.58 per cent in May; 13.72 per cent in April, 12.77 per cent in March and 11.38 per cent in February 2016. The increase in headline inflation in June reflected increases in both food and core components of inflation. Core inflation rose sharply for the fourth time in a row to 16.22 per cent in June, from 15.05 per cent in May; 13.35 per cent in April; 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 15.30 per cent in June, from 14.86 per cent in May; 13.19 per cent in April; 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 was largely a reflection of structural factors, including high cost of electricity, high transport cost, high cost of inputs, low industrial activities as well as higher prices of both domestic and imported food products.

The MPC expressed strong support for the urgent diversification of the economy away from oil to manufacturing, agriculture and services; and called on all stakeholders to increase investment in growth stimulating and high employment elasticity sectors of the economy in order to lift the economy out of its current phase.

Monetary, Credit and Financial Markets Developments

Broad money supply (M2) grew by 8.26 per cent in June, 2016, a 4.80 percentage points increase from 3.46 per cent in May compared with the 0.54 per cent contraction in June 2015. When annualized, M2 grew by 16.52 per cent in June 2016 against the provisional growth benchmark of 10.98 per cent for 2016. Net domestic credit (NDC) grew by 12.52 per cent in the same period and annualized at 25.04 per cent. At this rate, the growth rate of NDC exceeded the provisional benchmark of 17.94 per cent for 2016. There was no change in the level of banking sector net credit to government in June, contrasting the 31.45 per cent growth in May. Credit to the private sector grew by 14.45 per cent in June 2016, which annualizes to a growth of 28.90 per cent, outperforming the benchmark growth of 13.38 per cent for the year. The MPC expressed cautious satisfaction over the improved performance of credit to the private sector and urged the Bank to ensure that the tempo is sustained inorder to stimulate recovery of output growth.

The MPC noted that the level of money market interest rates largely reflected the liquidity situation in the banking system during the review period. Average inter-bank call rate, which stood at 20.0 per cent on 17th June 2016, closed at 50.0 per cent on July 15, 2016. The increase was attributed in part; to the newly introduced foreign

exchange framework and the mop up of naira liquidity due to increased sale of foreign exchange by the CBN during the period. Generally, the period under review witnessed a decline in volume of activity in the inter-bank market owing to injections by FAAC and maturity of some CBN securities.

The MPC also noted the decline in the indices of the equities segment of the capital market. The All-Share Index (ASI) declined by 6.55 per cent from 29,597.79 on June 30, 2016, to 27,659.44 on July 22, 2016. Similarly, Market Capitalization (MC) declined by 6.26 per cent from N10.17 trillion to N9.50 trillion during the same period. Relative to end-December 2015, the indices fell by 3.43 per cent and 3.55 per cent, respectively. Globally, however, the equities markets remained generally bearish, in the aftermath of the Brexit vote.

External Sector Developments

The MPC noted the actions taken by the Bank as part of the implementation of the flexible foreign exchange regime decided at its meeting in May which was designed to improve liquidity and stabilize the foreign exchange market. The Bank introduced a flexible exchange rate regime in the inter-bank market; introduced a Naira-settled OTC-FMDQ-OTC trading platform, adopted two-way quote trading platform at the inter-bank foreign exchange market and appointed foreign exchange primary dealers.

However, the average naira exchange rate weakened at the inter-bank segment of the foreign exchange market during the review period following the liberalization of the market. The exchange rate at the interbank market opened at N197.00/US$ and closed at N292.90/US$, with a daily average of N244.95/US$ between May 25 and July 19,

2016. The initial weakness was attributable to the normal market reaction to a new regulatory reform. The MPC reaffirmed its commitment to its statutory mandate of achieving a stable naira exchange rate.

The MPC's Considerations

The MPC recognized the weak macroeconomic environment, as reflected particularly in increasing inflationary pressure and contraction in real output growth. In view of this, the MPC underscored the imperative of coordinated action, anchored by fiscal policy, to initiate recovery at the earliest time. Members called on the Federal Government to fast-track the implementation of the 2016 budget in order to stimulate economic activity to bridge the output gap and create employment. In the same vein, the MPC expressed concern over the non-payment of salaries in some states and urged express action in that direction to help stimulate aggregate demand. On its part, and as a complementary measure, the MPC restated its commitment to measures and deployment of relevant instruments within its purview to complement fiscal policy with a view to restarting growth. The Committee also enjoined deposit money banks (DMBs) to partner with Government and the Bank in this direction, by redirecting credit from low employment generating sectors to those capable of supporting growth, reducing unemployment and improving citizen standards of living.

Members agreed that the economy was passing through a difficult phase, dealing with critical supply gaps and underscored the imperative of carefully navigating the policy space in order to engender growth and ensure price stability. The MPC therefore,

summarized the two policy options it was confronted with as restarting growth or fighting inflation. The MPC was particularly concerned that headline inflation spiked significantly in June 2016, approaching twice the size of the upper limit of the policy reference band.

The Committee noted that inflation had risen significantly, eroding real purchasing power of fixed income earners and dragging growth. The MPC was further concerned that while the situation called for obvious tightening of the monetary policy stance, the recession confronting the economy and the prospects of negative growth to year-end needed to be factored into the policy parameters.

The arguments in favour of growth were anchored on the premise that the current inflationary episode was largely structural. In particular, members noted the prominent role of cost factors arising from reform of the energy sector, leading to higher domestic fuel prices and electricity tariffs and prolonged foreign exchange shortages arising from falling oil prices leading to higher inputs costs, domestic fuel shortages, increased transportation costs, security challenges, reform of the foreign exchange market reflected in high exchange rate pass-through to domestic prices of imports. Consequently, the current episode of inflation, being largely non-monetary but largely structural, tightening at this point would only serve to worsen prospects for growth recovery as the Bank had in June 2016, withdrawn substantial domestic liquidity through the foreign exchange market upon introduction of the flexible foreign exchange market regime. Members however, noted the negative effect of inflation on consumption and investment decisions and its defining impact on the efficiency of resource allocation and investment.

The MPC further noted the prolonged non-payment of salaries, a development which has affected aggregate demand and worsened growth prospects. It also noted that at the May MPC meeting, members weighed the risks of the balance of probabilities against growth and voted to hold, allowing fiscal policy some space to stimulate output with injections, but this has been long in coming.

The MPC in putting forward for tightening considered the high inflationary trend which has culminated into negative real interest rates in the economy; noting that this was discouraging to savings. Members also noted that the negative real interest rates did not support the recent flexible foreign exchange market as foreign investors attitude had remained lukewarm, showing unwillingness in bringing in new capital under the circumstance. Members further noted that there existed a substantial amount of international capital in negative yielding investments globally and Nigeria stood a chance of attracting such investments with sound macroeconomic policies. Consequently, members were of the view that an upward adjustment in interest rates would strongly signal not only the Bank's commitment to price stability but also its desire to gradually achieve positive real interest rates. Such a decision, it was argued, gives impetus for improving the liquidity of the foreign exchange market and the urgent need to deepen the market to ensure self-sustainability. Members were of the opinion that this would boost manufacturing and industrial output, thereby stimulating growth which is desired at this time.

