CENTRAL BANK OF NIGERIA

MONETARY POLICY REVIEW

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Central Bank of Nigeria

Mandate

▪Ensure monetary and price stability

▪Issue legal tender currency in Nigeria

▪Maintain external reserves to safeguard the international value of the legal tender currency

▪Promote a sound financial system in Nigeria

▪Act as banker and provide economic and financial advice to the Federal Government

Vision

"By 2015: Be the model Central Bank delivering Price and Financial System Stability and promoting Sustainable Economic Development"

Mission Statement

"To be proactive in providing a stable framework for the economic development of Nigeria through effective, efficient and transparent implementation of monetary and exchange rate policy and management of the financial sector"

Core Values

- Meritocracy
- Leadership
- Learning
- Customer - Focus

MONETARY POLICY DEPARTMENT

Mandate

To Facilitate the Conceptualization and Design of
Monetary Policy of the Central Bank of Nigeria

Vision

To be Efficient and Effective in Promoting the
Attainment and Sustenance of Monetary and
Price Stability Objective of the
Central Bank of Nigeria

Mission

To Provide a Dynamic Evidence-based
Analytical Framework for the Formulation and
Implementation of Monetary Policy for
Optimal Economic Growth

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STATEMENT BY THE GOVERNOR

Monetary policy environment in the first half of 2016 was shaped by a number of global and domestic economic developments. The global developments included the slowdown in global growth; the US monetary policy normalization and the associated policy divergence in the advanced economies; protracted financial market turbulence worsening global risk aversion; geopolitical tensions as well as China's continuing transition to a balanced growth path. Although the global economy has witnessed a modest recovery in the prices of crude oil and other commodities in the first half of 2016, government receipts remained low, thereby pressuring the domestic economy. This resulted in limited fiscal space, low accretion to foreign reserves, continuing depreciation of the naira and the slippage of the economy into a recession.

These headwinds weakened consumer and business confidence, as well as domestic spending, and slowed economic activity. Accordingly, the Gross Domestic Product (GDP) dipped for two consecutive quarters by -2.06 and -0.36 per cent (year-on-year) in the second and first quarters of 2016, respectively, compared with a growth of 2.35 per cent in the corresponding quarter of 2015. This development implies that the Nigerian economy is now in recession, in the face of rising domestic price level. The pass-through of exchange rate depreciation to domestic prices owing to uncertainties surrounding the implementation of flexible exchange rate regime as well as increases in the prices of petroleum products and energy exacerbated pressure on the domestic price level. Consequently, headline inflation rose to 16.5 per cent in June from 9.6 per cent in January 2016.

The Bank's monetary policy in the review period, accordingly, focused on restarting economic growth, curtailing inflation, reducing unemployment rate, boosting external reserves to stabilize exchange rate and moderating liquidity levels in the banking system.

The imperative of these developments is that the Bank steered a cautious monetary tightening course during the review period by raising the MPR from 11.0 to 12.0 per cent and narrowing the asymmetric corridor to +200/-500 basis points around the MPR. The Monetary Policy Committee (MPC) also increased the CRR from 20.0 to 22.5 per cent of total reserve deposits. The Liquidity Ratio was, however, retained at 30.0 per cent.

The near-term outlook for the domestic economy suggests the Bank's major challenge remains balancing price stability mandate against the urgent imperative to restart growth. The challenge is further emphasized by lack of sizeable fiscal adjustments as well as the negative developments in the external sector and their potential impact on exchange rates. The Bank is, however, optimistic about increased coordination between fiscal and monetary policies, as the monetary authority alone cannot anchor the suite of policies required to steer the economy back to stability and growth. Monetary policy would, therefore, remain proactive, to confront macroeconomic challenges in order to achieve its objectives.

Godwin I. Emefiele
Governor, Central Bank of Nigeria
August, 2016

CHAPTER ONE

1.0 OVERVIEW

In the first half of 2016, monetary policy was influenced by a number of key developments in the global and domestic economic and financial environments. On the external front, the key factors were weak growth from depressed aggregate demand, output deterioration in the euro area, continued rebalancing of the Chinese economy, and the referendum by the United Kingdom to exit the European Union (EU). Others included: the US policy normalization, as well as weak global commodity prices which have adversely pressured the foreign exchange reserves and the exchange rates.

On the domestic front, the substantial depreciation of exchange rates following the introduction of the flexible exchange rate policy, the depletion in foreign exchange reserves, as well as the resurgence of militancy in the Niger Delta continued to put pressure on domestic prices. Accordingly, headline inflation rose to 16.48 per cent in June 2016 from 9.6 per cent in December 2015. Food and Non-Alcoholic Beverages remained a major driver of headline inflation in the period under review. This was followed by housing, water, electricity, gas and other fuels.

The severe shock witnessed in the domestic economy triggered by falling private and public expenditures due largely to the impact of weak oil prices, low consumer demand and shortages of foreign exchange resulting in the depreciation of the currency, the prolonged budget impasse as well as continued inflationary pressures, combined to depress domestic output growth in the review period.

Data from the National Bureau of Statistics (NBS) showed that the real GDP contracted by 0.36 per cent (year-on-year) in the first quarter of 2016 in contrast to 2.1 per cent growth in the previous quarter. The decline in the first quarter was lower by 2.46 percentage points from the preceding quarter and 4.32 percentage points compared with the corresponding quarter of 2015. The contraction was mainly driven by the oil sector which further declined by 1.89 per cent in the first quarter of 2016 from a decline of 8.28 per cent in the preceding quarter; and the non-oil sector, which fell by 0.18 per cent in the review period. The growth performance was influenced by: Agriculture (0.61%), and Trade (0.36%), while contractions were recorded in Services (-0.07%), Construction (-0.23 %) and Industry (-1.03%). In the second quarter, output growth further contracted by 2.06 per

cent, (year-on-year) from the contraction of 0.36 per cent in the first quarter, compared with the growth of 2.35 per cent recorded in the corresponding quarter of 2015. This further contraction in output was driven largely by contractions in the industry, services, construction and trade sectors. The agricultural sector, however, grew by 0.96 per cent.

In the foreign exchange market, the persistent decline in crude oil prices limited the supply of foreign exchange which, when confronted with the continued increase in the demand for foreign exchange, led to further depreciation of the Naira. In a bid to curtail further depletion of external reserves to fund the market, as well as reduce the demand pressure for foreign exchange, the Bank introduced a series of measures culminating in the adoption of a new flexible foreign exchange framework which effectively resulted in the floating of the Naira. It also maintained the discontinuation of sale of foreign exchange to Bureau de Change (BDC) operators and the exclusion of forty-one (41) ineligible import items from accessing the official foreign exchange window. As a result of these policy measures, the demand pressure in the foreign exchange market slightly moderated during the review period.

Activities in Nigeria's financial markets remained challenged by continued global economic uncertainties reflected in the general slowdown in economic activities in emerging markets; China's rebalancing of economic activity away from investment and manufacturing to consumption and services; low oil prices, and the impact of Brexit from the European Union. Accordingly, the Bank deployed various instruments to ensure price and financial system stability in order to boost investor confidence and encourage foreign inflows. The key instruments were the Monetary Policy Rate (MPR), the Cash Reserve Ratio (CRR), Open Market Operations (OMO), Discount Window Operations (DWO), and the introduction of the flexible exchange rate policy.

In the period under review, the MPR, which was 11.0 per cent in January 2016, was reviewed upward by 100 basis points to 12.0 per cent in March 2016. Also, the asymmetric corridor around the MPR was narrowed from +200 and -700 basis points to +200 and -500 basis points in March 2016. In addition, the CRR was adjusted upwards from 20.0 per cent to 22.5 per cent of total deposits. The adjustments were intended to address the excess liquidity condition observed in the banking system and the growing reluctance of DMBs to grant new credits owing partly to the rising cases of non-performing loans (NPLs). The liquidity ratio, however, remained unchanged at 30.0 per cent in the first half of 2016.

The Bank increased its reliance on open market operations (OMO) as the main tool in managing banking system liquidity in the first half of 2016. As a result, actual OMO sales increased by 34.47 per cent to ₦2, 329.75 billion in the first half from ₦1, 732.55 billion in the second half of 2015. The increased reliance on OMO in the first half of 2016 arose from a need to reduce the level of liquidity in the banking system and ultimately, moderate inflationary pressures.

The interbank and Open Buy Back (OBB) rates remained largely below the floor of the asymmetric corridor around the MPR for most of the period. The interbank and OBB rates however, rose above the corridor in the later part of the review period. The Nigerian money market reference rate, the NIBOR, was relatively stable across all tenors during the review period. The NIBOR, however, spiked at 17.62 per cent in June, owing largely to the introduction of the flexible exchange rate system. In the first half of 2016, the capital market performance was moderately bullish. The All-Share Index (ASI) rose by 3.49 per cent to 29,597.79 at end-June 2016, from 28,642.25 at end-December 2015. This, however, represented a decline of 11.40 per cent compared with 33,456.83 at end-June 2015.

The bonds market was largely driven by Federal Government of Nigeria (FGN) securities. Sub-national governments and corporate bonds also registered some activity. The corporate bonds segment recorded the least share by market volume. The yield on the 10-year dollar-denominated bonds recorded a decrease of 1.74 per cent to 6.74 per cent at end-June 2016, from 8.48 per cent at end-December 2015. It, however, showed an increase when compared with 5.91 per cent recorded at end-June 2015. This development was attributable to improved investor perception of the country's sovereign risk as well as the correction of market reaction that followed the delisting of Nigeria from the JP Morgan's Government Bond Index for Emerging Markets (GBI-EM) in September, 2015. Headline inflation has remained in double digits since February 2016 and is projected to rise till year-end. Staff projections indicate that year-on-year headline inflation would remain in double digits throughout 2016, closing at 16.83 per cent in December 2016. The anticipated increase would be due, primarily, to the effects of exchange rate depreciation (owing to the introduction of greater flexibility in foreign exchange management) as well as increases in the prices of petroleum products and energy, on account of recent policy reforms.

Domestic output in 1H, 2016 took a downturn into negative territory. According to the National Bureau of Statistics (NBS), Gross Domestic Product (GDP) contracted by -0.36% (year-on-year) in real terms, 2.46

percentage points lower than the preceding quarter and 4.32 percentage points lower than the corresponding quarter of 2015. The contraction in GDP growth has been attributed to decline in oil prices and oil production, and consequently, oil revenue which remains the major source of government revenue. The economy is projected to continue on a weak growth path in the second half of 2016. This relatively weak growth outlook is based largely on the current low oil price which is projected to be low in the medium to long term with attendant implications for the fiscal position. The International Monetary Fund (IMF) had in April 2016, revised Nigeria's GDP growth for 2016 downward to -1.8% from the earlier projection of 2.3%. .

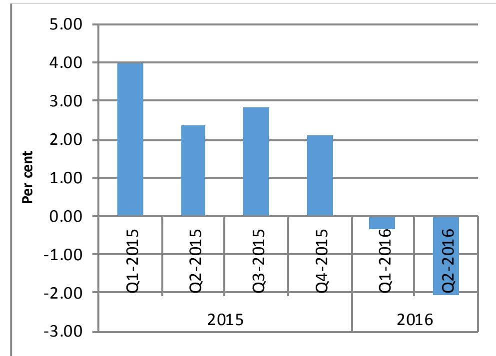
This bleak outlook is exacerbated by persistent fragilities in the international economy, principally the slow global economic recovery; low crude oil prices; falling demand for crude oil from Nigeria; and the continued depletion of foreign exchange reserves.

CHAPTER 2

2.0 OUTPUT IN DOMESTIC ECONOMY

The Nigerian economy slipped into recession in the first half of 2016, due mainly to persisting challenges in the oil sector which impacted adversely on foreign exchange receipts and revenue of government. Real GDP contracted by 0.36 per cent (year-on-year) in the first quarter of 2016, in contrast to the growth of 2.11 and 3.96 per cent in the previous quarter and the corresponding period of 2015, respectively. This development was driven by contractions in both the oil and non-oil sectors of 1.89 and 0.18 per cent, respectively. In terms of the primary sectors, the major drives of the contraction were largely Industry (-1.03%), Construction (-0.23%) and Services (-0.07%), while Agriculture and Trade grew marginally by 0.61 and 0.36 per cent, respectively. The contraction of the industrial sector was due to the contractions recorded in all its sub-sectors, namely: crude petroleum and natural gas (-0.20%), solid minerals (-0.12%) and manufacturing (-0.71%). The relative shares of the key sectors in GDP were: Services (37.35%), Agriculture (20.48%), Industry (19.86%), Trade (18.19%) and Construction (4.13%).

Figure 2.1
Real GDP Growth (%) 2015 Q1 – 2016 Q2



In the second quarter of 2016, real GDP further contracted by 2.06 per cent (year-on-year), following a contraction of 0.36 per cent in the previous quarter and growth of 2.35 per cent in the corresponding period of 2015. Contractions in both the oil and non-oil sectors of 17.48 and 0.38 per cent accounted for the development. The contraction was driven largely by Industry (-2.03%), followed by Services (-0.70%), Construction (-0.28%) and Trade (-0.01%); while Agriculture grew by 0.96 per cent. The deepening contraction of the industrial sector was attributed to the shrinkage in crude petroleum and natural gas (-1.71%) and manufacturing (-0.32%). The relative shares of the key sectors in GDP were: Services (37.74%), Agriculture (22.55%), Industry (17.83%), Trade (17.57%) and Construction (4.30%). The persistent contraction of the oil sector has led to the drop in the contribution of industry to overall GDP from 19.86 per cent in the first quarter

to 17.83 per cent in the second quarter of 2016. Similarly, during the same period, the contribution of trade to GDP fell from 18.19 to 17.57 per cent, possibly indicating the effect of dwindling oil receipts in financing trade.

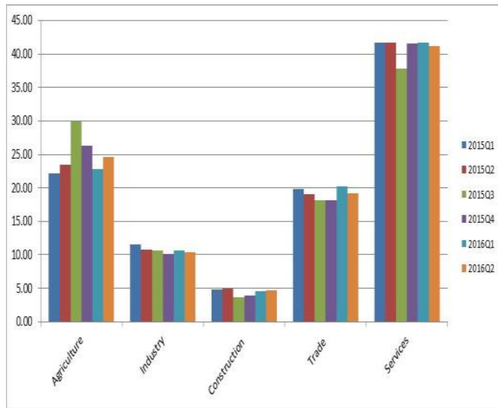
Overall, the major factors responsible for the output contraction in the first half of 2016 was the persistent low crude oil prices, compounded by delayed passage and implementation of the 2016 fiscal budget, which negatively impacted other macroeconomic indicators . These indicators include weak aggregate demand worsened by non-payment of salaries, rising energy costs due to tariff and foreign exchange reforms, shortage of foreign exchange leading to pressure on the exchange rate etc.

2.1 Domestic Economic Activities

Activities in the first quarter of 2016 remained limp, reflecting sustained weakness in the oil sector, spilling over to the non-oil sector. Non-oil real GDP contracted by 0.18 per cent in the first quarter of 2016, compared with a growth of 3.14 and 5.59 per cent in the preceding and corresponding quarters of 2015 respectively. The contraction in the non-oil sector in the first quarter of 2016 was largely driven by food, beverages and tobacco (-0.57%), financial institutions (-0.46%), real estate (-0.35%) and electricity and gas (-0.18%). This compares with their respective contributions of -0.05, 0.32, 0.24, and -0.16 per cent in the corresponding quarter of 2015. However, crop production and telecommunications and information services recorded positive contributions to growth at 0.58 and 0.47 per cent, respectively, during the first quarter 2016.

In the second quarter of 2016, non-oil GDP further contracted to 0.38 per cent from 0.18 per cent in the first quarter, in contrast to the growth of 3.46 per cent in the corresponding period of 2015. The deepening contraction in the non-oil sector was largely driven by real estate (-0.46%); financial institutions (-0.42%); food, beverages and tobacco (-0.27%); and public administration (-0.17%). This compares with their respective contributions to non-oil growth of 0.26, 0.20, -0.31, and -0.35 per cent in the corresponding quarter of 2015. However, crop production, telecommunications and information services, broadcasting and livestock recorded positive contributions to growth at 0.98, 0.16, 0.11 and 0.11 per cent, respectively, during the second quarter 2016.