The Committee's Decisions

The MPC, recognizing that the Bank lacked the instruments required to directly jumpstart growth, and being mindful not to calibrate its instruments in such a manner as to undermine its primary mandate and financial system stability, in assessment of the relevant issues, was of the view that the balance of risks remains tilted against price stability. Consequently, five (5) members voted to raise the Monetary Policy Rate while three (3) voted to hold.

In summary, the MPC voted to:

(i) Increase the MPR by 200 basis points from 12.00 to 14 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

Thank you for listening.

Godwin I. Emefiele

Governor, Central Bank of Nigeria

26th July 2016

PERSONAL STATEMENTS BY MEMBERS OF THE MONETARY POLICY COMMITTEE

1.0 ADELABU, ADEBAYO

The lingering challenges in both the global and domestic economies have not shown signs of waning, rather new issues seem to be unfolding which, invariably, have complicated the fragility of the macroeconomic conditions. A number of new issues in the global economy such as the shocking Brexit vote, the rising wave of terrorism particularly in the US and Europe, the wobbling recovery as well as the volatile financial markets conditions in the Euro zone, and the palpable uncertainty regarding the forthcoming general election in the US are part of unanticipated developments that have impacted on domestic macroeconomic conditions. Within the domestic economy, issues such as the adjustment in the exchange rate, negative shock to oil output arising from resurgence of militancy in the Niger Delta areas, prolonged lag effects of adjustment in fuel and electricity tariffs are all parts of the major phenomenon that have pushed key macroeconomic indicators out of the comfort zone. Key macroeconomic indicators have therefore not only displayed lackluster performance but the challenge of stagflation is now real, more than ever before. Apart from the twin challenges of output contraction and inflation, the pressure in the FX market has not eased even when the exchange rate has shown sharp adjustment. Against the perspective of these multi-dimensional challenges therefore, it is exceedingly clear that monetary policy cannot address all of the issues simultaneously thus requiring optimal-mix of policies.

I have argued severally in my previous statements on the imperative of far reaching structural reforms in our quest to provide a stable macroeconomic environment, and I would like to stress that emerging issues on daily basis continue to reinforce my conviction. The main challenges confronting the macroeconomy at this period could be broadly dimensioned along four lines: contraction in output; rising price level; exchange rate pressure; and high lending rate. I am of the view that the underlying drivers of all these issues reside largely in the real side of the economy rather than the monetary side. With regard to inflation for instance, it is well known that there is a partial suppression in aggregate demand on the backlash of default in wages and salaries by many sub-national governments, thus the likelihood of inflation being driven by excess demand is out of place. Available statistics revealed that the increase in headline inflation in the first half of the year was largely driven by imported food inflation which increased by 20.0 percent in June 2016. A most worrisome dimension is that imported food price, unlike other items, did not only show an uptick on year-on-year basis but the upward trend was also observed on month-on-month basis, suggesting a low likelihood of moderation in the near term. It is equally disturbing to note that the items that accounted for the significant uptick in imported food inflation during the period included rice, bread, cake, frozen fish, and edible oils. The reason for the upward adjustment in the prices of these items was mainly due to exchange rate pass-through as commodity prices are easing in the global market.

With the adoption of the flexible exchange rate model at the last meeting, it is envisaged that real equilibrium would soon be attained in the FX markets and thereby minimize incessant adjustments in domestic price on the heels of swings in the

exchange rate. In as much as this is a realistic projection, it is however, necessary to recognize that sustainability of the exchange rate, among others, is a function of terms of trade of a country's export commodities in the international market. The price of crude oil, the country's main export, has been severely hit by negative shock since mid-2014 while the prospects of improvement in the medium term is highly diminished in light of several factors like the slow recovery in the global economy and persistence of supply glut. Besides, developments in the global financial markets also pose considerable risks to the medium path of the domestic currency. With Brexit and the attendant softening of pound sterling, portfolio investors, particularly in the Euro zone, now place much premium on security rather than returns, which has naturally shifted investors' sentiment to dollar denominated assets. In addition, the evolving monetary policy stance of the US Federal Reserves would much likely weigh on the currencies of emerging economies. The singular reason why the Federal Open Market Committee (FOMC) did not hike its policy rate at the last meeting in June was because inflation was still running below the target of 2 percent as labor market had sufficiently strengthened. In the view of the Committee, the underlying currents for the softness in consumer price were transitory in nature and expected to dissipate soonest. The point here is that it is logical to expect that the FOMC would soon hike interest rate with implication of further strengthening of the US dollar against most currencies particularly currencies of emerging market economies. In the light of all these issues, attempt to strengthening naira by increasing policy rate with a view to attracting capital flow could be a desirable option, but the most enduring option to reducing addressing inflation, in my view, is to reduce the pass-through effect of exchange rate on domestic prices.

A reliable way forward, therefore, to minimizing the impact of exchange rate pass-through on domestic prices is to drastically reduce the weight of imported food in the average consumer's basket. In essence, my view is that further tightening of monetary policy stance may not achieve the best result over the medium to long term. This informs my concerns on the need to stimulate activities in the real sector particularly in agricultural value chain that could enhance domestic production of staples such as rice, corns, meats and dairy products. Large scale farming in these products supported by government incentives is one of the right strategic direction. On its part, the Bank should rejuvenate its various development financing schemes, most especially the NIRSAL. Structural reforms measures that enhances production would not only address the price concern but it would equally address the contraction in output.

Another dimension of the current challenge is the contraction in output which emanates from both non-oil and oil sectors. Apart from the regular issues like infrastructural constraint on the manufacturing sector, the decline in oil-GDP, in particular has price and output dimensions. Oil production hovered around 1.5mbd against the production quota of 2.2mbd during the first half of the year, resulting in a net production loss of about 32 percent as a result of the resurgence of militancy in the Niger Delta. The point here is that the underlying drivers of the current recession goes beyond monetary factors, as there are significant issues that must be addressed by all stakeholders including the security agencies in order to produce an enduring solution.

In as much as most of the factors fuelling the current downward trend in output is outside the scope of monetary policy, issues bothering on appropriate monetary policy

stance in a period of recession cannot be completely ruled out. One of the essential elements of a sound macroeconomic policy, including monetary policy, is the need to be countercyclical with the business cycle. This was amply demonstrated by notable central banks like the Fed and ECB in the wake of the recent global economic and financial crisises. While I will subscribe to the fact that the issue of stagflation in our peculiar circumstance may not afford the monetary authority the latitude to significantly ease monetary policy stance, I will equally averse to raising interest rate at this period as such is synonymous to procyclical monetary policy with potential effect of accelerating recessionary process. Increase in policy rates, on the basis of inflation concerns, poses further upside risk to the stability of the banking system, among others. The NPLs of the banking system have increased considerably in the last one year on the backlash of slowdown of activities in virtually all sectors of the economy. Increase in policy rates will, therefore, have either of these two impacts on the banking system; the banks would most likely transfer the cost to the customers with implication of heightening the level of NPLs or the banks could absorb the cost but cut down on the level of lending. Either of these outcomes, therefore, is not desirable at this point in time.

In my opinion therefore, the challenge may look a bit complicated but the most enduring solution lies in working with necessary stakeholders to remove the binding structural constraints in the real sector of the economy. From the monetary side, the most desirable way to support the process of recovery is through easing of monetary policy stance, but in the light of concern for inflation as well as rising pressure on the exchange rate, I am of the view that the MPR should be reviewed upward .

Consequently, I vote for an increase of 200 basis point in the MPR to 14 percent while CRR remains 22.5 percent and Liquidity ratio at 30%. Asymmetric window at +200/-500 basis point around the MPR is also recommended.

2.0 ALADE, SARAH O

This is the first MPC meeting since the historic Brexit vote which has added additional risks to global economic growth. The big concern is whether a retreat from financial risk due to Brexit will disturb the existing fault lines in the world economy, notably in China and southern Europe, although the Bank of England have put in place some monetary policy intervention measures to cushion these effects. These developments, coupled with domestic economic environment have increased risks to the Nigerian economy. Oil prices remain low, even as militant activities in the Niger Delta are affecting output, putting undue pressure on the fiscal and external sectors and adversely affecting the domestic economy. Headline inflation remains elevated at 16.48 percent in June up from 15.58 percent recorded in May, a further drift from the single digit goal of the Central Bank. The growth for the second quarter of 2016 remains subdued even for the rest of the year. These developments call for balanced monetary policy measures to fight inflation and attract foreign investments to cushion the loss in foreign earnings from oil. I will therefore support an increase in monetary policy rate.

Global economic growth continue to be sluggish: Weak demand and slowing productivity coupled with the vote of the United Kingdom to exit the European Union "BREXIT" is undermining global growth for 2016. In addition, the *Brexit* vote has created widespread uncertainty and elevated volatility in the global financial markets. The International Monetary Fund's (IMF) World Economic Outlook (WEO) for July 2016 downgraded its baseline forecast for global growth to 3.1 percent from 3.2 percent in the April version. In the Emerging Market and Developing economies, weak aggregate

demand and low commodity prices have translated to output decline and resulting in difficult economic and business environment. Depressed commodity prices continued to pose downside risk to growth in emerging markets, especially on commodity exporting countries, thus, dampening prospects for near term economic and financial recovery in those economies.

The shocks experienced during the first quarter of the year are still affecting Gross Domestic Product (GDP) growth negatively: Contraction in output which started in the first quarter due to energy shortages, high electricity tariffs, fuel price hikes, scarcity of foreign exchange and depressed consumer demand continued to determine growth outcomes in the second quarter. In addition, the implementation of the 2016 budget in the second quarter remained slower than expected affecting the speed of economic activities at a time when fiscal policy is needed to complement the efforts of monetary policy to spur growth. First quarter GDP growth stood at -0.36 percent compared to a 2.11 percent expansion in the previous period and way below forecasts of 1.7 percent growth. It is the first contraction since the second quarter of 2004 as the non-oil sector contracted, mainly due to a slowdown in the services sectors as a result of a weakening naira, while lower oil prices keep dragging the oil sector down. GDP Annual Growth Rate in Nigeria averaged 4.12 percent from 1982 to 2016, reaching an all-time high of 19.17 percent in the fourth quarter of 2004 and a record low of -7.81 percent in the fourth quarter of 1983. The resuscitation of economic growth will require the cooperation and collaboration of monetary and fiscal policy and delicate balancing of both global events and domestic risks in the coming months. In addition, policy

measures targeted as expanding the revenue base such as improving tax administration and broadening the tax base should be pursued vigorously to help lift depressing consumer demand and increase growth. While an increase in tax rate might not ordinarily be the best at this time, the fact that is declining calls for additional measures to increase government revenues and spending to lift the economy out of the current crisis. In addition, efforts should be made in the area of concessional borrowing to finance infrastructure development and spur employment which will help increase aggregate demand.

Headline inflation elevated even as foreign exchange supply remain limited. Headline inflation further increased to 16.48 percent in June 2016, from 15.58 percent recorded in May. The increase in headline inflation in June reflected increases in both food and core components of inflation. Core inflation rose sharply for the fourth time in a row to 16.22 per cent in June, from 15.05 per cent in May and 13.35 per cent in April. Food inflation also rose to 15.30 per cent in June, from 14.86 per cent in May and 13.19 per cent in April. The rising inflationary pressure was largely a reflection of structural factors, including high electricity tariff, high transport cost as a result of higher fuel prices, high cost of inputs, low industrial activities as well as higher prices of both domestic and imported food products. The persistent upsurge in inflation calls for monetary policy intervention. High inflation causes lenders to demand higher fixed interest rate on borrowing. It also hurts the poor since it erodes their purchasing power. High inflation is harmful to growth and Central Bank at this time can only support growth by keeping inflation low since it cannot increase aggregate demand by lowering interest

rate. Thus fighting increasing inflation pressure by increasing MPR will also help to attract foreign inflows into the country to cushion the lost revenue from both lower oil prices and lower output.

The recently adopted foreign exchange regime is bringing more transparency into the foreign exchange market. After a period of restriction in the foreign exchange market, a new market driven approach was adopted in June, 2016. This has brought the needed transparency, price discovery and greater participation in the market. In addition, the new framework is attracting inflows into the market, increasing supply and ensuring continuation of economic activities, although more should be done to further increase supply. In addition, the decision to increase the monetary policy rate will further help encourage foreign inflows to curb capital outflow and provide liquidity to the interbank market. At this time, monetary policy should be focused on restoring confidence in the domestic economy and increasing supply of foreign exchange to attract inflows, therefore an increase in MPR is in the right direction.

Against this background, I support a rate increase to help bring inflation gradually under control and bring interest rate to a less negative territory. Decreasing rate at this time will make interest rate more negative which is bad for savers and for investment at a time when the nation needs all the investment it can get to support growth. However, increasing Monetary Policy Rate rapidly to make interest rate positive will ground economic activities. The increase in rate coupled with the new liberalized foreign

exchange policy will lead to stable currency as foreign inflow increases and inflation moderate.

I therefore support an increase in Monetary Policy Rate by 200 basis points, to 14 percent, the retention of Private Sector Cash Reserve Requirement (CRR) at 22.5 percent, retention of the Liquidity Ratio at 30.00 per cent; and retention of the Asymmetric Window at +200 and -500 basis points around the MPR to help attract capital inflow and resuscitate the economy.

3.0 BALAMI, DAHIRU HASSAN

At the global level, the IMF downgraded its 2016 economic growth projection to 3.1per cent from 3.4 per cent due to high level of uncertainty which include some of the following vulnerabilities and risks: the British vote to leave the EU; the continuous fall in crude oil and other commodity prices; the divergence of monetary policy between the USA and other major economies of the world; and the slowing down of the Chinese economy, all of which have had impacts on the Nigerian economy. There is the need for the G20 to deliberately enact policies that would stimulate growth at the global level. It should however, be noted that manufacturing and industrial development are the key drivers of growth and economic transformation for any economy at the global level.