Figure 2.2
Non-oil Sector Performance 2015Q1-2016Q2

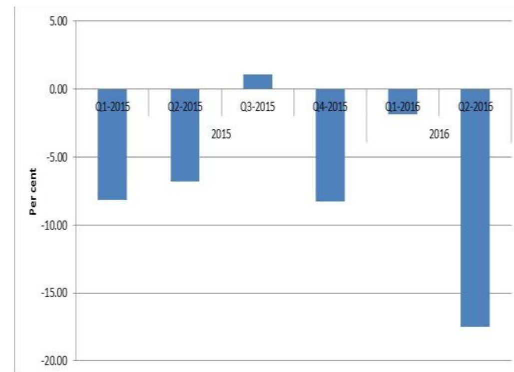


In the review period, the weakness of the oil sector which dampened non-oil performance continued. The oil sector contracted moderately by 1.89 per cent (year-on-year) in the first quarter of 2016, from contractions of 8.28 and 8.15 per cent in the preceding and the corresponding quarters of 2015. The contraction was due to average daily crude oil production declining from 2.11million barrels per day (mbpd) in the first quarter of 2016 compared with 2.16 and 2.18 mbpd in the preceding and corresponding quarters of 2015. This was attributed to the increasing incidences of pipeline vandalism from to militant activities, leading to production cuts.

The contraction in the oil sector deepened to 17.48 per cent (year-on-year) in the second quarter of 2016, compared with 1.89 per cent in the preceding quarter of 2016, and 6.79 per cent in the corresponding quarter of 2015. Oil production in the second quarter of 2016 also declined to 1.69 mbpd from 2.11 mbpd in the preceding quarter, compared with 2.05 mbpd in the corresponding quarter of 2015.

Following the continued contraction of the oil sector, its percentage contribution to GDP declined to 8.26 per cent in the second quarter from 10.29 per cent in the first quarter of 2016, compared with 9.80 per cent in the corresponding quarter of 2015.

Figure 2.3
Oil Sector Performance 2015Q1-2016Q2



2.2 Sectoral Analysis

This section analyses the sectoral performance of the economy taking into account key institutional developments that shaped domestic output growth in the first half of 2016.

2.2.1 Agriculture

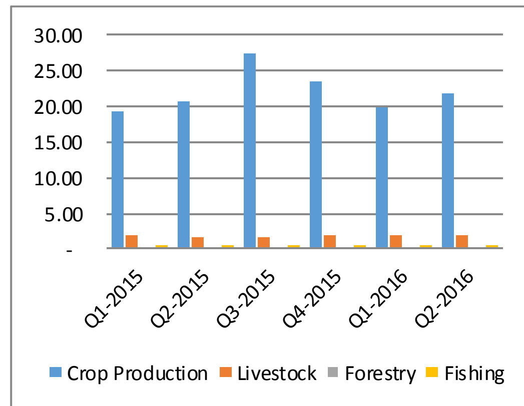
Agricultural output slowed to 3.09 per cent in the first quarter of 2016 down from 3.48 and 4.70 per cent in the preceding and corresponding quarters of 2015. The share of agriculture in total GDP decreased to 20.48 per cent in the first quarter of 2016 from 24.18 per cent in the preceding quarter. It was, however, 19.79 per cent in the corresponding quarter of 2015.

At the growth rate of 3.86 per cent, activity in the livestock sub-sector was the main driver of agricultural output in the first quarter of 2016. This was followed by fishing (3.25%), crop production (3.02%) and forestry (2.31%). This compares with 6.44, 6.97, 4.46 and 4.33 per cent recorded in the corresponding quarter of 2015 for livestock, fishing, crop production and forestry, respectively.

In the second quarter of 2016, agricultural output grew by 4.53 per cent up from 3.09 per cent in the preceding quarter and 3.49 per cent in the corresponding quarter of 2015. The share of agriculture in total GDP increased to 22.55 per cent in the second quarter of 2016 from 20.48 and 21.12 per cent in the preceding quarter of 2016 and the corresponding period of 2015.

At the growth rate of 6.32 per cent, activity in the livestock sub-sector still remained the key driver of agricultural output in the second quarter of 2016. This was followed by crop production (4.72%) and forestry (3.84%), while the fishing sub-sector contracted by 6.85 per cent. This compares with livestock (6.20%), crop production (3.20%), forestry (4.01%) and fishing (5.53%) recorded in the corresponding quarter of 2015.

Figure 2.4
Agricultural Sector Contribution by Activity, 2014Q4-2016Q1



2.2.1.1 Agricultural Policies and Institutional Support

During the first half of 2016, the agricultural sector benefited from a number of key policies, reforms and institutional support. These included:

- **The Agricultural Credit and Guarantee Scheme (ACGS)**

A total of 23,774 loans valued at N3.633 billion were granted between January and June, 2016. A total of 29,519 loans valued at N4.034 billion

were fully repaid in the period under review.

- **N200 Billion Commercial Agriculture Credit Scheme (CACS)**

The sum of N35.992 billion was released from CACS repayments in respect of thirty nine (39) projects between January and June, 2016.

- **N200 Billion SME Credit Guarantee Scheme (SMECGS)**

A total of 88 projects valued at N4.25 billion was guaranteed from January to June, 2016. Cumulatively, however, the total number of fully repaid loans since inception is 40, valued at N2.76 billion.

2.2.2 Industry

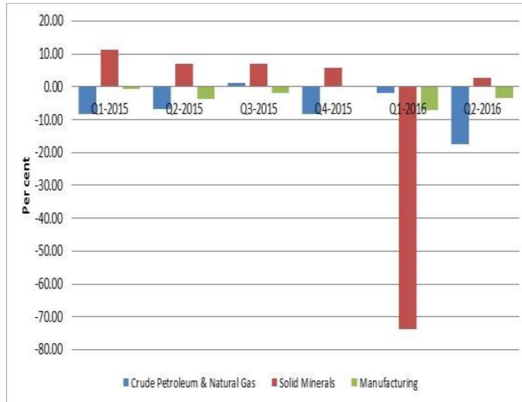
2.2.2.1 Industrial Production

Industrial sector output further contracted by 4.94 per cent in the first quarter of 2016, compared with 3.80 and 4.51 per cent contractions in the preceding and corresponding quarters of 2015. The contraction of the sector was due largely to the huge shrinkage of the solid minerals and manufacturing sub-sectors by 73.63 and 7.00 per cent, respectively in the first quarter of 2016, although crude petroleum and natural gas also contracted by 1.89 per cent. Compared with the corresponding period of 2015, manufacturing contracted by 0.70 per cent, while solid minerals grew by 11.28 per cent. This was, however, in contrast to the growth of 0.38 and 5.73 per cent for manufacturing and solid minerals in the preceding quarter. The huge contraction in the solid minerals sub-sector was primarily due to the 88.87 per cent contraction in quarry and other mining activities, reflecting the general slowdown in construction.

In the second quarter of 2016, the contraction of the industrial sector intensified to 10.42 per cent from 4.94 and 5.27 per cent in the preceding quarter of 2016 and corresponding quarter of 2015, respectively. During the quarter, the sector's contraction stemmed from the 17.48 and 3.36 per cent contraction in crude petroleum & natural gas and manufacturing sub-sectors, respectively, while the solid minerals sub-sector grew by 2.64 per cent. Compared with the corresponding period of 2015, crude petroleum & natural gas and manufacturing sub-sectors contracted by 6.79 and 3.82 per cent respectively, while solid minerals grew by 7.09 per cent. This followed the trend of contraction witnessed in the preceding period for crude petroleum & natural gas (1.89%), manufacturing (7.00%) and solid minerals (73.63%). The deepening contraction of the crude petroleum & natural gas sub-sector was due to continued softening of the global oil market and domestic production challenges, including: lack of investment, declaration of force

majeure by oil companies, production cuts and resurgence of militancy in the oil producing areas.

Figure 2.5
Industrial Sector's Contribution by Activity, 2014Q4-2016Q1



2.2.2.2 Industrial Policy and Institutional Support

In the first half of 2016, the performance of the industrial sector benefited from existing and new reforms and incentives including:

- **N300 Billion Power and Airline Intervention Fund (PAIF)**

The sum of N11.59 billion was disbursed for two projects during the first half of 2016, while the sum of N11.35 billion was received as principal repayment under the PAIF in the first half of 2016. The sum of N6.31 billion was received from Power Projects while the sum of N5.04 billion was from Airline Projects.

- **Nigerian Electricity Market Stabilization Facility (N213 billion)**

During the first half of 2016, the sum of N41.88 billion was released to seven (7) market participants who had satisfied the conditions precedent to the disbursement.

- **N300 Billion Real Sector Support Facility (RSSF)**

Under the N300 billion Real Sector Support Facility (RSSF), a total of N4.60 billion was disbursed to two (2) projects between January and June, 2016.

2.2.3 Construction and Trade

2.2.3.1 Construction

The construction sector contracted by 5.37 per cent in the first quarter of 2016 in contrast to a growth of 11.17 per cent in the corresponding quarter of 2015. The sector also contracted by 0.35 per cent in the preceding quarter. In the second quarter of 2016, the sector's contraction deepened to 6.28 per cent in contrast to the growth of 6.42 per cent in the corresponding quarter of 2015. The sector contracted by 5.37 per cent in the preceding quarter of 2016. This development reflected the slowdown in fiscal sector activities during the period.

2.2.3.2 Trade

Activity in the trade sector has slowed down in recent times. In the first quarter

of 2016, the sector slowed to 2.02 per cent from 6.47 and 4.69 per cent in the corresponding and preceding quarters of 2015.

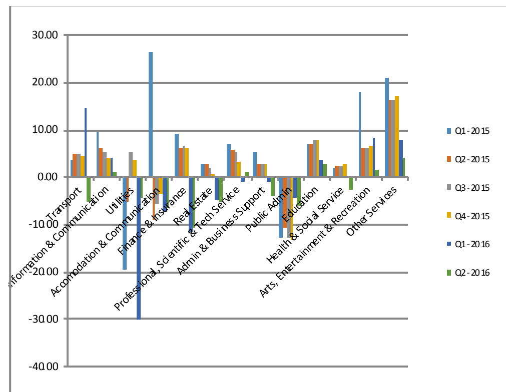
This dismal performance continued into the second quarter, leading to a further contraction of 0.03 per cent in contrast to the growth of 5.07 per cent recorded in the corresponding quarter of 2015 and 2.02 per cent in the preceding quarter of 2016. The poor performance of the trade sector was partly traced to the general slowdown of the economy on account of declining government receipts as well as weaknesses in the external sector.

2.2.4 Service Sector

The general weakness in the economy permeated the services sector in the first half of 2016. Consequently, the sector contracted by 0.18 per cent in the first quarter of 2016, in contrast to the growth of 3.25 and 6.85 per cent in the preceding and corresponding quarters of 2015 respectively. This contraction was due largely to the significant shrinkages in the following sub-sectors: utilities (30.03%); finance & insurance (11.28%); accommodation & foods services (7.41%); and real estate (4.69%) in the first quarter of 2016. This compares with utilities (-19.47%): finance & insurance (9.01%); and accommodation & foods services (26.66%); and real estate (3.08%) in the corresponding period of 2015.

In the second quarter of 2016, the services sector further contracted by 1.86 per cent from 0.18 per cent in the preceding quarter, in contrast to the growth of 4.35 per cent in the corresponding period of 2015. This was due to contractions in finance & insurance (10.82%), accommodation & foods services (6.39%), transport (5.34%), real estate (5.27%) and utilities (4.47%) subsectors. This compares with finance & insurance (6.41%), accommodation & foods services (-8.97%), transport (4.84%), real estate (2.97%) and utilities (-4.93%) in the corresponding period of 2015.

Figure 2.6
Services Sub-Sector Contribution, 2014Q4-2016Q1

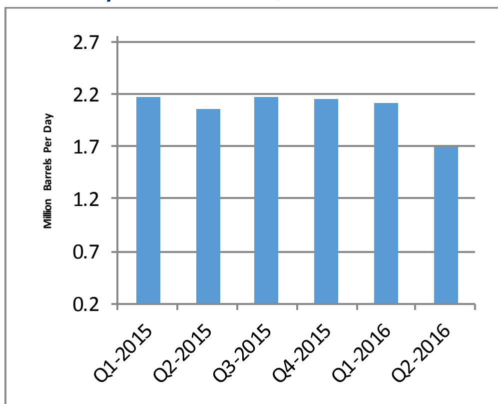


2.2.6 Oil Sector

The performance of the oil sector remained weak in the first half of 2016, indicating the persistent softening of the international oil market. In the

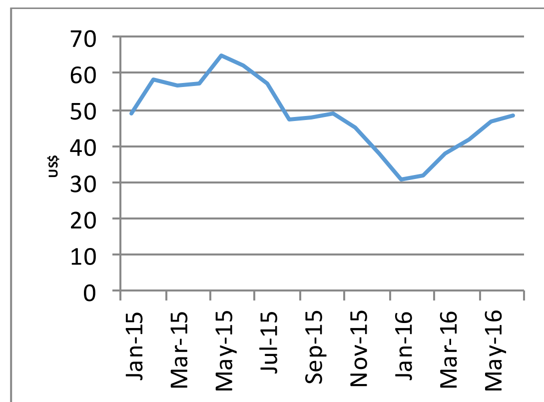
second quarter, average daily crude oil production declined to 1.69 mbpd from 2.05 mbpd in the corresponding period of 2015 and 2.11 mbpd in the preceding quarter. The average daily oil production of 2.11 mbpd in the first quarter represented a decline compared with 2.18 and 2.16 mbpd in the corresponding and preceding quarters of 2015.

Figure 2.7
Quarterly Oil Production, 2014 Q1 – 2015 Q4



During the review period, the global oil price which had remained low showed signs of modest recovery. The price of Nigeria's reference crude, the Bonny Light 37^{0}API, rose from US$30.66 per barrel in January to US$37.76 per barrel in March and further to US$48.46 per barrel in June, 2016. The increase in price of Bonny Light crude (and other global crude streams) was largely as a result of the decline in US inventories and shale oil production as well as decreased supplies from major OPEC producers including Nigeria, Libya, Kuwait and Venezuela. The sluggish recovery in global oil prices has been traced to weak demand, slow output growth and supply glut due to increased production from non-OPEC member countries, including Russia. The appreciation of the US dollar and dollar-denominated assets were also contributory factors. The persistent weak oil price has continued to constrain foreign exchange receipts and fiscal activities. Overall, the average Bonny Light price of US$40.51 per barrel in the review period was slightly above the Federal Government 2016 budget benchmark price of US$38.00 per barrel.

Figure 2.8
Monthly Bonny Light Oil Price, January 2015 – June 2016



Economic Recession in Nigeria

Economic recession simply refers to negative economic growth for two consecutive quarters, reflecting a general slowdown in economic activity. The technical indicator of a recession is two consecutive quarters of negative economic growth of a country's real GDP. Primarily, economic recessions usually occur due to a general fall in aggregate demand, owing to a number of factors, including financial crisis, credit crunch caused by high interest rates, reduced purchasing power due to high inflation and low income, decline in asset prices as well as uncertainty and weak consumer and business confidence relating to general economic conditions. During recessions, certain key macroeconomic indices such as real GDP, investment spending, capacity utilization, household income and spending and business profits usually decline. As such, negative trends such as bankruptcies, factory closures and unemployment rate tend to rise.

The Nigerian economy officially slipped into recession after the second quarter 2016 GDP dipped by -2.06 per cent. The growth rate was lower by 1.70 percentage points when compared with the contraction of 0.36 per cent recorded in the preceding quarter and lower by 4.41 percentage points compared with the growth rate of 2.35 per cent recorded in the corresponding quarter of 2015. According to the National Bureau of Statistics (NBS), the Nigerian economy recorded its lowest growth rate in three decades. Available statistics indicate the Nigerian economy last had this magnitude of decline in 1987, when the economy recorded consecutive declines of 0.51 per cent and 0.82 per cent in first and second quarters, respectively. The recent dismal economic activity generally reflected the sharp contraction in the oil sector, due to the combined effects of lower crude oil prices owing to supply glut among OPEC members, and low production arising from militancy and pipeline vandalism in the Niger Delta region of the country.

Causes of the recession

Recession generally reflects the combined effects of a number of developments in an economy. In Nigeria, the current recession was triggered primarily by the persistent decline in crude oil prices. The low crude oil prices, which crashed to less than $50 per barrel, added to Nigeria's production disruptions caused by militant activities against oil infrastructure in the Niger Delta region. Oil production dropped to 1.69 million barrels per day (mbpd) in the second quarter of 2016, down from 2.11 mbpd in the first quarter, with oil GDP contracting by 17.5per cent in the second quarter, compared with 1.9per cent in the first quarter. Over the

years, the Nigerian government failed to build sufficient fiscal buffers. As crude oil receipts fell due to low oil prices, monthly Federation revenue also fell, thereby impacting the ability of the sub-national governments to meet their expenditure obligations. Added to that was the lack of fiscal adjustment to the lower crude oil prices. With a hugely significant government consumption expenditure in Nigeria, a fall in government spending adversely affected consumer spending, as well as funding of the real, and other growth-enhancing sectors of the economy.

The impact of the recession

Prior to NBS' announcement of the second quarter GDP contraction, the Nigerian economy manifested a number of negative macroeconomic outcomes, indicating the weakness of the economy. Banks and other companies began to downsize, while twenty-seven (27) state governments could not pay the salaries of their employees. Consequently, the total number of the unemployed increased by 1,158,700 persons, resulting in an increase in the national unemployment rate to 13.3 per cent in Q2 2016, compared to 12.1 per cent in the preceding period and 10.4 per cent in the corresponding period of 2015. In the financial sector, a few banks showed signs of stress following the depreciation of the Naira and rising non-performing loans (NPL). The ratio of NPL to total credit rose to 11.7per cent against the regulatory maximum of 5per cent at the end of June from 5.3per cent at the end of 2015. Businesses recorded losses, with some foreign airlines exiting the Nigerian aviation market due to high operating costs and weakening currency. The Naira weakened by 38 per cent against the dollar since the Central Bank of Nigeria (CBN) introduced greater flexibility to the foreign exchange regime in June 2016.

CHAPTER 3

3.0 PRICE DEVELOPMENTS

In spite of the generally tight monetary environment, inflationary pressure in the domestic economy intensified in the first half of 2016. All measures of inflation, namely headline, core and food inflation, trended upwards in the review period. Headline inflation continued to breach the upper limit of the Bank's benchmark of 6-9 per cent during the period. Although both core and food inflation maintained an upward trajectory, food inflation stabilized towards the end of the second quarter. The driving forces for these price developments were both supply and demand-related.

Developments in the foreign exchange market resulted in significant volatility of the Naira, leading to substantial depreciation at both the interbank and BDC segments of the market. The Bank continued to implement a number of policies and administrative measures targeted at curbing excessive demand pressure, and stemming the depreciation of the Naira, such as the introduction of greater flexibility in the inter-bank foreign exchange market. In general, the depreciation can be attributed to several factors, including declining external reserves as a result of low oil prices, amongst others.

In the money market, the Inter-Bank Call and Open Buy Back (OBB) rates fluctuated significantly, reflecting varying levels of liquidity in the banking system during the review period. Reduced borrowing from the money market by the Federal Government, due to the build-up in the Treasury Single Account (TSA), resulted in excess banking system liquidity. Periods of liquidity shortage were due to the combined effects of mopping by the Bank as well as fiscal restraints.

3.1 Trends in Inflation

All measures of inflation maintained upward trends in the first half of 2016. In particular, significant increases were recorded in food and core measures of this Consumer Price Index (CPI) between January and June 2016. Both measures rose from 187.9 and 178.2 in January to 205.4 and 198.3, in June respectively. Food inflation (year-on-year) increased from 10.6 per cent in January to 15.3 per cent in June 2016. Similarly, core inflation (year-on-year) rose progressively from 8.7 per cent in January to 16.2 per cent in June 2016. This development resulted in an increase in headline inflation (year-on-year) from 9.6 per cent in January to 16.5 per cent in July 2016 (Table 3.1and Figure 3.1). The food component remained the key driver of headline inflation due to its significant weight in the consumer basket.

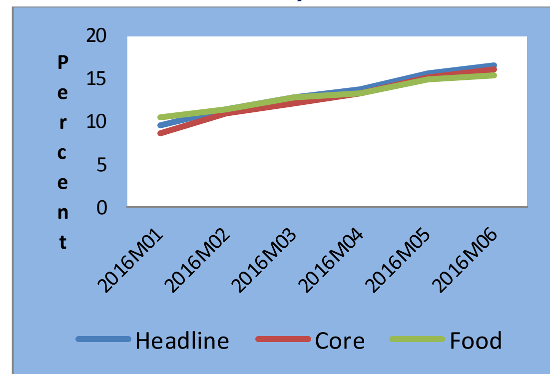
Most components of food inflation continued their upward trend in the review period, as was experienced in the preceding half year. Farm produce remained the major driver of food inflation, increasing by 2.64 percentage points to 8.04 per cent in June from 5.40 per cent in January 2016. Processed food component increased by 2.01 percentage points to 7.26 per cent in June from 5.25 per cent in January. Other components of food inflation that recorded price increases included: fish and sea foods (0.47 percentage point); meat (0.43 percentage point); vegetables (0.32 percentage point); and Yam, potatoes & other tubers (0.22 percentage point).

Table 3.1
Inflation Rates, January – June 2016

	Headline Inflation			Core Inflation			Food Inflation		
	CPI	Y-on-Y	12 MMA	CPI	Y-on-Y	12 MMA	CPI	Y-on-Y	12 MMA
Jan-16	181.71	9.62	9.13	178.19	8.73	8.39	187.92	10.6	10.02
Feb-16	185.89	11.38	9.39	183.03	11.04	8.73	190.51	11.4	10.18
Mar-16	189.94	12.77	9.75	186.42	12.17	9.13	194.87	12.7	10.47
Apr-16	192.99	13.72	10.18	189.55	13.35	9.61	197.40	13.2	10.79
May-16	198.30	15.58	10.75	194.70	15.05	10.20	202.46	14.9	11.22
Jun-16	201.70	16.48	11.37	198.27	16.22	10.86	205.39	15.3	11.67

Source: Nigerian National Bureau of Statistics data base

Figure 3.1
Headline, Core and Food Inflation Rates (Jan - Jun 2016)



Source: Nigerian National Bureau of Statistics database

3.1.1 Headline Inflation

The rise in major components of headline inflation continued, as reflected in the upward trend in domestic prices during the first half of the year. Food & non-alcoholic beverages remained the major driver of headline inflation, rising from 5.61 per cent in January to 8.07 per cent in June, 2016. This was followed by housing, water, electricity, gas & other fuels, which increased from 1.29 per cent to 4.19 per cent over the same period (Table 3.2 and Figure 3.4). In general, headline inflation increased as a result of the combined effects of the increase in the prices of food & non-alcoholic beverages, electricity and other energy sources as well as cost of imported products.

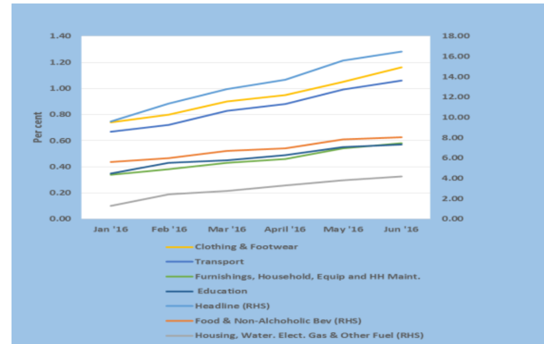
Inflationary pressure witnessed during the period was attributed to several

factors, including the increase in electricity tariff and the removal of subsidy on petroleum products which increased domestic costs. In addition, the pass-through to domestic prices from the depreciation of the naira at the interbank and parallel markets heightened inflationary pressure. Other factors included the impact of disruptions to the food supply chain due to insurgency in the north east region of the country as well as uncertainties surrounding the delayed implementation of the 2016 fiscal budget which impacted adversely on business confidence, economic activity and price expectations.

Table 3.2
Major Components of Headline Inflation (Y-on-Y), January-June 2016

Date	Headline	Food & Non-Alchoholic Bev	Housing, Water. Elect. Gas & Other Fuel	Clothing & Footwear	Transport	Furnishings, Household, Equip and HH Maint.	Education
Jan '16	9.62	5.61	1.29	0.74	0.67	0.34	0.35
Feb '16	11.38	5.98	2.43	0.80	0.72	0.38	0.43
Mar '16	12.77	6.71	2.77	0.90	0.83	0.43	0.45
April '16	13.72	6.95	3.30	0.95	0.88	0.46	0.49
May '16	15.58	7.83	3.82	1.05	0.99	0.54	0.55
Jun '16	16.48	8.07	4.19	1.16	1.06	0.58	0.57

Figure 3.2
Major Components of Headline Inflation (Y-on-Y), Jan-Jun 2016

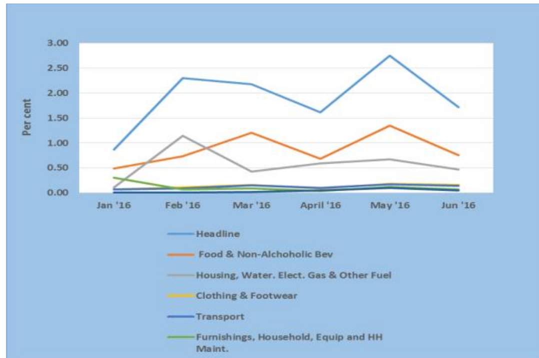


On a month-on-month basis, headline inflation fluctuated, rising from 0.87 per cent in January to peak at 2.75 per cent in May and close at 1.71 per cent in June, 2016. The major components accounting for the increase were the prices of food & non-alcoholic beverages, which fluctuated between 0.49 and 1.35 per cent; and housing, water, electricity, gas & other fuels, which also fluctuated between 0.11 and 1.14 per cent (Table 3.3 and Figure 3.5).

Table 3.3
Major Components of Headline Inflation (M-on-M), January-June 2016

Date	Headline	Food & Non-Alchoholic Bev	Housing, Water. Elect. Gas & Other Fuel	Clothing & Footwear	Transport	Furnishings, Household, Equip and HH Maint.	Education
Jan '16	0.87	0.49	0.11	0.07	0.07	0.30	0.01
Feb '16	2.30	0.73	1.14	0.11	0.09	0.07	0.01
Mar '16	2.17	1.20	0.43	0.16	0.15	0.09	0.02
April '16	1.61	0.68	0.59	0.09	0.10	0.04	0.05
May '16	2.75	1.35	0.67	0.18	0.17	0.12	0.10
Jun '16	1.71	0.75	0.47	0.16	0.14	0.07	0.05

Figure 3.3
Major Components of Headline Inflation (M-on-M), Jan-Jun 2016



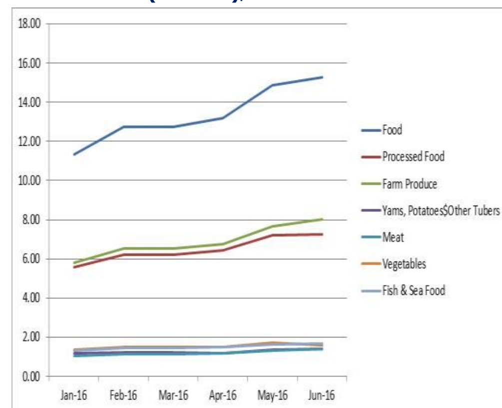
3.1.2 Food Inflation

Food inflation (year-on-year) maintained an upward trajectory, trending from 10.64 per cent in January to 15.30 per cent in June 2016, an increase of 4.66 percentage points. This was largely attributed to increases in the prices of its components: processed food and farm produce. The price of processed food rose from 5.25 to 7.26 per cent, while that of farm produce also rose from 5.40 to 8.04 per cent between January and June 2016. Of the 4.66 percentage point increase in food inflation, farm produce contributed a higher share of 2.25 percentage points compared with processed food (1.70 percentage points). Food supply shortages due to the displacement of farmers by insurgency, rising fuel and transport costs as well as the incidence of plant diseases may have been responsible for the development (Table 3.4 and Figure 3.6).

Table 3.4
Major Components of Food Inflation (Y-on-Y), January - June 2016

	Jan-16	Feb-16	Mar-16	Apr-16	May-16	Jun-16	Change Jan - Jun
Food	11.35	12.74	12.74	13.19	14.86	15.30	3.95
Processed Food	5.56	6.22	6.22	6.44	7.20	7.26	1.70
Farm Produce	5.79	6.52	6.52	6.75	7.66	8.04	2.25
Yams, Potatoes$Other Tubers	1.18	1.24	1.24	1.19	1.35	1.42	0.24
Meat	1.04	1.15	1.15	1.20	1.31	1.39	0.35
Vegetables	1.35	1.49	1.49	1.51	1.72	1.61	0.26
Fish & Sea Food	1.31	1.47	1.47	1.52	1.64	1.68	0.37

Figure 3.4
Major Components of Food Inflation (Y-on-Y), Jan - Jun 2016



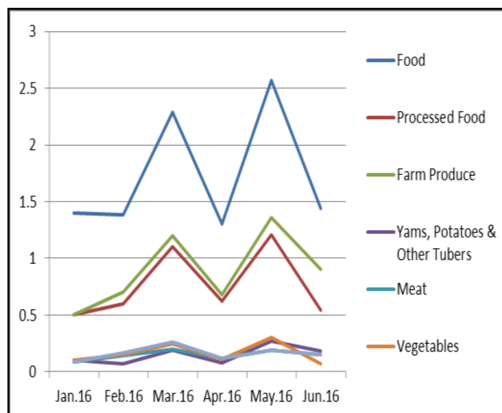
On a month-on-month basis, food inflation increased from 1.00 per cent in January to 1.44 per cent in June 2016, moving in the same direction as the year-on-year trend, but with a smaller rise of 0.44 percentage point compared with 4.66 percentage points year-on–year. The price of processed food increased from 0.50 to 0.54 per cent, while farm produce rose from 0.50 to 0.90 per cent between January and June. Thus, the 0.44 percentage point increase in food inflation during the

period was contributed by the two components – farm produce (0.40 percentage point) and processed food (0.04 percentage point). Within the farm produce category, the major increases came from yams, potatoes & other tubers (0.08 percentage point), meat (0.06 percentage point) and fish & sea food (0.06 percentage point), respectively (Table 3.5 and Figure 3.7).

Table 3.5
Major Components of Food Inflation (M-on-M), January -June 2016

	Jan.16	Feb.16	Mar.16	Apr.16	May.16	Jun.16	Change Jan - June 2016
Food	1.4	1.38	2.29	1.30	2.57	1.44	0.04
Processed Food	0.50	0.60	1.10	0.62	1.21	0.54	0.04
Farm Produce	0.50	0.70	1.20	0.68	1.36	0.90	0.4
Yams, Potatoes & Other Tubers	0.10	0.07	0.19	0.08	0.27	0.18	0.08
Meat	0.09	0.14	0.20	0.12	0.19	0.15	0.06
Vegetables	0.10	0.15	0.25	0.11	0.30	0.07	-0.03
Fish & Sea Food	0.09	0.17	0.26	0.12	0.19	0.15	0.06

Figure 3.5
Major Components of Food Inflation (M-on-M), Jan - Jun 2016



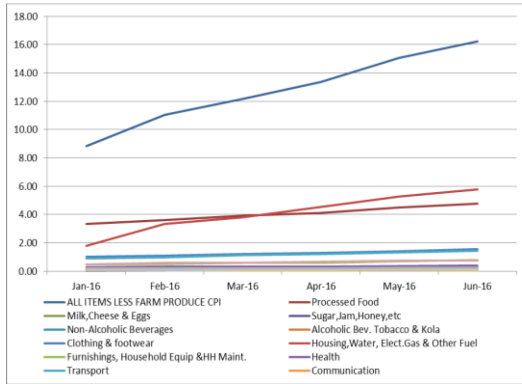
3.1.3 Core Inflation

Core inflation (year-on-year) trended upwards from 8.8 per cent in January to 16.2 per cent in June 2016, reflecting an increase of 7.3 percentage points. The increase was largely accounted for by housing, water, elect., gas & other fuel (4.02 percentage points), processed food (1.43 percentage points), clothing & foot wear (0.57 percentage point), Transport (0.52 percentage point) and furnishings, household equipment maintenance (0.32 percentage points). All components of core inflation increased except restaurant and hotels which declined by 0.01 percentage point (Table 3.6 and Figure 3.8). The increase in core inflation was largely due to the removal of petroleum subsidy as well as the depreciation of the Naira, which fed into higher prices and pressured household spending.