At the domestic level, the Nigerian economy is currently in recession with the twin problem of negative growth indices and rising inflation. It has been observed that for two consecutive quarters, the growth rate has declined Q1 at -0.36% and Q2 at -1.8% while inflation has risen from 15.58 per cent in May to 16.48 per cent in June. The nation is also caught up in economic crisis with pressure on its foreign exchange market and slow growth in the economy, with the private sector being crowded out. Also, sub-national governments are unable to pay salaries which affects the consumption expenditure. The critical questions then are: How do we stimulate growth of output in the face of high lending rate and inflation? Will an increase in interest rate reduce inflation? Will it encourage households to save? Do we control inflation and leave growth or the other way round? How do we stimulate private investment? Do we shift resources to higher productive sectors of the economy? In agriculture for instance, should the government direct social funds to farmers through providing improved

seedlings, water pumps and fertilisers etc.? In the light of the questions raised above, growth can be encouraged through diversification of the economy. However, there are a lot of constraints due to the reasons earlier discussed in my personal statement of May 2016. These include lack of adequate infrastructural facilities like energy; poor roads network; insecurity; low level of household income; and the lag in the implementation of the 2016 budget which was expected to be expansionary.

At the theoretical level, any economy in recession would require both expansionary fiscal and monetary policies to move the economy forward. At the Monetary policy level, it requires raising the level of money supply and reducing interest rates to attract more investors. At the fiscal level, the government is expected to raise public expenditure and reduce the level of taxes to raise the disposable income of both households and firms. A lot has been done on the monetary side, particularly to encourage the banking industry to lend to the real sectors of the economy. However, with rising non-performing loans, not much has been achieved in stimulating growth. Hence, the CBN has had to intervene several times in various sectors of the economy, like the Anchor Growers Programme, to encourage the growth of the agricultural sector where Nigeria has comparative advantage if properly planned. Similar interventions have been done to the small and medium scale enterprise sectors of the economy. For growth to take place, proactive and creative planning is needed.

Another important aspect of monetary policy objective is price stability. Currently, inflation rate of 16.5% is much outside the CBN band of 6 - 9%. However, inflation in Nigeria is partly not a monetary phenomenon, but due to structural reforms in the

economy. These include removal of energy subsidies; foreign exchange depreciation; rising cost of transportation; poor electricity and infrastructural facilities. The point here is that the CBN as a regulatory body, should be seen promoting financial system stability, hence the need for taming inflation and sending signals to the fiscal side to pursue growth vigorously. Impact analysis of earlier monetary policies should be made available to the government to complement the fiscal side. In view of monetary policies put in place in May 2016, there is need to allow time for the CRR, liquidity ratio and symmetric corridor to hold while the MPR be varied by 200 point basis to promote the inflow of FDI. These would gradually reduce inflation in the economy. For treasury bills, the banks are quoting 18.5%, then why do we have to leave policy rate at 12%? It should be noted that the policy of setting MPR at 12% is ineffective because it is too far from the current inflation rate of 16.5%. Again, we cannot leave the control of current level of liquidity to the banks because the DMB's are not using it appropriately. On the basis of the above analysis, I vote to:

(I) Retaining the CRR at 22.5%.

(II) Raising MPR by 200 basis points from 12% to 14%.

(III) Retaining the liquidity ratio at 30%.

(IV) Retaining the asymmetric corridor at +200/-500 point basis.

4.0 BARAU, SULEIMAN

Background

The drag on key macroeconomic indicators since the beginning of the year is still very much at play. It has been complicated by new shocks like the Brexit vote, and rising wave of global terrorism and ascendancy of militancy in the domestic environment. A key outcome of the last meeting in May 2016, was the deployment of a flexible exchange rate model, which, to a large extent, has reduced the high rate of depletion of the external reserves but it is glaring that the pressure in the FX market is still reasonably high given the significant depreciation in the exchange rate even when some slowdown could still be observed on external reserves.

Besides, other major issues include the acceleration in domestic price level and sliding output, with statistics pointing to the likelihood of the economy being in recession at the end of the year. However, this should not be interpreted as a complete bad news because the underlying cause is pretty clear and monetary policy measures will always be proactive in response. The contraction in output was principally a result of unprecedented shocks on both the demand and supply sides. The sharp adjustment in the exchange rate impacted production negatively, while the fall in public revenue arising from the slump in oil price has equally eroded consumption with many subnational governments unable to pay wages and salaries on regular basis. Structural issues including productivity declines from negative spillover in the global environment, exchange rate adjustment, increase in electricity tariffs, and supply deficit from conflict ravaged north eastern part of the country, has accelerated inflation.

A simultaneous rise in inflation and contraction in output would naturally pose serious challenge to any monetary authority, but I am of the view that restoring confidence in the macroeconomic environment should be critical. The policy rate (MPR) was increased by 100 basis points in March against the background of creeping inflation but my view is that the challenge in the macroeconomic environment demands further tightening through upward adjustment in the policy rate. Perhaps, the most compelling case against the *status quo ante* is the emergence of unanticipated shocks which have caused inflation to overshoot forecast as well as putting additional pressure on external reserves. In the light of this, my vote is to increase the Monetary Policy Rate with a view to addressing inflation concerns as well as enhancing the competiveness of the economy for foreign capital required to shore up the external reserves.

Pressure Points

Global Environment:

There are a number of significant negative developments in the global environment with potential spillover to the domestic economy. One of such key developments is the exit of Britain (Brexit) from the European Union via the outcome of the referendum in June. Although events are still unfolding, evidence so far reveals amplification of downside risks in the global financial markets with potential spillover to both the real and financial sectors of the domestic economy. Preliminary data shows that the pound sterling has shed about 15 percent, while the credit rating of UK has been downgraded from triple to double "A"s. Pound Sterling denominated assets continued to shed weight on the heel of anxiety by investors who are moving out to a more secured haven. Naturally, the

likely destination of most of these investments is the US with implication of further strengthening of the dollar against most currencies particularly emerging economies' currencies. This could possibly accentuate the risk of depreciation of the Naira against the US dollar and heighten the pressure in the foreign exchange market. Besides, given that most primary commodities exported by emerging market economies, crude oil inclusive, are quoted in US dollar, an appreciating dollar should result in softening of prices of these commodities. The implication of such development on the domestic economy particularly on the fiscal sector is fairly obvious.

Another challenge of worrisome dimension brought about by Brexit is the increase in the level of uncertainty in the global output as the IMF has undertaken a third downward revision of 2016 global growth. Global growth in 2016 is now projected at 3.1 per cent compared to 3.4 and 3.2 percent in October 2015 and April 2016, respectively. Although the downward adjustment from the latest revision is restricted mostly to Euro economies but when cognizance is taken that the leading emerging economies like China are still contending with growth challenges under its rebalancing model, then the prospects of increase in exports for most developing economies is highly diminished.

The increase in global terrorist activities, especially in the US and Europe have profound macroeconomic implications. These activities divert attention of leaders in large global economies with likely severe consequence on allocation of resources for real economic activities. Secondly, most of these activities are concentrated in the Euro zone and in view of the fact that the zone is yet to fully recover from recession since the 2008/9 global financial crisis, even after series of quantitative easing by the ECB, the

current spate of terrorism challenges confronting the zone would only aggravate the slide into recession.

The last issue in the global environment is the evolving monetary policy stance of systematically important global central banks like the Bank of England (BOE) and the US Federal Reserves (FOMC). Both the BOE and the FOMC kept their rates unchanged at their last meeting in June and July, respectively, which, naturally, is a good news to emerging economies. The reason for keeping the rate unchanged was similar in the two countries but a deeper appreciation of issues should make emerging economies treat the news with caution. In the US, for example, the labor market has strengthened and economic activities were expanding at moderate pace. The only reason why the Fund's rate was kept unchanged was inflation running below the long run target of 2 percent as a result of transitory factor of earlier decline in energy price. As the effect of transitory factor dissipates, uptick in inflation should be expected with the FOMC responding with rate hike. The implication of such development on the domestic economy is obvious but more importantly, the Naira may slide further against the US dollar.

Domestic Environment

Pressure on Exchange Rate: The adoption of a flexible rate model at the last meeting represented a giant stride in aligning the exchange rate framework to the realities of the operating environment. The model has considerably enabled the exchange rate to

absorb much of the pressure in the market but it appears the pressure is yet to abate as external reserves is still slowing down. It is worrisome that demand pressure in the FX market continued to increase at a period when the real side of the economy is contracting, suggesting that some speculative forces could still be at play. Among others, the likely drivers of the excess demand is the difference in rate between the interbank and parallel market rates which is still relatively high although some form of narrowing has been achieved. Additional risk to the pressure in the FX market is the lingering liquidity surfeit in the banking sector.

Slowing Output: The GDP contracted by 0.36 percent at the end of first quarter after persistent slowdown since the latter half of 2014. The key forces at play are yet to ease. The insurgency in the North East, and the militancy in the Niger Delta have impacted negatively on economic activities of those areas. From, the demand side, though there was bailout programme for some states, a considerable number are still owing on wages and salaries thereby reducing consumption and depressing aggregate demand. The softening output portends a lot of adverse consequences. Among others, given the recourse to borrowing to finance budget due to falling fiscal revenue, a softening GDP, therefore, would accentuate the contraction of fiscal space.

Rising Domestic Price: The domestic price level continued its upward trend in June as headline inflation accelerated to 16.48 percent, the highest level since 1994. The pressure on domestic price level emanated from both core and food components with an increase of 15.30 and 16.22 percent, respectively, suggesting that both monetary and non-monetary factors are at play. The medium term path is still challenged by

significant upside risks including the lag effect of upward adjustment in energy prices, recent increase in electricity tariff, and rising prices of imported food items on account of depreciation of domestic currency.

High Lending Rates: The challenge to growth is further impeded by the subsisting high lending rate regime. The prime lending rate rose to 16.78 percent in June while the Maximum lending rate increased to 26.93 percent in the same month. A commissioned study on the viability of small scale agro-allied business in Nigeria in 2015 revealed an Internal Rate of Return (IRR) of between 21 to 43 percent for the various agriculture sectors. With the current lending rate, most of the sectors would definitely drop out of the viability zone. Besides, the current monetary policy rate regime has revealed the inefficiency of resource allocation inherent in oligopolistic banking structure such as ours. It is difficult to understand that while the lending rate increased between May and June 2016, there was a reduction in consolidated deposit rate. The consolidated deposit rate fell to 3.26 percent in June, culminating to wide spread of 23.67 percent between savings and lending rates. The wide spread in rate would not only inhibit maturity transformation role of banks but the negative real interest rate on savings deposit could reduce incentive to save and thereby threaten banking system stability.

Way Forward

To reduce the risk inherent in the macroeconomic environment, the following measures may become necessary.

Address the Rising Inflation: The persistent rise in inflation deserves attention. Although the significant drivers of the current inflationary trend could be ascribed to shocks and structural challenges, nevertheless the demand for money needs to be well managed to avert stagflation. The current policy rate may appear fairly high but in the light of the conventional Taylor's rule, the central bank's policy rate must be increased whenever inflation exceeds the target rate regardless of whether the source of the pressure is from decline in productivity or increase in aggregate demand. The current inflation rate is 16.4 percent against the bank's inflation target of 9 percent, suggesting the need to adjust the policy rate upward. Argument for upward adjustment is further reinforced by the fact that the current level of inflation has taken the real policy rate to negative territory, which is an indicator of loose monetary condition. It is equally significant to mention that the decision to hold the MPR at the last meeting was in the hope that it would elicit reversal of the declining growth trend. However, the result was a rise in inflation and decline in growth, confirming the thesis that though inflation could be beneficial but it is harmful to growth if it exceeds certain threshold.

Stabilize the Foreign Exchange Market: The perception of economic agents about the medium term path of key economic variables is very crucial to reversing recession and restoring growth on sustainable basis. One of such variables is the exchange rate. It is appreciated that the currencies of most emerging economies particularly oil exporting countries, are facing pressure but the effect seems much more on Nigeria. Available statistics reveal that Naira depreciated by about 34 percent in July 2016 on year-on-year basis while the South Africa rand depreciated by about 16 percent during the period. When examined on month-on-month basis, however, Naira still depreciated by

about 6 percent while South Africa rand appreciated by about 4 percent. This shows that the switch to a flexible exchange rate model at the last meeting, though a logical step, has not completely eliminated the pressure in the FX market. The model, could only work on one side of the equilibrium path- the demand side, as the supply side is yet to be addressed. At a time when accretion to external reserves through oil proceeds is threatened from both the price and output sides, the only available leeway is capital account. Global capital flow is generally influenced by both push and pull factors. A significant push factor is already at work in the aftermath of the exit of Britain (Brexit) from the EU but the domestic economy needs to strengthen the pull factors. As such, it may be in order to put in place measures that can enhance the attraction of some of these capitals into the domestic economy. Thus, beside the need to address inflation concerns, another reason to increase the policy rate is the need to improve the competitiveness of the domestic economy for foreign capital and thereby shore up the external reserves.

Support the Real Sector: Given the lingering infrastructural challenge coupled with the need to raise the policy rate in order to curtail inflationary pressure, the vulnerable sectors of the economy particularly agriculture and manufacturing may be worse hit in terms of flow of credit. Credit to the core private sector grew by 12.63 percent at the end of the first half, annualized to 25.26 percent, which is below the optimum requirement at a time of softness in critical sectors. As a result, it may be in order for the Bank to intensify its various development finance scheme, like the Nigerian Incentive based Risk Sharing System for Agriculture Lending (NIRSAL), the CAC, and the Anchor Borrowers Programme.

Strong Sectorial Policies: Stabilization of the macroeconomic environment is imperative in reversing the slide to recession but it is important to appreciate the fact that the relationship between stable macroeconomic environment and growth is not symmetry. Instability in the macroeconomic environment would hurt growth but restoring stability does not translate to automatic restoration of growth. This is even more important for developing economies such as ours with a lot of bottlenecks in the production process. At this point in time, there is a compelling need for government to spend in order to halt the slide to recession while at the same time cautiously guides against unproductive consumption that could exert further pressure on price level. It is therefore critical for government to prioritize spending to critical sectors that could promote non-inflationary growth. It is noteworthy to mention some recent initiatives of government, particularly in the transport sector despite the dwindling revenue. The proposed launch of Abuja-Kaduna rail line as well as Lagos-East bound line are good examples of such projects. Other critical sectors like the power sector need to come with robust policies that must be faithfully implemented in order to promote spending that could stimulate growth without necessarily increasing the risk to inflation.

Protection of Oil and Gas Installations: I mentioned this issue in my last statement in May 2016, but it is quite disheartening that the condition has not improved but rather deteriorating with the recent bombing of some key oil installations. We have not benefited from the rally in oil price since April. Instead, our production level had dropped to 2.2million to 1.6million per day. We must implore all initiatives to stop this haemorrhage in order to take advantage of the current rally in oil price and by extension halt the declining fiscal revenue.