Table 3.6
Major Components of Core Inflation (Y-on-Y) January- June 2016

YEAR-ON-YEAR (CORE)	Weights	Jan-16	Feb-16	Mar-16	Apr-16	May-16	Jun-16	Change btw Jan. to Jun. 2016
ALL ITEMS LESS FARM PRODUCE CPI	730.50	8.84	11.04	12.17	13.35	15.05	16.22	7.38
Processed Food	237.53	3.33	3.61	3.93	4.11	4.51	4.76	1.43
Milk,Cheese & Eggs	12.75	0.14	0.14	0.13	0.14	0.15	0.16	0.02
Sugar,Jam,Honey,etc	11.10	0.15	0.15	0.16	0.16	0.17	0.18	0.04
Non-Alcoholic Beverages	10.97	0.11	0.11	0.11	0.11	0.12	0.12	0.01
Alcoholic Bev. Tobacco & Kola	10.87	0.12	0.13	0.14	0.15	0.17	0.18	0.06
Clothing & footwear	76.50	1.00	1.08	1.22	1.29	1.42	1.57	0.57
Housing,Water, Elect.Gas & Other Fuel	167.34	1.77	3.35	3.80	4.55	5.26	5.79	4.02
Furnishings, Household Equip &HH Maint.	50.27	0.45	0.51	0.57	0.60	0.70	0.77	0.32
Health	30.04	0.29	0.31	0.31	0.32	0.35	0.38	0.09
Transport	65.08	0.91	0.98	1.12	1.19	1.33	1.44	0.52
Communication	6.80	0.02	0.03	0.03	0.03	0.03	0.04	0.01
Recreation & culture	6.91	0.06	0.06	0.06	0.07	0.08	0.08	0.02
Education	39.44	0.47	0.57	0.59	0.65	0.73	0.75	0.29
Restaurant & Hotels	12.12	0.11	0.11	0.09	0.09	0.10	0.10	-0.01
Miscellaneous Goods & Services	16.63	0.18	0.19	0.19	0.20	0.24	0.23	0.05

Figure 3.6
Major Components of Core Inflation
(Y-on-Y) January-June 2016

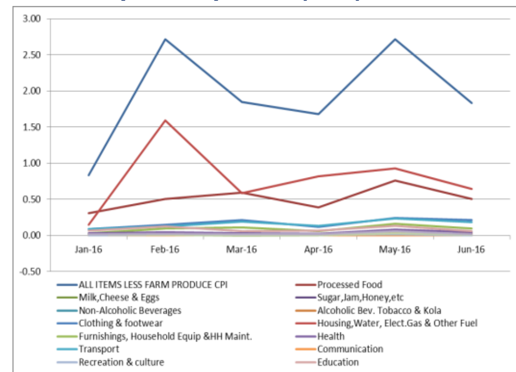


Core inflation, on a month-on-month basis, rose by 0.99 percentage point from 0.84 per cent in January to 1.83 per cent in June 2016. Housing, water, electricity gas & other fuel remained the major driver of core inflation, increasing from 0.15 per cent in January to 0.65 per cent in June. This was followed by processed food, which increased from 0.31 per cent in January to 0.51 per cent in June. Clothing and footwear also increased from 0.09 per cent in January to 0.21 per cent in June 2016. Similarly, transport increased from 0.09 per cent in January to 0.19 per cent in June (Table 3.7 and Figure 3.9).

Table 3.7
Major Components of Core Inflation
(M-on-M) January- July 2016

MONTH-ON-MONTH (CORE)	Weight	Jan-16	Feb-16	Mar-16	Apr-16	May-16	Jun-16	Change btw Jan. to Jun. 2016
ALL ITEMS LESS FARM PRODUCE CPI	730.50	0.84	2.72	1.85	1.68	2.72	1.83	0.99
Processed Food	237.53	0.31	0.51	0.60	0.39	0.76	0.51	0.20
Milk,Cheese & Eggs	12.75	0.01	0.01	0.00	0.02	0.03	0.02	0.01
Sugar,Jam,Honey,etc	11.10	0.01	0.01	0.03	0.01	0.03	0.02	0.01
Non-Alcoholic Beverages	10.97	0.01	0.01	0.01	0.01	0.02	0.01	0.00
Alcoholic Bev. Tobacco & Kola	10.87	0.01	0.02	0.02	0.01	0.03	0.02	0.01
Clothing & footwear	76.50	0.09	0.15	0.21	0.12	0.24	0.21	0.12
Housing,Water, Elect.Gas & Other Fuel	167.34	0.15	1.60	0.59	0.82	0.93	0.65	0.50
Furnishings, Household Equip &HH Maint.	50.27	0.04	0.10	0.11	0.06	0.16	0.10	0.06
Health	30.04	0.03	0.05	0.03	0.03	0.08	0.05	0.01
Transport	65.08	0.09	0.12	0.19	0.14	0.24	0.19	0.09
Communication	6.80	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Recreation & culture	6.91	0.01	0.01	0.01	0.01	0.02	0.00	0.00
Education	39.44	0.07	0.13	0.06	0.07	0.13	0.06	0.00
Restaurant & Hotels	12.12	0.02	0.01	-0.01	0.00	0.03	0.01	-0.01
Miscellaneous Goods & Services	16.63	0.02	0.02	0.02	0.02	0.06	0.02	0.00

Figure 3.7
Major Components of Core Inflation
(M-on-M) January-July 2016



3.1.4 Seasonally-Adjusted Inflation

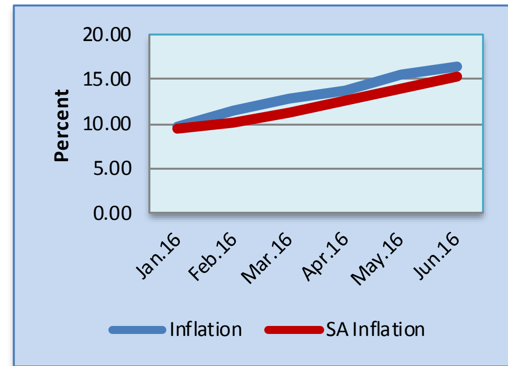
Both the actual and seasonally-adjusted measures of headline inflation trended upwards in the first half of 2016 (Table 3.8 and Figure 3.10). Actual headline inflation extended its upward trajectory during the period, reflecting the general increase in domestic prices.

In the review period, the seasonally-adjusted headline inflation rate remained below actual headline inflation. This was an indication that seasonality impacted inflation positively in the first half of the year. The upward trend in both the actual and seasonally-adjusted measures was primarily due to the removal of petroleum subsidy as well as the increase in electricity tariff. Other factors were the significant pass-through of the depreciation of the Naira to domestic prices and the uncertainties surrounding the late passage and implementation of the 2016 budget.

Table 3.8
Actual and Seasonally Adjusted Headline Inflation
Jan -June 2016

Date	Inflation	S-A Inflation
Jan.16	9.60	9.53
Feb.16	11.40	10.20
Mar.16	12.80	11.27
Apr.16	13.70	12.63
May.16	15.60	14.03
Jun.16	16.50	15.27

Figure 3.8
Actual and Seasonally Adjusted Headline Inflation
January - June 2016



3.2 Key Factors that Influenced Domestic Prices

In the first half of 2016, the general upward movements in all measures of inflation reflected the combined effects of both demand- and supply-side factors. These factors included the removal of subsidy on petroleum products which resulted in the increase of the official pump price of PMS; the introduction of greater flexibility in the foreign exchange market resulting in increased costs of imported goods; increase in electricity and energy tariff; liquidity implications of the bailout of state governments; the impact of festive and other seasonal effects; the tomato epidemic as well as the disruption to the food supply chain by insurgency in the North East.

3.2.1 Demand-side Factors

Despite the Bank's tight monetary policy in the review period, a number of demand-side factors exerted upward pressure on domestic price levels. A major demand-side factor which significantly influenced prices was the strong pass-through of the depreciation of the Naira. This was caused by demand pressure, accentuated by the recent introduction of greater flexibility in the foreign exchange market. The depreciation of the Naira thus exerted significant pressure on consumer prices. In addition, the bailout of sub-national governments and the associated increase in aggregate demand exerted further pressure on prices. Also, spending related to Christian and Muslim festivities further influenced domestic prices.

3.2.2 Supply-side Factors

The removal of subsidy on petroleum products, resulting in the increase of the official pump price of PMS, coupled with the increase in electricity and energy tariffs were the major supply-side factors in the review period. These factors contributed significantly to domestic and business costs, exerting upward pressure on domestic price levels. Despite the success so far recorded in tackling insurgency in the North East, attacks against soft targets remained, causing disruptions to the food supply chain. In addition, the onset of the planting season, along with the tomato epidemic in the later part of the review period, affected food supply.

3.2.3 Moderating Factors

In the first half of 2016, domestic price developments were moderated by a number of factors. On the demand-side, the Bank adopted a tight monetary policy stance by increasing the MPR and CRR to manage banking system liquidity. In addition, there was a general reduction in government spending due to lower oil receipts, delayed passage and implementation of the 2016 Federal Government budget as well as the non-payment of salaries by sub-national governments. The full implementation of the TSA which led to the withdrawal of government funds from the banking system also moderated demand pressure. On the supply-side, the effects of the recent reforms in the foreign exchange market, expected to reduce the supply gap as well as the persisting low inflation in the advanced economies continued to moderate domestic prices.

CHAPTER FOUR

4.0 MONETARY POLICY AND LIQUIDITY MANAGEMENT

Monetary policy in the first half of 2016 remained challenging following developments in the global and domestic economic and financial environment. On the global front, the key challenges were the continued rebalancing of the Chinese economy and the associated financial market volatility, the buildup of uncertainties surrounding the British referendum to exit the European Union (Brexit) and deepening deflation in Europe and Japan. Others included deep recession in Russia and Brazil, widening divergence in monetary policies of some major advanced economies due to the expectation of further rate hikes by the US Federal Reserve Bank and sustained softness in oil and other commodity prices. These developments led to persistent tepid recovery in global output and sluggish global trade.

On the domestic front, monetary policy was significantly influenced by the removal of petroleum subsidy as well as the increase in electricity tariff. Other factors were the reform towards greater flexibility in the foreign exchange market, which led to substantial depreciation of the exchange rate, generating a significant pass-through to domestic prices. In addition, the uncertainty surrounding the late passage and implementation of the 2016 budget impacted adversely on business confidence and investment. The low crude oil prices manifested in the domestic economy as low foreign exchange receipts and revenue for government, leading to low fiscal activities and foreign exchange shortages. The net effect of these developments was that the economy slipped into recession during the first half of 2016. These challenges and the need to rapidly restart growth under an environment of stable prices provided the context for monetary policy decisions and actions in the review period.

4.1 Decisions of the Monetary Policy Committee (MPC)

In the first half of 2016, decisions of the Monetary Policy Committee (MPC) were shaped by key global and domestic developments. The global developments were the divergence in monetary policy between the US and the Euro Area and Japan; sluggish recovery of the global economy; weakening macroeconomic conditions in China; softening crude oil and other commodity prices; and the gradual normalization of the US monetary policy. Other global issues included the threat of deflation in some advanced economies; tight external financial conditions, deteriorating global trade and geopolitical tensions.

On the domestic front, the major concerns were low accretion to external reserves leading to pressures on the exchange rate, declining oil revenue from lower crude oil prices; persistent liquidity surfeit in the banking system and high costs of liquidity management; perennial shortage of petroleum products and heightened inflationary pressures as well as security challenges in some parts of the country.

4.1.1 January 2016 MPC Meeting

The January 2016 MPC meeting reviewed the weakening international economic environment and the fragile prospects for global recovery with the increasing spillover of risks to the domestic economy.

On the external front, the key challenges were widespread stock market weakness and worsening macroeconomic conditions in China which exacerbated the already slow global economic recovery; increased uncertainties and geopolitical tensions in the international crude oil market likely to prolong the prospects of price recovery; and feeble response to monetary and fiscal stimuli in some major advanced economies. Also, growth in the emerging market and developing economies remained challenged by low commodity prices, slowing productivity, weak global trade, financial market volatility and policy uncertainty, which were eroding policy buffers.

At the domestic front, the Committee noted that the economy grew by 2.84 per cent in the third quarter of 2015, up from 2.35 per cent in the second quarter. The economy was expected to continue on its moderate growth path in the first quarter of 2016, predicated on current low global oil prices projected to hold over the medium-to long term. The downside risks to growth in 2016 were identified as: declining government revenue and foreign exchange receipts, capital flow reversals, high lending rates, sluggish credit to private sector and bearish trends in the equities market. In terms of price developments, the Committee observed the slight uptick in year-on-year headline inflation to 9.6 per cent in December, from 9.4 per cent in November 2015. The observed price development was in spite of key monetary aggregates performing below their benchmarks. The MPC noted that growth in aggregate credit mainly reflected credit to the Federal Government, which grew by 151.56 per cent in December 2015, partly attributable to the need for borrowing to implement the 2015 supplementary budget. Other concerns expressed by the Committee included the bearish movement in the equities segment of the capital market, prevailing low money market interest rates and activities in the informal segment of the foreign exchange market, which led to

the stoppage of dollar sales to BDCs. The Committee underscored the necessity of improving the supply of foreign exchange to the market, especially from autonomous sources. Accordingly, the Bank is fine-tuning the framework for foreign exchange management with a view to ensuring a more effective and liquid foreign exchange market.

In its considerations, the Committee was of the view that given sound and properly coordinated monetary, fiscal, and external sector policies, there was room for optimism about the medium to long term macroeconomic prospects for the Nigerian economy, given the clarity in the policy direction of the administration. It acknowledged the continuous banking system liquidity surfeit stemming partly from the recent growth-stimulating monetary policy measures, as well as the tendency of the banks to invest excess reserves in government securities, rather than channel credit to the real economy. In this regard, the MPC urged deposit money banks (DMBs) to improve lending to the real economy, as part of their patriotic obligations to the country and enjoined the CBN to continue to explore ways of incentivizing lending to employment- and growth-generating sectors. It further noted that given the current realities of dwindling oil revenue and the unclear outlook for commodity prices, there would be need for a recalibration of the fiscal strategy to explore opportunities in non-oil tax revenue.

In consideration of the headwinds in the domestic economy and the uncertainties in the global environment as well as the need to allow previous policy measures to fully work through the economy, the MPC decided unanimously to retain: the Monetary Policy Rate (MPR) at 11.0 per cent, Cash Reserve Requirement (CRR) at 20.0 per cent, Liquidity Ratio (LR) at 30.0 per cent and the asymmetric corridor of +200 basis points and -700 basis points around the MPR.

4.1.2 March 2016 MPC Meeting

The March 2016 Monetary Policy Committee held within the context of uncertain global economic prospects and continuing challenges in the domestic economy. Accordingly, the Committee appraised the international and domestic economic and financial environments in the first two months of 2016 as well as the outlook for the rest of the year.

Persistence of decelerating growth remained a key challenge on the external front. The deceleration stemmed from the continuous slowdown of growth in the emerging market economies, worsened by deteriorating conditions in the Euro area and China as well as key emerging market economies. In addition, the

normalization of monetary policy in the US, depressed global oil market and persistently weakened global aggregate demand continued to exert pressure on global financial markets. Downside risks to growth prospects in the in the Emerging Market Development Economies (EMDEs) include low commodity prices, troubled financial markets, tepid global demand, policy uncertainty as well as feeble global trade. Others are diminished capital inflows, rising borrowing costs and geopolitical factors.

At the domestic front, growth remained subdued, with GDP growing by 2.11 per cent in the last quarter of 2015, compared with 2.84 per cent in the third quarter and 5.94 per cent in the corresponding period of 2014. The Committee noted that the tepid growth performance was in spite of the Bank's accommodative monetary policy since July 2015 in the hope of addressing growth concerns in the economy, by lowering both CRR and MPR. Notwithstanding, DMBs remained cautious in lending, and did not grant credit as envisaged, preferring to build liquidity profiles in anticipation of government borrowing. Moreover, the delay in passage of the 2016 Budget further accentuated the difficult financial condition of economic agents as output continued to decline due to low investment and weak demand.

The Committee identified the downside risks to growth to include fiscal uncertainties, fuel scarcity, increased energy tariffs, foreign exchange scarcity as well as slow growth in credit to private sector in preference to high credit growth to the public sector. Given that many of these factors are structural and outside the purview of monetary policy, the Committee advocated complementary fiscal and structural policies as essential for reinvigorating growth.

In terms of price developments, the Committee observed that year-on-year headline inflation increased markedly to 11.38 per cent in February 2016, from 9.62 per cent in January and 9.55 per cent in December, 2015, reflecting increases in both food and core components of inflation. The rising inflationary pressure was traced to mainly structural factors, such as the lingering scarcity of refined petroleum products, exchange rate pass through from imported goods, seasonal factors and increase in electricity tariff. The Committee was also concerned about the dismal performance of growth in credit to the private sector, in spite of growth in broad money aggregates, noting that even at that, credit went primarily to low employment intensive sectors of the economy.

The Committee expressed concerns over the reluctance of deposit money banks to grant new credit despite the

observed liquidity surfeit in the banking system. This was traced to the rising incidence of non-performing loans (NPLs), mainly in the oil sector. While the average Naira exchange rate remained stable at the inter-bank segment of the foreign exchange market, the MPC was concerned that activities in the foreign exchange market remained overshadowed by speculative demand, hence the need to speed up reforms of the market to improve certainty, eliminate noise and arbitrage opportunities.

The Committee was worried that the conflicting signals from slowing growth and rising inflation presented a daunting challenge to policy. While being mindful of the limitations of monetary policy in influencing the drivers of the current tepid growth and price spiral, the MPC stressed the need to urgently address the key structural sources of the pressures. In this regard, the Committee reaffirmed its commitment to closely monitor developments while encouraging relevant authorities to address the structural bottlenecks.

The MPC equally noted that excess liquidity in the banking system was contributing to the current pressure in the foreign exchange market with a strong pass-through to consumer prices. The surfeit of liquidity in the interbank market emanated from previous efforts to reflate the economy in order to spur growth, which did not elicit the required response from DMBs, hence the need for the Bank to explore innovative ways of ensuring the unhindered flow of credit to key growth sectors of the economy.

The Committee, in its assessment of relevant internal and external indices, concluded that the balance of risks was tilted against price stability. The MPC therefore, voted to tighten the stance of monetary policy. Consequently, the MPC decided to: raise MPR by 100 basis points from 11.00 per cent to 12.00 per cent; raise CRR by 250 basis points from 20.00 to 22.50 per cent; retain Liquidity Ratio at 30.00 per cent; and narrow the asymmetric corridor from +200 and -700 basis points to +200 and -500 basis points.

4.1.3 May 2016 MPC Meeting

The May 2016 MPC was held against a backdrop of challenging global and domestic economic and financial conditions.

On the external front, continued decline in global output remained a key challenge to monetary policy. Prospects for global growth recovery remained weak as weaknesses in major EMDEs, including adverse commodity prices, low capital inflows, rising costs of funds and continuing geopolitical factors continued to provide strong headwinds against growth.

At the domestic front, the economy witnessed the first negative growth in many years, contracting by 0.36 per cent in Q1, 2016. This represents a drop of 2.47 percentage points in output from the 2.11 per cent reported in the last quarter of 2015, and 4.32 percentage point lower than the 3.96 per cent recorded in the corresponding period of 2015. The Committee noted that the contraction in growth performance was due to severe shocks suffered by the economy from factors related to energy shortages and price hikes, scarcity of foreign exchange and depressed consumer demand, among others. In addition to these, the prolonged budget impasse denied the economy the timely intervention of complementary fiscal policy to stimulate economic activity in the face of dwindling foreign capital inflows. The Committee noted a further increase in year-on-year headline inflation to 12.77 per cent and 13.72 percent in March and April 2016, respectively, from 11.38 per cent in February 2016. The rising inflationary pressure was traced to key monetary aggregates performing above their benchmarks and being accentuated by other legacy factors including energy crisis reflected in incessant scarcity of refined petroleum products, exchange rate pass through from imported goods, high cost of electricity, high transport cost, reduction in food output, high cost of inputs and low industrial output.

The Committee observed with concern, the continuous dismal performance of growth in credit to the private sector, noting that in spite of the Bank's efforts, DMBs continued to direct credit largely to low employment elastic sectors of the economy, a phenomenon that had significantly contributed to the low performance of the economy. The Committee interrogated the issues around the existing foreign exchange market regime, tracing them to the low foreign exchange earnings of the economy. In the Committee's opinion, the key issue remained how to increase the supply of foreign exchange to the economy. Accordingly, the MPC decided that the Bank should embrace some level of flexibility in the foreign exchange market and directed the Bank to work out the modalities and timeline for implementation of the new framework.

The Committee conducted the risk assessment and concluded that although, the balance of risks was tilted against growth, previous decisions needed time to crystallize. Consequently, in a period of stagflation, policy options are very limited. To avoid complicating economic conditions, the Committee decided on the least risky option which was to "hold". Consequently, the MPC voted unanimously to adopt greater flexibility in exchange rate policy to restore the automatic adjustment properties of the exchange rate.

The MPC decided to retain: the MPR at 12.00 per cent; the CRR at 22.50 per cent; the Liquidity Ratio at 30.00 per cent; and the asymmetric Window at +200 and -500 basis points around the MPR.

4.2 Instruments of Liquidity Management

During the review period, the Bank deployed various instruments in the conduct of monetary policy to achieve the objectives of price and macroeconomic stability. The key instruments were the Monetary Policy Rate (MPR), the Cash Reserve Ratio (CRR), Open Market Operations (OMO) and Discount Window Operations, supported by foreign exchange market interventions.

4.2.1 Monetary Policy Rate (MPR)

The MPR continued to be the main instrument for monetary management in the review period. The MPR, which was 11.0 per cent in January 2016, was reviewed upwards by 100 basis points to 12.0 per cent in March 2016. The asymmetric corridor around the MPR was also adjusted to +200 and -500 basis points from +200 and -700 basis points. The adjustments were intended essentially to reduce the excess liquidity in the banking system that was contributing to the pressure in the foreign exchange market, culminating in a strong pass-through to consumer prices.

4.2.2 Open Market Operations (OMO)

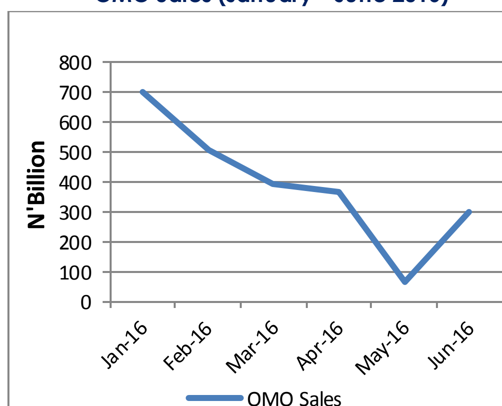
Contrary to what was witnessed in the second half of 2015, the Bank increased its reliance on Open Market Operations (OMO) as the main tool for managing banking system liquidity in the first half of 2016. As a result, actual OMO sales increased by 34.47 per cent to ₦2,329.75 billion in the first half of 2016 from ₦1,732.55 billion in the second half of 2015. This was targeted at moderating the level of liquidity in the banking system in order to stem inflationary pressure. On a year-on-year basis, however, OMO sales decreased by 45.33 per cent below the level in the first half of 2015 (Table 4.1).

Table 4.1
OMO Bills Auction (January 2015 – June 2016)
(₦'million)

Date	2015	2016	% Change
Jan	1,295.88	698.42	
Feb	217.33	509.23	
Mar	543.86	394.63	
Apr	933.74	363.72	
May	524.54	64.63	
Jun	746.37	299.12	
1st Half	4,261.72	2,329.75	-45.33
Jul	366.87		
Aug	257.61		
Sep	315.35		
Oct	265.25		
Nov	242.9		
Dec	284.57		
2nd Half	1,732.55		
Cumulative Figure	4,261.72		

Source: Financial Market Department

Figure 4.1
OMO Sales (January - June 2016)



4.2.3 Reserve Requirements

In the review period, the Bank deployed the CRR as a macro-prudential and liquidity management tool to complement the MPR and OMO as instruments of monetary policy. The Monetary Policy Committee reviewed the CRR upwards to 22.5 per cent from 20.0 per cent. This policy measure was intended to address the excess liquidity in the banking system arising from DMBs cautious approach to lending, owing to the rising incidence of non-performing loans (NPLs), especially in the oil sector. The liquidity ratio remained unchanged at 30.0 per cent in the first half of 2016.

4.2.4 Standing Facilities

The Bank continued to use the standing facilities (lending/deposit) window to meet daily liquidity requirements of DMBs and a Discount House (DH) during the period under review. The asymmetric corridor of +200/-700 basis points was narrowed to +200/-500 basis points around the MPR during the MPC meeting in March 2016. The requests for standing lending facility (SLF) increased significantly by 44.49 per cent to ₦5,137.66 billion in the first half of 2016 from ₦3,555.62 billion in the second half of 2015. The volume of SLF increased by 104.28 per cent (year-on-year) at end-June 2016 compared with N2,515.05 billion in the corresponding period of 2015 (Table 4.2).

In contrast to the volume of demand at the SLF window, total deposits at the SDF window decreased by 0.85 per cent to ₦13,112.23 billion in the first half of 2016 from ₦13,224.91 billion in the second half of 2015. This, however, represented an increase of 41.64 per cent compared with ₦9,257.46 in the corresponding period of 2015 (Table 4.3). The transactions at the two windows resulted in a net deposit of N7,974.57 billion in the second half of 2016. This development was associated with the sustained liquidity overhang in the banking system and the DMBs' cautious approach to lending during the review period.

Table 4.2
CBN Standing Lending Facility (January 2015 – June 2016) (₦'billion)

Date	2015	2016	% Change
Jan	104.75	84.26	
Feb	922.28	4.11	
Mar	541.13	474.75	
Apr	529.77	942.66	
May	229.36	869.52	
Jun	187.76	2,762.36	
1st Half	2,515.05	5,137.66	104.28
Jul	48.75		
Aug	1,415.06		
Sep	1,154.96		
Oct	667.62		
Nov	207.39		
Dec	61.84		
2nd Half	3,555.62		113.68
Total	6,070.67		

Source: Financial Market Department

Figure 4.2
Standing Lending Facility (January - June 2016)

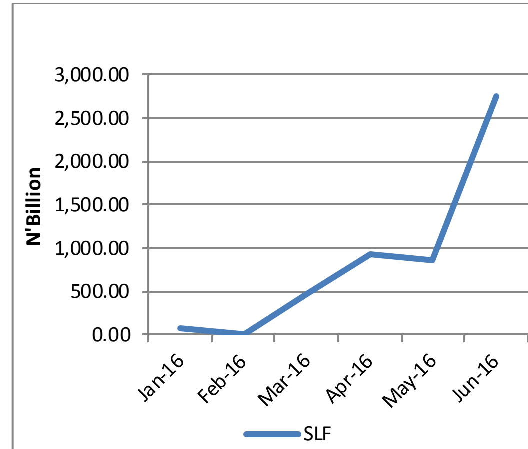
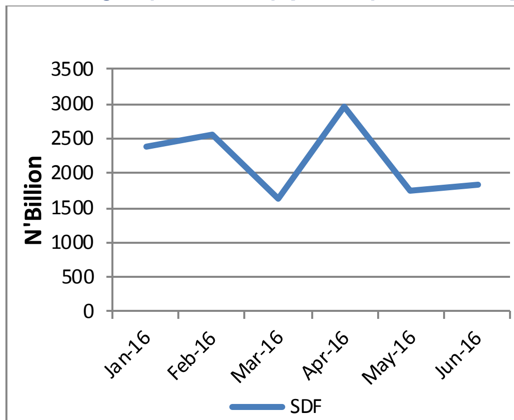


Table 4.3
CBN Standing Deposit Facility (January 2015 – June 2016) (₦'billion)

Date	2015	2016	% Change
Jan	2,562.15	2,369.31	
Feb	862.15	2,553.89	
Mar	1,298.46	1,635.43	
Apr	864.11	2,971.33	
May	1,958.72	1,760.02	
Jun	1,711.87	1,822.25	
1st Half	9,257.46	13,112.23	41.64
Jul	2,005.52		
Aug	752.78		
Sep	1,928.37		
Oct	2,625.93		
Nov	3,035.04		
Dec	2,877.27		
2nd Half	13,224.91		
Total	9,257.46		

Source: Financial Market Department

Figure 4.3
Standing Deposit Facility (January - June 2016)



4.2.5 Foreign Exchange Intervention

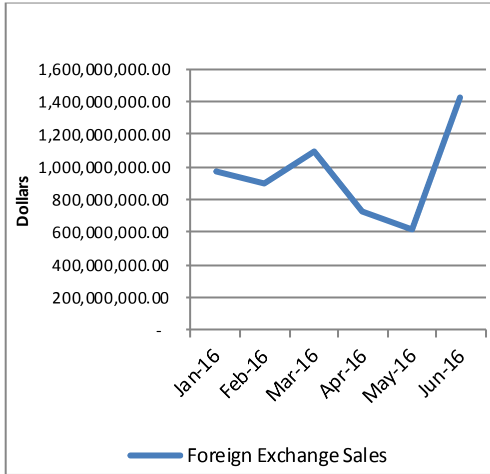
In the first half of 2016, the Bank introduced greater flexibility in the foreign exchange market to improve liquidity, transparency and efficiency all aimed at easing pressure on the Naira. The Bank adopted a single market structure for the implementation of the new policy measure, with CBN participating either directly in the inter-bank market or through a dynamic secondary market mechanism. In order to deepen the market, the Bank introduced the Naira-Settled Over-The-Counter (OTC) FX Futures Market, where contracts are agreed between parties for an exchange rate at a predetermined future date without the obligation to deliver the underlying US dollar (notional amount) on the settlement date. In addition, the Bank introduced the FX Primary Dealers (FXPDs) system to improve the effectiveness of CBN interventions to boost market liquidity. The Authorized Dealers were accorded access to transact FX products directly with the CBN.

In the review period, total supply of foreign exchange declined by 58.99 per cent to US$5,731.40 million in the first half of 2016 from US$13,974.24 million in the corresponding period of 2015. This also represented a decline of 47.26 per cent compared with US$10,867.47 million in the second half of 2015 (Table 4.4). The significant decrease in the supply of foreign exchange was largely due to lower accretion to external reserves caused by the dwindling oil receipts and reduced capital inflows. The Bank, however, introduced a number of administrative measures to moderate speculation in the foreign exchange market, restore investor confidence and stem the depletion of external reserves. The measures were the suspension of the Bank's funding of BDCs and the directive to DMBs to accept cash deposits into domiciliary accounts.

Table 4.4
Foreign Exchange Supply by the CBN (US$ Million)

	2015				2016
	Sales to rDAS	Sales to interbank	Sales to BDC	Total Supply (rDAS+interbank + BDC)	
Jan	1,987.40	N/a	184.70	2,172.10	973.57
Feb	1,197.10	2,334.90	371.40	3,903.40	895.77
Mar		1,866.10	301.60	2167.7	1,093.05
Apr		1,375.70	370.40	1746.1	727.69
May		1,856.60	309.90	2166.5	617.50
Jun		1,448.50	369.97	1818.47	1,423.81
1st Half	**3,184.50**	**8,881.80**	**1,907.97**	**13,974.27**	**5,731.40**
Jul		1,801.97	399.99	2,201.96	
Aug		1,694.74	385.51	2,080.25	
Sep		1,348.02	485.04	1,833.06	
Oct		1,220.96	530.09	1,751.05	
Nov		1,545.21	330.74	1,875.95	
Dec		1,018.88	106.32	1,125.20	
2nd Half	**-**	**8,629.78**	**2,237.69**	**10,867.47**	
Total	3,184.50	17,511.58	4,145.66	24,841.74	

Figure 4.4
Foreign Exchange Sales (January - June 2016)



The New Flexible Exchange Rate Regime in Nigeria

Exchange rate regimes can be represented according to the degree of fixity of exchange rates. Using this as a yardstick, exchange rate regimes can be characterized on a spectrum that constitutes hard pegs (currency union, dollarization, and currency board), conventional fixed peg, intermediate regimes (band, basket peg, and crawling peg), managed floating, and independent floating. Prior to the announcement of the new flexible exchange rate regime, CBN had operated a managed floating exchange rate regime.