Decisions

In view of the need to restore stability in the macroeconomic environment and most especially to stem the rising inflation and equally make the domestic economy competitive for foreign capital, I propose that the MPR be increased by 200 basis points, while retaining other measures.

5.0 SALAMI, ADEDOYIN

The Monetary Policy Committee (MPC) meeting in May 2016 had issues around exchange rate management as its overriding challenge. At the end of that session I was clear in my mind that with GDP data for Q1-2016, released in the run-up to that meeting, already showing a contraction and the outlook for both activity growth and inflation indicating a worsening in both parameters, our meeting in July would have to provide clarity as to the priority between inflation and growth.

At the end of deliberations, I voted with a minority of colleagues in favour of the proposal to leave policy rates unchanged.

Additional data published since the meeting in May simply confirmed my feeling that the primary issue at this meeting is for the MPC to indicate its preference for policy attention between growth and inflation. The most recent revision of the 2016 forecast for Nigeria published by International Monetary Fund (IMF) just ahead of this meeting foresees output of the economy in Nigeria contracting by 1.8 percent this year. The National Bureau of Statistics (NBS), on the sanguine assumption that Nigeria attains daily average oil production of 1.7mn barrels for 2016, expects GDP to contract by 1.3 percent this year. On available information concerning the current state of oil-export production, this assumption looks optimistic.

It is perhaps noteworthy that the forecasts from both the IMF and the NBS show a marked worsening of the economic environment. While the IMF's January 2016 forecast

for Nigeria has swung from 4.2 percent annual growth to contraction of 1.8 percent in updated forecasts published in July, the NBS' forecast similarly swings from its January forecast of 3.8 percent growth to a conservative estimate of 1.3percent contraction! Allowing for the 0.4percent contraction in Q1-2016, the most optimistic forecasts for growth suggest a minimum average contraction of approximately 1.6percent in each of the remaining 3 quarters of the year.

For inflation, data published (by the NBS) for June shows Aggregate prices rising at 16.5 percent when compared with the same month last year. Both Core and Food inflation also rose by 10.9 percent and 11.67 percent respectively. These figures represent a worsening of inflation when compared with the similar data for the previous month. The trend in inflation is however not fully captured by the year-on-year figures. The month-on-month data however shows a sharp improvement in the rate of aggregate price increase from 2.8 percent in May 2016 to 1.7percent in June 2016. Core inflation and the rate of increase in food prices similarly showed a marked reduction – rising slower, at 1.8 percent and 1.4 percent respectively when compared with 2.7percent and 2.6 percent the previous month.

It is also noteworthy that the rate of change of the month-on-month data has been quite volatile in 2016. In other words, whilst prices doubtless continue to rise, it is not conclusive that inflationary conditions are worsening. Indeed, forecasts for inflation provided by Bank Staff show a deceleration in the rate of aggregate price increase to 15.95percent in August before increasing to 16.83percent, year-end. Forecasts for

month-on-month inflation show a deceleration to October before rising in the final two months of the year.

In my judgment, raising the MPR is inappropriate at this time. To begin with, the primary causes of rising prices are not driven from the demand-side – indeed, credit conditions are quite tight. Year-to-date has seen credit increase by just 1.3percent. This compares with price rise of almost 12percent between December 2015 and June 2016. It is clear that rising inflation is the result of reform in Energy Costs and the Naira's weakness.

Whilst it is tempting to conclude that at the very least the Naira's weakness might be halted by raising the MPR, I am not convinced this will happen. The fundamental challenge facing the Naira is the negative shock in Nigeria's Terms of Trade caused by sharply lower oil prices. This has been worsened by ineffectual policy responses, leading to a loss of policy credibility with the resultant inability to provide supply stimuli needed to revive the economy. In my view it is unduly optimistic to expect international investors to be attracted to Nigeria until policy credibility and consistency is not only restored but also successfully maintained. Indeed, initial implementation of the supposed flexibility in exchange rate determination simply saw movement from a 'hard' peg at N197/US$1 to a "soft" peg in the range N282-284/US$. This, in my view, sent a needlessly negative signal from which we now appear to be belatedly back-tracking.

The 'market' rates for Naira are in my view an over-adjustment given the fundamentals of the economy. I have seen estimates that suggest a Purchasing Power Parity (PPP)

rate of N315/US$ at the time of this meeting. In all markets, the Naira has weakened beyond this level and shows no sign of appreciation anytime soon. The difference within markets is what can only be described as the cost of FOREX Market illiquidity with a further premium for policy uncertainty. *At this point, it may be that the most credible option open to the Central Bank for improving FOREX liquidity is to specifically borrow USD for the purpose*.

If, as I contend, upward movement in the Policy rate fails to attract the size of FOREX flows immediately required, the case for raising rates also fails. In my view higher interest rates also worsen the financial stability problems already evident in the banking sector. Data provided by Bank Staff for June 2016, show Non-Performing Loans (NPL) amounting to 10.71percent of the Banking Industry Loan Book, which is well above its regulator's mandate. My hope remains that the data reflects full disclosure of NPLs.

In charting a path out of the present situation, we could not do worse than to draw on lessons from the reaction of Central Banks in other jurisdictions on the prioritization between inflation and GDP Growth. As we have seen time and again in the period of sub-par growth prevailing since the sub-prime induced financial and economic crisis, Central Banks have placed priority on growth, even to the extent of using the instrumentality of unorthodox monetary policy.

The collapse in government revenue in H1-2016 means that the fiscal side will face enormous challenges to deliver any significant stimulus to the economy, through the

2016 Appropriation Act, as hoped. Indeed the government has already warned that it is unlikely to fully implement the budget for this year. Raising rates at this point is unlikely to achieve anything other than to worsen the economic and business circumstances of Nigeria.

6.0 UCHE, CHIBUIKE U

With the Nigerian economy now in recession, inflation and bank NPLs in double digit territory, oil prices tottering and no visible sign that our oil dependent economy is being diversified, few will dispute the fact that our country currently has no clear path towards economic recovery. Under the above scenario, as I have argued in the past, it is clear to me that there is a limit to what monetary policy alone can achieve. While some MPC members have argued that we should focus on the main mandate of monetary policy, which is price stability, I am of the view that such a mandate is not an end in itself. This is because the very essence of price stability is to engender economic growth. Since it is now prudent to assert that the days of high oil prices are unlikely to return, the only reasonable path towards encouraging economic growth in Nigeria is to diversify the economic base of our economy by promoting real sector development. Tightening of money supply at the present time, will therefore be counterproductive towards achieving the above objective.

At another level, I also very much doubt whether tightening at the present time will indeed curtail inflation. This is because evidence available to MPC suggests that liquidity is not the main causative factor of the current inflationary pressure. Rather such inflation has in the main been caused by the reforms in the electricity and petroleum sectors which have resulted in higher prices for the above energy products, which impact on the input costs to the real sector of our economy. Another important factor that has contributed to the present inflation is the oil revenue induced scarcity of foreign exchange which has resulted in both the explicit and implicit devaluation of the Naira.