Exchange rate management by the CBN was challenged by the steep decline in foreign currency earnings, occasioned by the continuing fall in global oil prices and accentuated by the spates of militancy in the oil-rich Niger Delta. The CBN had instituted series of exchange rate management measures. First, in November 2014, the peg was removed from about from about 160 to 176 to the US$. This was again followed in February 2015 with the suspension of the dollar auction system and a further devaluation to N196.5 per US$ at the interbank segment. The Naira devaluation could not ease the pressure on the foreign exchange market, necessitating further administrative measures aimed at sustaining the currency stability.

In April 2015, relying on Section 20 of the CBN Act (2007) the Bank issued a circular prohibiting pricing of goods and services in any other currency besides the Naira with the exemptions of certain organizations, including revenue agencies, operators in the oil and gas industry, maritime, aviation and operators in the free trade zones. Further administrative measures included the exclusion of a list of 41 prohibited items by the CBN circular of 30 June, 2015 from eligibility in accessing foreign exchange in the Nigerian foreign exchange market i.e. through interbank, exports proceeds and Bureau de Change (BDC). These measures were aimed at encouraging local production and to preserve the dwindling foreign reserves.

The periods leading to the MPC meeting of May 2016 had signposted the unsustainability of the exchange rate managemnt regime in Nigeria. The attenuating earnings of foreign reserves had put enormous pressures on foreign exchange management, with the attendant uncertainties about investments prospects in the economy, particularly on the part of savvy foreign investors. In addition, the widening gaps between the official and parallel markets rates increased rent-seeking and price arbitrage tendencies that undermined the managed floating regime. It was against the foregoing background that the Monetary Policy Committee of May 2016 undertook reforms to engender greater

flexibility and transparency in the operation and management of the inter-bank foreign exchange transactions by introducing greater flexibility to the market. A flexible market allows a free float of the exchange rate, a mechanism that enables the Naira find its equilibrium with minimal intervention from the monetary authority.

On 15th June 2016, guidelines for the implementation of the new flexible exchange rate regime was published by the CBN. The guidelines made provision for a single Inter-Bank Foreign Exchange Market structure with the CBN participating in the market through interventions, either directly in the inter-bank market or through dynamic Secondary Market Intervention Mechanisms.

The guidelines made provisions for the appointment and registration of foreign exchange (FX) Primary Dealers (FXPDs) which would deal with the CBN on two-way quote basis for large trade FX transactions. Participants in the inter-bank FX market would include Authorised Dealers, Authorised Buyers, Oil Companies, Oil Service Companies, Exporters, End-users and any other entity the CBN may designate from time to time. Transactions in the FX market among participants would be on a two-way quote basis via the financial market dealers quotations (FMDQ) Thomson Reuters FX Trading Systems or any other system approved by the CBN. In addition a futures market that enables buyers and sellers to hedge by locking in current prices for future sale was also introduced.

While the implementation of the new flexible exchange rate regime portends greater transparency and efficiency in the management of scarce foreign reserves, the challenge of adequate supply to the market remained daunting, as the CBN continued to be the major source of supply to the market. Uncertainties and risk perceptions of the market by investors remained high, delaying the much anticipated foreign inflows from manifesting. The situation was further worsened by depleting foreign reserve earnings, accentuated by production disruptions and restiveness in the Niger Delta region. Another challenge to the operation of the new regime is the existence and widening gap between the interbank and parallel market rates, contrary to a single market structure expected under a fully flexible regime. This still provides incentives for arbitrage and rent seeking activities.

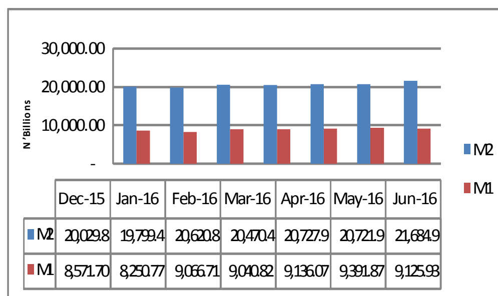
4.3 Developments in Monetary Aggregates

In the first half of 2016, monetary aggregates generally underperformed relative to their targets, due largely to the significant drop in government borrowing, although the Net Foreign Assets (NFA) improved following modest recovery in oil price. However, monetary aggregates showed improved performance when compared with the preceding and the corresponding periods of 2015.

4.3.1 Broad Money (M2)

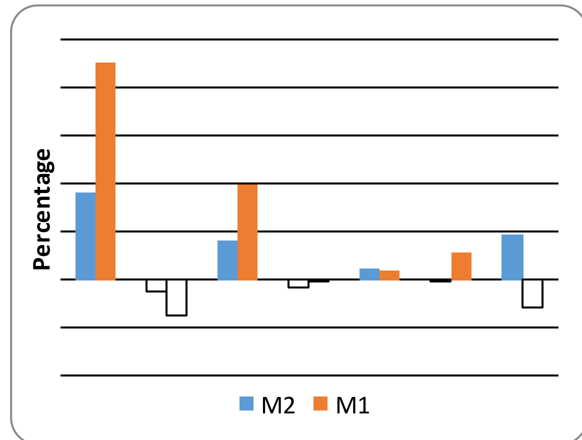
Broad Money (M2) increased by 8.26 per cent to ₦21,684.97 billion at end-June 2016 from ₦20,029.83 billion at end-December 2015. Compared with the end-June 2015 level of ₦18,811.43 billion, M2 grew by 15.28 per cent. The year-on-year growth in M2 of 15.28 per cent was above the 2016 indicative growth target of 10.98 per cent.

Figure 4.5
Money Supply (M1) and (M2) (Dec 2015 – June 2016)



	Dec-15	Jan-16	Feb-16	Mar-16	Apr-16	May-16	Jun-16
M2	20,029.8	19,799.4	20,620.8	20,470.4	20,727.9	20,721.9	21,684.9
M1	8,571.70	8,250.77	9,066.71	9,040.82	9,136.07	9,391.87	9,125.93

Figure 4.6
Growth in Money Supply (M1) and (M2) (Dec 2015 – June 2016)



4.3.2 Narrow Money (M1)

Narrow Money (M1) grew by 6.47 per cent to ₦9,125.93 billion at end-June 2016 from ₦8,571.7 billion at end-December 2015. When compared with the end-June 2015 figure of ₦6,542.39 billion, M1 grew by 39.49 per cent. The year-on-year growth in M1 of 39.49 per cent was above the indicative growth target of 11.34 per cent for 2016 (Figures 4.4 and 4.5).

4.3.3 Net Foreign Assets (NFA)

Net Foreign Assets (NFA) increased by 25.69 per cent to ₦7,105.66 billion at end-June 2016 from ₦5,653.32 billion at end-December 2015. Compared with the end-June 2015 figure of ₦5,951.45 billion, the NFA grew by 19.39 per cent, which was above the 2016 growth target of -40.58 per cent. The improved performance was attributed to the

significant increase in Petroleum Profit Tax receipts and improved oil prices.

4.3.4 Net Domestic Assets (NDA)

Net Domestic Assets (NDA) grew by 1.41 per cent to ₦14,579.30 billion at end-June 2016 from ₦14,376.51billion at end-December 2015. Compared with the end-June 2015 figure of ₦12,859.97 billion, NDA increased by 13.37 per cent which was below the growth benchmark of 25.88 per cent.

Figure 4.7
Net Domestic Asset (NDA) (Dec 2015 – June 2016)

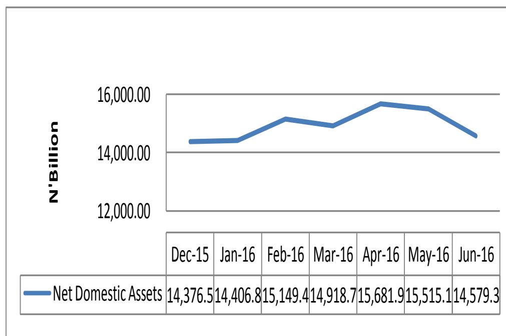
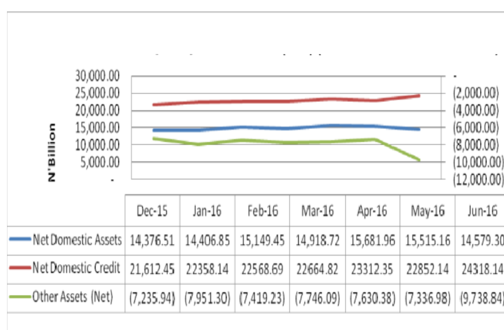


Figure 4.8
NDA, NDC and Other Assets (net) (Dec 2015 – June 2016)



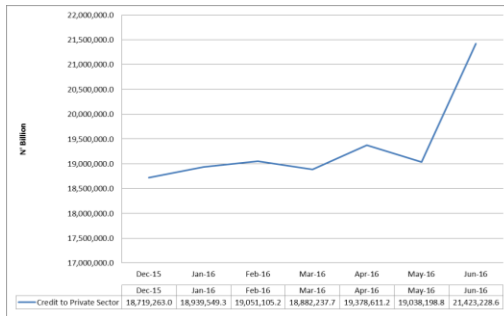
4.3.5 Credit to the Government (C_g)

Credit to government (Cg) remained at ₦2,893.19 billion in the first half of 2016, the same as the figure at end-December 2015. Cg, however, grew by 15.15 per cent compared with the end-June 2015 figure of ₦2,512.46 billion, which was significantly below the 2016 growth benchmark of 47.43 per cent. This development was largely attributable to the full implementation of the TSA, delayed passage and implementation of the 2016 Federal Government budget, improved generation of revenue from non-oil sources as well as depreciation of the naira.

4.3.6 Credit to the Private Sector (Cp)

Credit to the private sector (Cp) grew by 14.45 per cent to ₦21,424.95 billion at end-June 2016 from ₦18,719 billion at end-December 2015. Compared with the end-June 2015 figure of ₦18,897.31 billion, Cp rose by 13.38 per cent, which met the indicative growth target of 13.38 per cent for 2016. The improvement in credit to the private sector, despite weak economic indices, can be partly attributed to sustained CBN intervention initiatives to enhance the flow of lending to the real sector.

Figure 4.9
Domestic Credit to Private Sector (Dec 2015 – June 2016)



	Dec-15	Jan-16	Feb-16	Mar-16	Apr-16	May-16	Jun-16
Credit to Private Sector	18,719,263.0	18,939,549.3	19,051,105.2	18,882,237.7	19,378,611.2	19,038,198.8	21,423,228.6

4.3.7 Reserve Money (RM)

Reserve Money (RM), decreased by 7.58 per cent to ₦5,372.01 billion at end-June 2016 from ₦5,812.74 billion at end-December 2015. On a year-on-year basis, RM decreased by 9.65 per cent when compared with its end-June 2015 level of ₦5,945.76 billion and was below the benchmark of ₦6,574.74 billion by 18.36 per cent. The year-on-year decrease in RM was due to the decline in DMBs deposits on account of the withdrawal of public sector funds following the full implementation of the Treasury Single Account (TSA) as well as the effect of the increase in CRR by 250 basis points in March 2016. A summary of the major monetary aggregates and provisional outcomes as at end-June 2016 are presented in Table 4.5.

Table 4.5
Monetary Aggregates Outcomes (Growth in % except otherwise stated)

						Change in H1 2016
	Actual	Actual	Actual	Benchmark	Deviation (N'b)	Actual
	June	Dec	June	2016		
	2015	2015	2016			
M2 (N'b)	18,811.43	20,029.83	21,684.97	22,229.40	-544.43	1,655.14
M2 (%)	-0.54	5.90	8.26	10.98	-2.72	8.26
M1 (N'b)	6,542.39	8,571.70	9,125.93	8,429.68	696.25	554.23
M1 (%)	-5.25	24.14	6.47	11.34	-4.87	6.47
RM (N'b)	5,945.76	5,812.74	5,372.01	6,580.39	-1,208.38	-440.73
RM (%)	0.25	-1.99	-7.58	13.21	-20.79	-7.58
NDC (N'b)	21,409.77	21,612.45	24,318.14	25,490.07	-1,171.93	2,705.69
NDC (%)	11.08	12.13	12.52	17.94	-5.42	12.52
Cg (N'b)	2,512.46	2,893.19	2,893.19	4265.47	-1,372.28	0.00
Cg (%)	118.45	151.56	0.00	47.43	-47.43	0.00
Cp (N'b)	18,897.31	18,719.26	21,424.95	21,224.60	200.35	2,705.69
Cp (%)	4.27	3.29	14.45	13.38	1.07	14.45
NFA (N'b)	5,951.45	5,653.32	7,105.66	4,131.89	2,973.77	1,452.34
NFA (%)	-13.81	-18.12	25.69	-40.58	66.27	25.69

CHAPTER FIVE

5.0 DEVELOPMENTS IN THE FINANCIAL MARKETS

The performance of the Nigerian financial market was largely shaped by a number of global and domestic economic developments in the review period. The developments included uncertainties arising from the buildup of expectations surrounding a further US rate hike, the ongoing transition of the Chinese economy to a balanced growth path and the general instability in global financial markets. In addition, the unexpected outcome of the Brexit referendum led to high market volatility and subdued global activity and trade. These developments heightened global market risks thereby impacting on financing conditions in the emerging market and developing economies. However, the largely accommodative monetary policy in the advanced economies as well as firming oil prices generally improved market sentiment.

Money market rates were generally stable during the review period. However, the Bank's tight monetary policy stance which included raising the MPR from 11.0 to 12.0 per cent and a 250 basis point increase in the CRR from 20.0 to 22.5 per cent resulted in rate spikes in the later part of the review period. In the foreign exchange market, the spread between the rates at the interbank and the parallel segments, however, continued to widen. This reflected the heightened demand pressure in the market, fuelled by speculative activities, capital reversals as well as increasing import requirements in the face of declining external reserves. In order to restore stability in the foreign exchange market, the Bank adopted a number of policy measures which included the suspension of foreign exchange sales to the BDCs and the introduction of greater flexibility in the foreign exchange market. These developments moderated the bullish trend in the equities market during the review period.

5.1 The Money Market

Activities in the money market generally reflected the banking system liquidity during the period under review. The key MPC decisions which influenced market developments included raising the MPR from 11.0 to 12.0 per cent, a 250 basis point increase in the CRR from 20.0 to 22.5 per cent and the introduction of greater flexibility in the foreign exchange market. Others were narrowing the asymmetric corridor from +200/-700 basis points to +200/-500 basis points around the MPR, as well as the retention of the liquidity ratio of 30.0 per cent. Money market rates which were relatively stable

initially, witnessed occasional spikes during the review period. This development reflected effects of fluctuations in the banking system liquidity, increased OMO transactions, maturing of government securities and intensified implementation of the TSA. The interbank and OBB rates remained largely below the floor of the asymmetric corridor around the MPR for most of the period. The interbank and OBB rates, however, rose above the corridor in the later part of the review period. Market activities were dominated principally by transactions in OMO instruments employed to manage liquidity surfeit associated with the monthly Federation Account Allocation Committee (FAAC) injections. In addition, low transaction levels were recorded in both the collaterized and uncollaterized segments of the money market initially, though transactions picked up in May and June due to the introduction of the new flexible exchange rate policy.

5.1.1 Short-term Interest Rate Developments

The money market interest rates reflected the liquidity conditions in the banking system during the first half of 2016. The liquidity condition was largely driven by the effects of increased OMO transactions, maturing government securities, intensified implementation of the TSA and the monthly FAAC injections. The Bank also adopted a tight monetary policy stance during the period by raising the MPR from 11.0 to 12.0 per cent, increasing the CRR from 20.0 to 22.5 per cent and narrowing the asymmetric corridor to +200/-500 basis points around the MPR as well as the introduction of greater flexibility in the foreign exchange market. There was, however, reduced appetite for transactions in both segments of the money market between January and April. Activities only picked up between May and June, 2016, helped by the introduction of the flexible exchange rate system.