In the light of the above, I do not see how tightening money supply can help curtail inflation at the present time. Rather such a policy move can only further exacerbate the present difficulties being experienced by operators in the real sector of the Nigerian economy. Tightening, which will definitely lead to increases in lending rates, will adversely affect our already contracting manufacturing sector and thus drive our economy further down the recession path. This will not be in the interest of our banking system which, given its current double digit NPL level, is already in a precarious state.

Throughout the meeting, I also carefully listened to the argument that tightening will help the country achieve higher interest rates which will positively impact on foreign portfolio inflows and thus on the value of the Naira. In my humble view, to tighten monetary policy with the main objective of attracting foreign portfolio flows will be a major policy error. This is because history teaches us that unless foreign capital inflows are deployed to the real sectors of our economy, their impact on stabilizing the exchange rate of the Naira are at best temporary. Given our current precarious economic situation therefore, I am convinced that it would be an error to continue to allow unhindered inflow of speculative capital into our economy.

For the avoidance of doubt, I am not fundamentally opposed to the inflow of foreign capital. All I am saying is that our country should encourage the inflow of foreign direct investments as opposed to foreign portfolio flows. Although some MPC members have argued that foreign portfolio flows are normally the precursor of foreign direct investments, history teaches us that this has thus far not been applicable to Nigeria. While portfolio flows can sometimes help to sustain the value of our currency, this is not

sustainable in the long run. Without investments in the real sector, which admittedly will require a clear strategy to diversify our current oil dependent economy, the value of our currency will continue to slide. Speculators cherish the above dynamics. In fact, some will argue that speculators are already exploiting the above scenario and reaping handsome profits to the detriment of both the value of the Naira and our economy.

In conclusion therefore, I believe that monetary policy tightening at the present time will be an error. Although maintaining status quo, when there is no clear path towards diversifying the nation's economy and making the country less dependent on foreign goods, may not provide the optimal solution to our complex economic problems, it is by far the lesser of the two evils. At the very least, this position will give the fiscal authorities the necessary space for it to adopt policies that will encourage the diversification of our economy.

Based on the above arguments, I am inclined to vote that status quo be maintained at the present time. I therefore vote as follows: (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.

7.0 YAHAYA, SHEHU

The Domestic Economy

The dominant challenge facing the Nigerian economy is the fall in GDP experienced in the first quarter of the year, as well as resurgent inflation. Government revenue is also low, and the 2016 budget has not yet really taken off. Substantial progress has been made in the de-regulation of the foreign exchange market, but there are still uncertainties; policies are still evolving and there is quite a bit of fine-tuning.

Output

The factors that have precipitated the historical decline in GDP are extant, and have certainly not played out. Crude petroleum output is still suffering from disruptions, and repairs have not completed on many of the breached pipelines, thereby impacting on exports and supply to domestic refineries. The destructions of gas pipelines has disrupted supplies to power plants and therefore reduced electricity output. The construction sector is reviving and many of the hitherto abandoned projects are coming back to life. However, very little of the capital resources of the budget have actually been disbursed. At any rate, much of the revival effect, including the boost to consumption, will show only in Q3 or Q4 and will not show in the growth figures for Q2 2016. It can only be hoped that the various policy measures deployed in the agricultural sector can substantially raise crop production and livestock sufficient to make up for declines in other sectors of the economy and thereby avoid another quarter of negative growth.

Prices

With respect to price levels, the surging trend of prices continue, with headline inflation, YOY, at 16.5% in June 2016, up from 15.6% last month. Both core and food prices combined to drive headline inflation forward. The most significant contributors to the headline inflation include processed food, farm produce, non-alcoholic beverages, clothing and footwear, utilities and fuel. In the meantime, there has been a sharp increase in diesel prices; the deregulation of PMS also implies that the depreciation of the Naira may trigger an increase in pump prices of PMS, with an additional inflationary impact on transport costs. It is worth noting though that month on month prices, for all items, have declined in June as compared to May 2016.

Forex Market

The foreign exchange market has been substantially liberalized and the value of the Naira is being increasingly determined by the market. Hopefully, this will lead to additional supply of foreign currency from external investors and other sources, and some movement in that direction is already being observed. But there is still a wait and see attitude from many investors who are weighing the still unfolding policies, the direction of the Naira value and other macro-economic variables in the economy, including foreign reserves and interest rates. However, it is necessary to do some intelligent market intervention to ensure that the market pulls in the direction of desired objectives. An increased intervention capacity from the CBN and a more realistic import

regime and overall fiscal policy are therefore essential for a more effective management of the foreign exchange market.

The banking system remains overall sound. The difficult macro-economic environment, particularly the negative growth rates, low government revenues, declines in crude oil export earnings, construction and the energy sector, combined with the effects of the implementation of the TSA have placed onerous burdens on the financial sector. Unsurprisingly, overall capital adequacy ratio, liquidity ratio have experienced some decline during Q2 2016. But they remain above the prudential thresholds. ROE, ROA have both improved recently, and are performing at least as well as comparators in other countries. Profitability is also stable. However, NPLs are rising, given the overall slow- down of the economy

The Global Economy

World output growth rate is forecast to be lower than previous estimates, to equate the growth rate in 2015, largely due to the UK vote to leave the EU. US growth rates have experienced a decline in Q1 2016, while unemployment rose slightly and prices remained stable. Overall, this makes it improbable that policy rates will be raised in that country in the near term.

Output growth rate in China continues its gradual slow down. Growth in the Eurozone is still low, although recovering somewhat, while unemployment remains fairly stable and prices remain negative. Effect of Brexit may cast a pall over recovery prospects. There is a slight slow down in UK. Most of the major oil producing developing and emerging economies are still undergoing some painful re-adjustments.

Global crude oil output is still characterized by over-supply. OPEC output is also rising. Overall, prices are holding up, although there was a bit of a decline in the third week of July.

There are unlikely to be any major challenges from imported inflation to Nigeria, except of course higher import prices due to the exchange rate depreciation effect. It also appears that there are unlikely to be threats from higher interest rates in the major trading partners of Nigeria in the near term

Conclusion and Recommendations

Many of the issues causing the sharp drop in output are also the same as causing the current inflationary pressures- i.e supply gaps for fuel, diesel, gas, infrastructure, as well as the effect of exchange rate depreciation on imports and now PMS- it is mainly the decline in consumption (salaries not paid and construction staff laid off, austerity and late take-off of the budget) that is undermining growth, but not fuelling inflation. Overall, the current inflationary pressure is not primarily fuelled by excess liquidity in the system. Under the circumstances, the challenge is for a policy response that addresses inflationary pressure as well as contributes to, or at least does not undermine growth.

The MPR, which is one of the main instruments available to help respond to inflationary pressure, will in this case not be much help, since the inflation is not largely a monetary phenomenon. Also, it cannot be very effective as an incentive for international portfolio investors, since there are currently more important macro-environmental factors for them to consider. Raising it is therefore unlikely to have a significant effect on the supply of foreign exchange. Yet raising the MPR may undermine efforts to re-generate

growth if DMBs thereby re-price their loans accordingly. Moreover, it may exacerbate the challenge of rising NPLs in the financial sector and complicate the quest for financial stability.

Under the circumstances, it may be necessary to tolerate, for a short time, the current negative MPR rate. Raising the CRR will also not help for similar reasons.