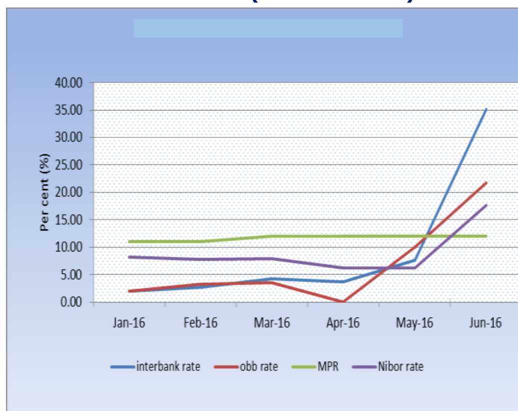
The average interbank call rate rose from 2.04 per cent in January to 4.32 per cent in March, and decreased marginally to 3.75 per cent in April. It, however, rebounded to 7.67 per cent in May and peaked at 35.26 per cent in June. The average OBB rate rose from 1.95 per cent in January to 3.55 per cent in March. It further rose to 10.00 per cent in May and peaked at 21.75 per cent in June. The average OBB rate which was 7.34 per cent, ranged between 1.95 and 21.75 per cent, while the average interbank call rate at 9.28 per cent, ranged between 2.04 per cent and 35.26 per cent during the review period. Consequently, the interbank call rate was generally higher than the OBB. The 30-day NIBOR ranged between 6.21 and 17.62 per cent during the review period.

Table 5.1
Weighted Average Monthly Money Market Interest Rates (January –June 2016)

Date	Inter Bank	OBB	MPR	*30 Day NIBOR
Jan	2.04	1.95	11	8.28
Feb	2.67	3.25	11	7.84
Mar	4.32	3.55	12	7.94
Apr	3.75	3.55	12	6.29
May	7.67	10.00	12	6.21
Jun	35.26	21.75	12	17.62
Ave	9.28	7.34	12	9.03

Source: (Statistics Dept., CBN)

Figure 5.1
Weighted Average Monthly Money Market Interest Rates (Jan.–Jun 2016)



(i) The Interbank Call Rate

During the first half of 2016, activity in the interbank market was generally sluggish, ranging from 2.04 per cent in January to 3.75 per cent in April, reflecting the lagged effects of the monetary easing adopted at the November MPC meeting as well as maturing NTB/OMO instruments. The rate, however, spiked to 7.67 and 35.20 per cent in May and June 2016, respectively, on account of the introduction of the flexible exchange rate system in June 2016, which stimulated activities in the market. In addition, the Bank's tight monetary policy stance impacted banking system liquidity and money market rates.

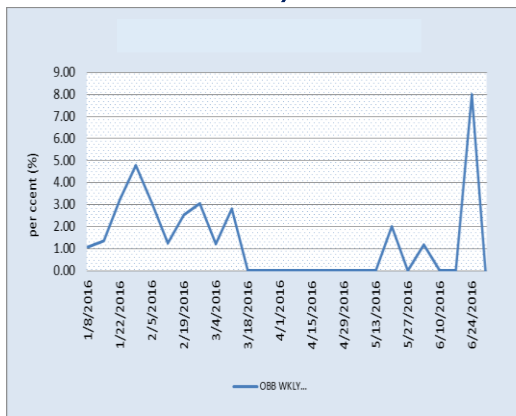
Figure 5.2
Weekly Interbank Call Rate (Jan – Jun 2016)

(ii) The Open Buy Back Rate

The OBB rate fluctuated between 1.95 per cent and 21.75 per cent, at an average of 6.75 per cent in the review period. Activity in the OBB segment of the money market was initially sluggish, with the weighted average OBB rate at 1.95 per cent in January rising to 3.55 per cent in March. The moderate activity in the segment reflected general liquidity surfeit in the banking

system and the lagged effects of the accommodative monetary policy stance of the Bank. There was no activity in April, as a result of the general preference for transactions in the uncollaterized segment of the market. Activity, however, resumed in May with the rate rising to 10.00 per cent and peaked at 21.75 per cent in June 2016, largely as a result of the introduction of the flexible exchange rate mechanism. In addition, the Bank's tight monetary policy stance including the increase in MPR and the CRR as well as the narrowing of the asymmetric corridor impacted banking system liquidity and money market rates.

Figure 5.3
Weekly Open Buy Back Rate (January-June 2016)



(iii) The Nigeria Interbank Offered Rate (NIBOR)

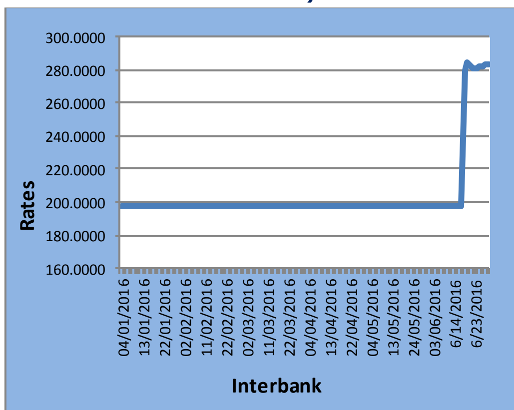
The Nigerian money market reference rate, the NIBOR, was relatively stable across all tenors during the review period. The weighted average 30-day NIBOR, fluctuated downwards from 8.28 per cent in January to 6.21 per cent in May and spiked at 17.62 per cent in June, 2016. It decreased progressively to 7.94 per cent and 6.21 per cent in March and May 2016, respectively, on account of general liquidity surfeit in the banking system. The NIBOR, however, rose significantly to 17.62 per cent in June, owing largely to the introduction of the flexible exchange rate system (Table 5.1).

5.2 Foreign Exchange Market

During the review period, the Bank adopted a number of policy measures to restore stability in the foreign exchange market. The spread between the rates at the interbank and the parallel segments, however, continued to widen, reflecting excessive demand pressure in the market. The persistent demand pressure was driven by speculative activities, capital reversals due to the US monetary policy normalization as well as increasing import requirements in the face of declining external reserves. These factors coupled with the dwindling foreign exchange receipts as a result of low crude oil prices, further increased the pressure in the foreign exchange market. The Bank observed that the official exchange rate of N197/US$ and its corridor of +/-5.00 per cent was no longer sustainable in the face of

increasing demand pressure and supply shortages. Consequently, at its May 2016 meeting, the MPC decided to introduce more flexibility in the exchange rate management, which came into effect on June 20, 2016. The regime is a market-determined exchange rate system, involving spot and forward instruments, aimed at stemming further depreciation of the Naira and preserve the dwindling external reserves.

Figure 5.4
Daily Naira/US Dollar Exchange Rate (January - June 2016)



5.2.1 Average Exchange Rates

The Interbank foreign exchange rate, at an average of ₦202.79/US$ depreciated by 2.86 per cent in the first half of 2016 from ₦196.99/US$ in the second half of 2015. During the same period, the BDC rate significantly depreciated by 28.64 per cent from an average of ₦231.93/US$ to ₦325.00/US$ (Table 5.2).

Table 5.2
Average Monthly Spot Exchange Rates (July 2015 – June 2016) (₦/US$)

Month/Year	Interbank Rate	BDC 'B' Rate
2015: Jul	196.97	236.65
Aug	197.00	216.58
Sep	197.00	222.68
Oct	196.99	224.98
Nov	196.99	232.38
Dec	196.99	258.30
Average	**196.99**	**231.93**
2016: Jan	197.00	289.78
Feb	197.00	329.83
Mar	197.00	320.93
Apr	197.00	320.71
May	197.00	336.93
Jun	231.76	351.82
Average	**202.79**	**325.00**

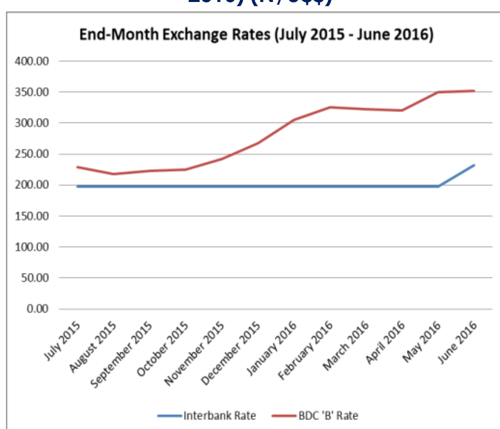
5.2.2 End-Period (Month) Exchange Rates

The Naira depreciated at the two segments of the foreign exchange market at end-June 2016. At the interbank foreign exchange market, the Naira depreciated by 44.04 per cent to ₦283.76/US$ at end-June, 2016 from ₦197.00/US$ at end-December 2015. At the BDC segment, it also significantly depreciated by 30.33 per cent to N348.00/US$ at end-June, 2016 from N267.00/US$ at end-December, 2015 (Figure 5.5 and Table 5.3).

Table 5.3
End-Month Exchange Rates (July 2015 – June 2016) (₦/US$)

Month/Year	Interbank Rate	BDC 'B' Rate
2015: Jul	197.00	229.00
Aug	197.00	218.00
Sep	196.95	223.00
Oct	197.00	225.00
Nov	197.00	242.00
Dec	197.00	267.00
Average	**196.99**	**234.00**
2016: Jan	197.00	305.00
Feb	197.00	325.00
Mar	197.00	322.00
Apr	197.00	320.50
May	197.00	350.00
Jun	283.76	348.00
Average	**211.46**	**328.42**

Figure 5.5
End-Month Exchange Rates (July 2015 – June, 2016) (₦/US$)



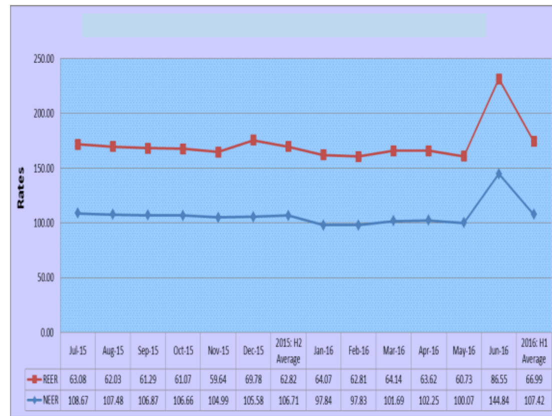
5.2.3 Nominal and Real Effective Exchange Rates

The Nominal Effective Exchange Rate (NEER) appreciated by 1.89 per cent to an average of 104.88 in the first half of 2016 from an average of 106.86 in the second half of 2015. It also appreciated marginally by 0.02 per cent when compared with the corresponding period of 2015. The REER appreciated by 10.20 per cent from an average of 71.86 in the second half of 2015 to average 65.21 in the first half 2016. When compared with the corresponding period of 2015, the average REER depreciated by 4.77 per cent (Table 5.4). In general, the Naira depreciated in both nominal and real terms relative to the currencies of Nigeria's major trading partners in the review period (table 5.4 and figure 5.6).

Table 5.4
Nominal and Real Effective Exchange Rates Indices (January 2015 – June 2016)

Date	NEER	REER
Jan-15	96.53	57.69
Feb-15	95.77	57.09
Mar-15	108.55	64.52
Apr-15	110.20	65.25
May-15	108.87	64.04
Jun-15	109.45	64.03
2015: H1 Average	**104.90**	**62.10**
Jul-15	108.89	74.22
Aug-15	107.79	73.05
Sep-15	106.76	71.91
Oct-15	106.70	71.74
Nov-15	105.42	70.43
Dec-15	105.58	69.78
2015: H2 Average	**106.86**	**71.86**
Jan-16	104.63	66.41
Feb-16	104.64	65.05
Mar-16	107.51	67.51
Apr-16	107.94	66.76
May-16	108.05	67.83
Jun-16	96.53	57.69
2016: H1 Average	**104.88**	**65.21**
2016: Average	**104.88**	**65.21**

Figure: 5.6
Nominal and Real Effective Exchange Rates Indices (July 2015 – June 2016)



5.2.5 Foreign Exchange Flows through the CBN

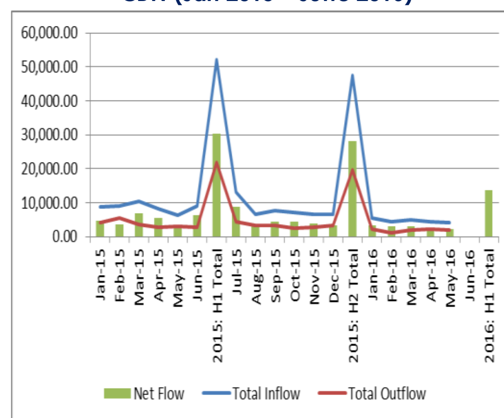
Foreign exchange inflows through the CBN significantly decreased by 52.19 per cent to US$8,713.12 million in the first half of 2016, from US$18,226.31 million in the second half of 2015. It also decreased by 42.99 per cent when compared with US$15,283.00 million in the corresponding period of 2015. Similarly, the gross foreign exchange outflows decreased by 37.84 per cent to US$10,742.86 million in the first half of 2016, from US$17,281.62 million in the second half of 2015. When compared with US$21,070.40 million in the corresponding period of 2015, it decreased significantly by 49.01 per cent. Thus, in the review period, there was a net outflow of US$2,029.74 million, compared with net inflow of US$944.69 million and (US$5,787.40) million in the preceding and

corresponding halves of 2015 (Table 5.5 and Figure 5.7).

Table 5.5
Monthly Foreign Exchange Flows through the CBN (January 2015 – June 2016)

Dates	Inflow (CBN)	Total Outflow (CBN)	Net Flow (CBN)
Jan-15	2442	4108.1	-1666.1
Feb-15	2554.5	5338	-2783.5
Mar-15	3310.5	3429.7	-119.2
Apr-15	2859.5	2569.1	290.4
May-15	1744.5	2916.4	-1171.9
Jun-15	2372	2709.1	-337.1
2015 H1 Total	**15,283.00**	**21,070.40**	**(5,787.40)**
Jul-15	6312.16	3383.08	2929.08
Aug-15	2598.05	3153.98	-555.93
Sep-15	2180.69	2987.06	-806.37
Oct-15	2821.22	2341.09	480.13
Nov-15	2481.21	2499.76	-18.55
Dec-15	1832.98	2916.65	-1083.67
2015 H2 Total	**18,226.31**	**17,281.62**	**944.69**
Jan-16	1329.4	1687.59	-358.19
Feb-16	1221.53	1025.73	195.8
Mar-16	1611.38	1764.89	-153.51
Apr-16	900.51	2053.33	-1152.82
May-16	1779.42	1690.29	89.13
Jun-16	1870.88	2521.03	-650.15
2016 H1 Total	**8,713.12**	**10,742.86**	**(2,029.74)**

Figure 5.7
Monthly Foreign Exchange Flows through the CBN (Jan 2015 – June 2016)



5.2.6 Foreign Exchange Flow through the Economy

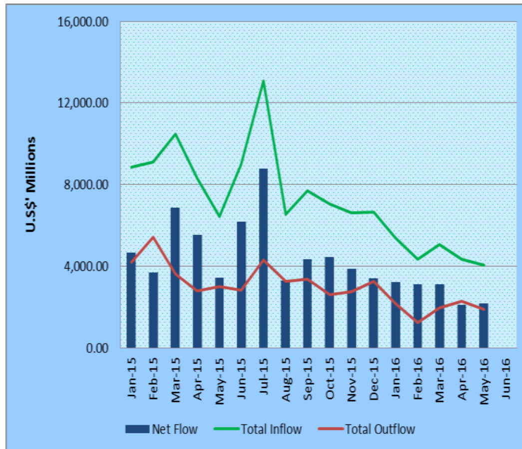
Gross foreign exchange inflow to the economy significantly declined by 38.76 per cent to US$29,159.54 million, from US$47, 610.47 million in the second half of 2015. It also decreased significantly by 44.12 per cent when compared with US$52,172.80 million in the corresponding period of 2015. Similarly, gross foreign exchange outflow declined by 39.26 per cent to US$11,880.53 million in the first half of 2016, from US$19,559.89 million in the second half of 2015. When compared with US$21,837.20 million in the corresponding period of 2015, it declined significantly by 45.59 per cent.