There is much greater scope to address inflationary pressures and contribute to growth through the foreign exchange market. As the forex market is being liberalized, it is necessary to ensure that its outcomes are guided to yield the necessary benefits to society. Efforts therefore need to be stepped up to find ways of augmenting the capacity of the CBN to intervene in the market, through additional forex resources. For an economy such as Nigeria, at the current level of development, and given the uncertainties regarding oil earnings, the time lag between policy and results in the effort to diversify the economy and add local value, the high level of import dependence, it is also necessary to manage the import regime through fiscal and other measures. This must be done to avoid market outcomes that destabilize the foreign exchange market and to ensure that the market can stabilize, help check inflationary pressures and help drive growth.

I therefore vote to hold, with respect to MPR, CRR and liquidity ratios. This does not exclude some tinkering with the corridor around the MPR. Much attention should be paid to stabilizing the foreign exchange market in order to build on the progress achieved so far.

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

In the first six months of 2016, the state of the global economy was broadly fragile and fragmented amidst lacklustre potential growth, weak demand and diminished productivity in many countries. The tepid global outlook was further complicated by the June 23 decision of the United Kingdom to exit the European Union. This exacerbated the uncertainties that pervaded global economic and financial markets, and lowered the medium-term growth prospects. The IMF, in the July 2016 vintage of the World Economic Outlook, reduced global growth forecast for 2016 and 2017 by 0.1 percentage point apiece to 3.1 percent and 3.4 percent. Similarly, 2016 growth prospect in advanced economies was downgraded by 0.1 percentage point to 1.8 percent while medium-term outlook in emerging market and developing economies remained cautious with a 2016 growth rate of 4.1 percent vis-à-vis 4.0 percent in 2015.

In Nigeria, macroeconomic performance remained weak in the first half of 2016 due to both economic and non-economic factors. Output growth declined from 2.1 percent in 2015Q4 to -0.4 percent in 2016Q1. This contraction, the first in many years, was due to the torrents of shockwaves that beleaguered the economy over the past three years. Aside the debilitating effect of lower oil prices, the economy experienced energy shocks (scarcities and price hikes), foreign exchange scarcity, weak domestic demand, late ratification of the 2016 budget, and poor financial markets sentiments. As the effects of these shocks lingered into 2016Q2, an immediate rebound in that quarter seems unlikely. Available indicators of economic activities signify an insipid second

quarter performance and the likelihood of a technical recession in 2016H1. I note that although the non-oil sector is the dominant driver of domestic GDP growth, the imperative of the oil sector remains fundamental and deep-seated. The non-oil sector relies heavily on foreign exchange inflows from crude oil, thereby weakening the fabric of our economy. This is why a broad-based diversification of the economy remains non-negotiable, incontrovertible and exigent at this time.

The prevailing difficulty of the Nigerian economy is worsened by rising inflationary trends. From an inflation rate of 9.6 percent in January 2016, domestic prices have assumed an exponential acceleration with year-on-year headline inflation rising persistently to 15.6 percent in May 2016 and 16.5 percent in June 2016. These increases reflected the ascent in both food and core components of inflation. Food inflation increased steadily from 10.9 percent in January 2016 to 14.9 percent and 15.3 percent in May and June, while core inflation rose abruptly over the same period from 8.8 percent to 15.1 percent and 16.2 percent, respectively. Although, the rising inflationary pressure was due essentially to aggregate supply factors, analysis revealed that it was reinforced by monetary factors. The critical supply-side drivers of inflation in the first half of 2016 include high and rising energy costs, high cost of transport, the exchange rate pass-through that is reflected in the rising costs of imported food, and low domestic supply as industrial activities remained lacklustre.

Data on monetary and credit conditions indicates rising domestic liquidity as the annualised growth of broad money supply (M2) in June 2016, at 16.5 percent, exceeded the 2016 growth threshold of 10.9 percent. Net domestic credit expanded at

an annualised rate of 25.0 percent vis-à-vis the target of 17.9 percent while private sector credit, at an annualised rate of 28.9 percent, exceeded its benchmark growth of 13.4 percent. To ensure that the private sector credit is productive it must be channelled to sectors that can deliver sustainable and inclusive growth rather than to ventures that will exert unwarranted pressure on the exchange rate and undermine economic recovery.

In the foreign exchange market, the CBN on 20 June 2016 further liberalised the interbank segment to eliminate the pressure on foreign reserves, allow market forces, and correct immanent distortions in the market. Accordingly, the naira-dollar exchange rate weakened from ₦197.00/US$ to ₦292.90/US$ as at 19 July 2016. This fall reflected the rush into the market as operators jostled to benefit from the freshly released hold on the market.

Overall, I note that the Nigerian economy is in an intricate conundrum as actual and potential output fall while inflationary pressures intensify. During the review period, we also noticed a faster than desired growth in M2 and a continuing weakening of the naira. I observe more delicately that the intersecting factor that is worsening both growth and inflation is supply-sided. Thus, I want to re-echo the urgent need to resolve the underlying structural imbalances of the Nigerian economy, diversify the economy, and reduce the dependence on imports for consumption, rather than production. This will not only remove the undue exchange market pressure, it will also ensure that the economy has the armour to withstand adverse shocks like the ones we are currently experiencing.

The choice before the Monetary Policy Committee of the CBN at this time is a very difficult one. Given the supply constraint nature of the underlying shocks, we are experiencing both a contracting economy and rising domestic prices. Growth considerations are germane, as growth will ensure that economic development is accelerated, while unemployment and poverty are reduced. But how do we achieve this growth if the needed investments to drive growth are hindered by the distortionary effects of high inflation. It may be more important at this time to contain inflation so that illusions in investment decisions are extricated. Economic theory suggests that inflation is innately undesirable and costly as it creates money illusion, uncertainties, relative prices distortions, market inefficiency, and perverse wealth transfer from creditors to debtors. The ramification of this is that at the current level of inflation no meaningful growth can occur. Our in-house forecasts indicate that, if we do nothing, inflation and growth outcomes will deteriorate rapidly.

I am strongly of the view that, on the balance of judgment and evidence, the MPC should take a stand and act now. If we must remove the distortions to efficient market operations we must use the tools at our disposal to fight inflation promptly while not losing sight of output growth. By raising interest rate, the MPC will signal its stance to curb inflation. Tangentially, this hike could moderate exchange market pressures as the higher yields on domestic instruments attract foreign investors. I acknowledge that a rate hike may inhibit real sector activities. However, the CBN is perceptive to the health of the critical sectors of the economy. Accordingly, the Bank will continue to support growth by broadening its development finance initiatives. We have seen the success of

the anchor borrowers' programme in rice: lowering prices and increasing supply. This will be extended to other agricultural products including tomato and palm oil for which we have domestic capacity. We will strategically extend the intervention to manufacturing and industrial sector ventures, while continuing activities with SMEs, power, etc. It is my utmost belief that this development finance activities in consonance with an ardent inflation combating will speed-up the rebound of the Nigerian economy.

Based on the foregoing, I vote to:

1. Raise the MPR by 200 basis points to 14.0 percent;
2. Retain the CRR at 22.5 percent;
3. Retain the asymmetric corridor at +200/–500 basis points; and
4. Retain Liquidity Ratio at 30 percent