Thus, during the first half of 2016, the total foreign exchange flows through the economy resulted in a lower net inflow of US$17,273.96 million, compared with US$28.050.58 million in the preceding half year, and US$30,335.60 million in the corresponding period of 2015. This represented decreases of 38.42 and 43.06 per cent in the preceding and corresponding periods, respectively. The reduced net inflow during the period reflected the decline in foreign exchange receipts, due largely to lower global crude oil prices as well as production shortfalls caused by militancy and illegal bunkering in the Niger Delta region. In addition, the inflows from autonomous sources also declined during the period, reflecting the general weakness in the global economy (Table 5.6 and Figure 5.8).

Table 5.6
Monthly Foreign Exchange Flows through the Economy (Jan 2015 – Jun 2016) (US$ Million)

Dates	Total Inflow	Inflow (CBN)	Inflow (Autonomous)	Total Outflow	Total Outflow (CBN)	Total Outflow (Autonomous)	Net Flow	Net Flow (CBN)	Net Flow (Autonomous)
Jan-15	8861.7	2442	6419.7	4190.3	4108.1	82.2	4671.4	-1666.1	6337.5
Feb-15	9091.5	2554.5	6537	5415.2	5338	77.2	3676.3	-2783.5	6459.8
Mar-15	10470.4	3310.5	7159.9	3620.8	3429.7	191.1	6849.6	-119.2	6968.8
Apr-15	8299.8	2859.5	5440.4	2784.8	2569.1	215.7	5515	290.4	5224.7
May-15	6447.5	1744.5	4702.9	3002.4	2916.4	86.1	3445.1	-1171.9	4616.8
Jun-15	9001.9	2372	6629.9	2823.7	2709.1	114.6	6178.2	-337.1	6515.3
2015 H1 Total	**52,172.80**	**15,283.00**	**36,889.80**	**21,837.20**	**21,070.40**	**766.90**	**30,335.60**	**(5,787.40)**	**36,122.90**
Jul-15	13081.61	6312.16	6769.45	4313.26	3383.08	930.18	8768.35	2929.08	5839.27
Aug-15	6547.27	2598.05	3949.22	3266.24	3153.98	112.25	3281.03	-555.93	3836.97
Sep-15	7687.11	2180.69	5506.42	3360.96	2987.06	373.9	4326.15	-806.37	5132.52
Oct-15	7033.96	2821.22	4212.73	2603.42	2341.09	262.33	4430.54	480.13	3950.4
Nov-15	6625.76	2481.21	4144.54	2767.66	2499.76	267.91	3858.1	-18.55	3876.63
Dec-15	6634.76	1832.98	4801.79	3248.35	2916.65	331.7	3386.41	-1083.67	4470.09
2015 H2 Total	**47,610.47**	**18,226.31**	**29,384.15**	**19,559.89**	**17,281.62**	**2,278.27**	**28,050.58**	**944.69**	**27,105.88**
Jan-16	5408.26	1329.4	4078.86	1923.31	1687.59	235.72	3484.95	-358.19	3843.14
Feb-16	4317.72	1221.53	3096.19	1215.34	1025.73	189.61	3102.38	195.8	2906.58
Mar-16	5280.89	1611.38	3669.51	1952.6	1764.89	187.71	3328.29	-153.51	3481.8
Apr-16	4109.9	900.51	3209.39	2189.07	2053.33	135.74	1920.83	-1152.82	3073.65
May-16	4331.42	1779.42	2552	1868.64	1690.29	178.35	2462.78	89.13	2373.65
Jun-16	5706.35	1870.88	3835.47	2731.62	2521.03	210.6	2974.73	-650.15	3624.87
2016 H1 Total	**29,154.54**	**8,713.12**	**20,441.42**	**11,880.58**	**10,742.86**	**1,137.73**	**17,273.96**	**(2,029.74)**	**19,303.69**

Figure 5.8
Monthly Foreign Exchange Flows through the Economy (Jan 2015 – Jun 2016) (US$ Million)



5.3 Capital Market

During the first half of 2016, the Nigerian capital market was moderately bullish, reflecting the combined effects of global and domestic factors. The key factors responsible for this development included the modest recovery in crude oil prices, slowing pace of the US monetary policy normalization and the continuing monetary policy divergence in advanced economies. In addition, the introduction of flexible exchange rate system and the reduction of insurgent activities in the North East bolstered investor confidence and spurred activities in the market. However, militancy in the Niger Delta region and communal tensions in some parts of the country, weak corporate earnings as well as the general contraction in the economy moderated investor sentiments and outlook on the Nigeria capital market.

5.3.1 Equities Market

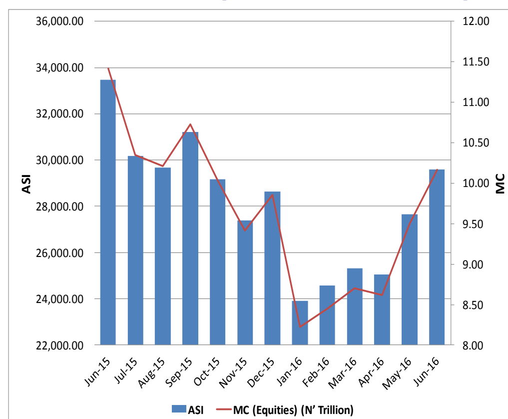
The All-Share Index (ASI) recovered moderately by 3.49 per cent to 29,597.79 at end-June 2016, from 28,642.25 at end-December 2015. It, however, declined by 11.40 per cent compared with 33,456.83 at end-June 2015. Market Capitalization (MC) also increased by 3.25 per cent to ₦10.17 trillion at end-June 2016, from ₦9.85 trillion at end-December 2015, but decreased by 10.95 per cent when compared with ₦11.42 trillion at end-June 2015 (Table 5.7 and Figure 5.9). The year-on-year decline of 11.53 per cent in the ASI was driven mainly by weak performance in the banking, consumer goods, insurance and oil and gas sectors, which declined by 18.9, 12.6, 2.5 and 12.1 per cent, respectively, below their levels at end-June 2015.

Table 5.7
NSE All-Share Index (ASI) and Market Capitalization (MC) (June 2015 – June 2016)

Date	ASI	MC (Equities) (N' Trillion)
Jun-15	33,456.83	11.42
Jul-15	30,180.27	10.34
Aug-15	29,684.84	10.21
Sep-15	31,217.77	10.73
Oct-15	29,177.72	10.03
Nov-15	27,385.69	9.42
Dec-15	28,642.25	9.85
Jan-16	23,916.15	8.23
Feb-16	24,570.73	8.45
Mar-16	25,306.22	8.70
Apr-16	25,062.41	8.62
May-16	27,663.16	9.50
Jun-16	29,597.79	10.17

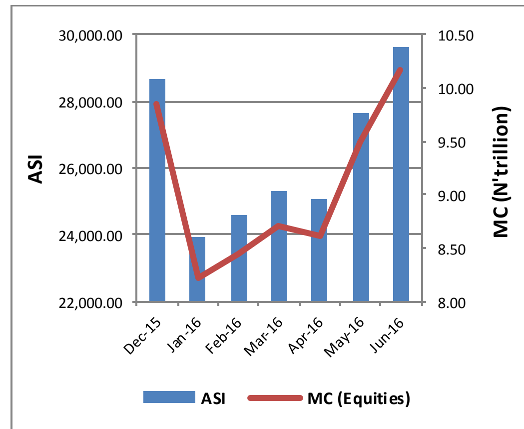
Source: NSE

Figure 5.9
NSE ASI and MC (June 2015 – June 2016)



Source: NSE

Figure 5.10
NSE ASI and MC (June 2015 – December 2015)



Source: NSE 2016

5.3.2 Market Turnover

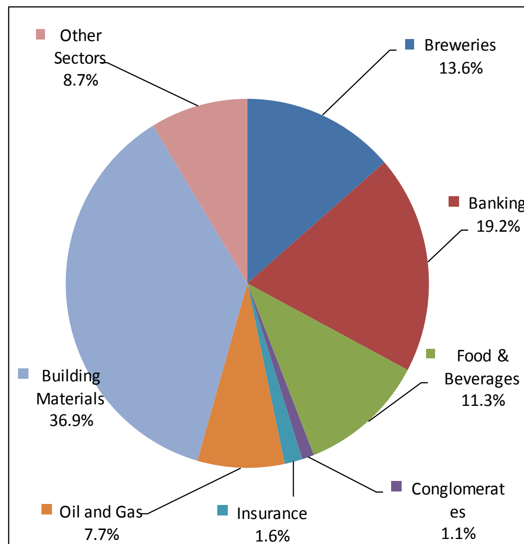
Aggregate stock market turnover in the first half of 2016 increased by 47.09 per cent to 61.97 billion shares (valued at N312.21 billion in 454,290 deals) compared with 42.13 billion shares (valued at N395.83 billion in 409,818 deals) in the second half of 2015. When compared with the first half of 2015, market turnover increased by 22.71 per cent from 50.50 billion shares (valued at N556.99 billion in 534,624 deals). Foreign portfolio investment inflow exceeded outflow by N15.71 billion in the first half of 2016, indicating moderate investor confidence in the market.

5.3.3 Sectoral Contribution to Equities Market Capitalization

Construction remained the dominant sector by market capitalization,

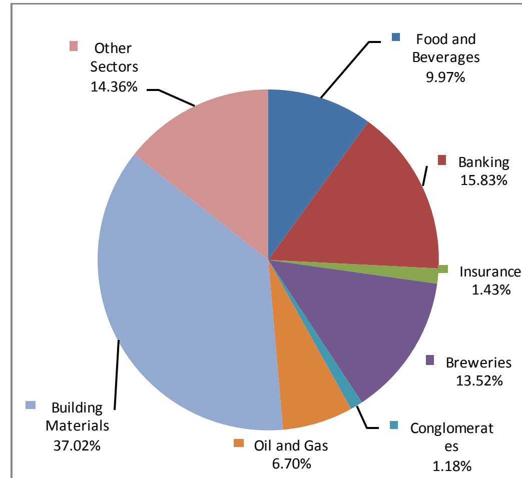
primarily due to activities in the building materials sub-sector. The sub-sector's share in overall market capitalization increased to 37.02 per cent at end-June 2016 from 36.9 per cent in the second half of 2015. This was due primarily to the market share of Dangote cement. Other major sub-sectors were banking, breweries, and food & beverages, with respective market shares of 15.83, 13.52 and 9.97 per cent, at end-June 2016 (Figure 5.12).

Figure 5.11
NSE Market Capitalisation by Sector as at End-December 2015



Source: NSE

Figure 5.12
NSE Market Capitalisation by Sector as at End-June 2016



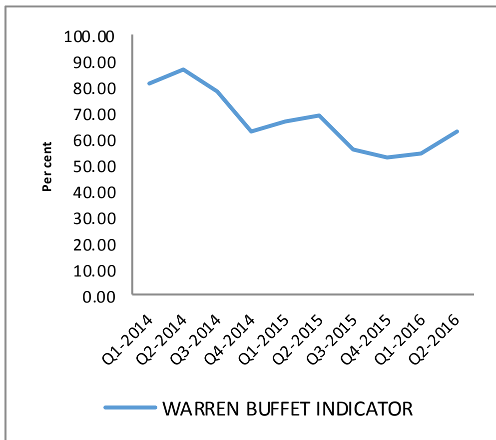
Source: NSE 2016

5.3.4 The Warren Buffett Valuation Metric and Nigeria's Equities Market

Based on Warren Buffett valuation metric, the Nigerian stock market in the first quarter of 2016 was undervalued at 54.43 per cent, which was below the threshold of 75.0 to 115.0 per cent. The metric measures the market value of securities as a ratio of GDP. In the second quarter of 2016, the metric stood at 63.04 per cent, also indicating an undervaluation. This development was attributed to a number of factors, including weak corporate earnings, US monetary policy normalization accentuating capital reversals as well as the general contraction in the domestic economy. The undervaluation of equities continues to

present attractive investment opportunities for domestic and foreign investors as the market recovers.

Figure 5.13
Warren Buffett Valuation of Nigerian Equities Market



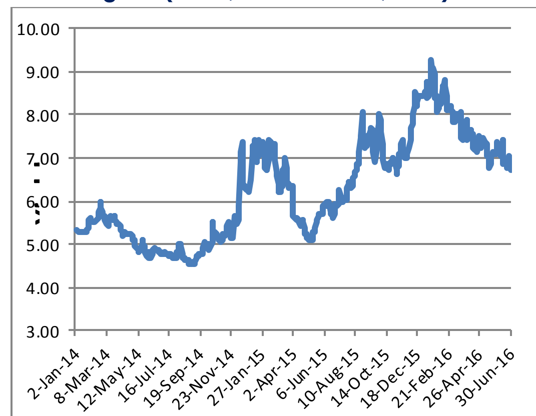
5.3.5 Bond Market

In the period under review, activities in the bonds market remained dominated by Federal Government of Nigeria (FGN) securities. Sub-national government and corporate bonds also recorded some activity, with the corporate bonds recording the least share by market volume.

5.3.5.1 FGN Eurobond

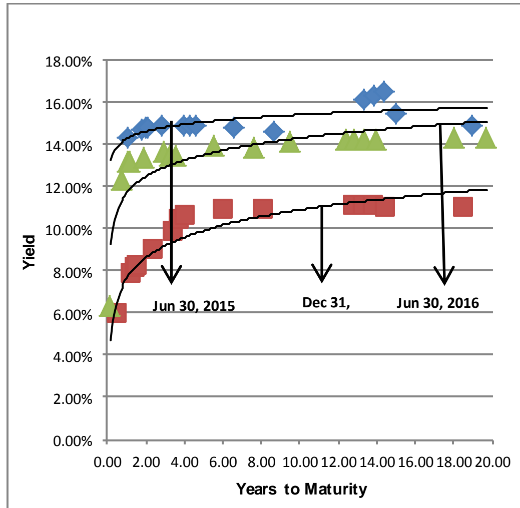
The yield on the 10-year dollar-denominated bond recorded a decrease of 1.74 percentage points to 6.74 per cent at end-June 2016, from 8.48 per cent at end-December 2015. It, however, showed an increase when compared with 5.91 per cent recorded at end-June 2015 (Figure 5.14). This development was attributable to improved investor perception of the country's sovereign risk as well as the correction of market reaction that followed the delisting of Nigeria from the JP Morgan's Government Bond Index for Emerging Markets (GBI-EM) in September, 2015.

Figure 5.14
10-Year U.S. Dollar-denominated Bond Yield for Nigeria (Jan 1, 2014 – Jun 30, 2016)



The FGN bond yield curve as at end-June 2016 trended upwards by 352 basis points to 13.31 per cent compared with 9.80 per cent at end-December 2015. It, however, trended downwards by 180 basis points when compared with 15.11 per cent at end-June 2015 (Figure 5.15). This development implied that FGN bond yields were negative and below the end-June 2016 inflation figure of 16.5 per cent.

Figure 5.15
FGN Bonds Yield Curves: end-Jun. 2015 vs. end-Dec. 2015 vs. end- Jun. 2016



5.3.5.2 State/Local Government Bonds

During the review period, the sub-national bonds market recorded low activity. At end-June 2016, the total value of outstanding state/local governments bonds stood at ₦535.08 billion, compared with ₦536.47 billion at end-December 2015 and ₦544.43 billion at end-June 2015.

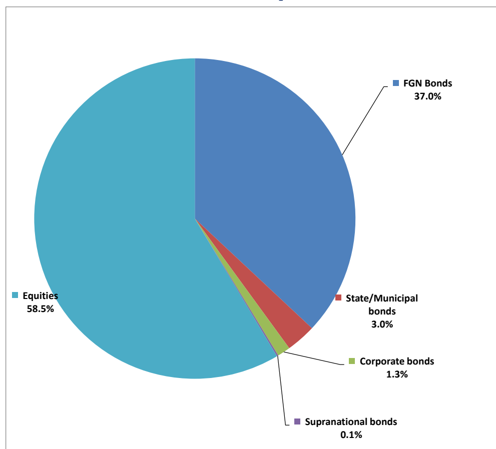
5.3.5.3 Corporate Bonds

Activity in the corporate bonds segment improved during the review period. The value of outstanding corporate bonds at end-June 2016 was ₦224.91 billion, compared with ₦205.89 billion at end-December 2015 and ₦220.39 billion at end-June 2015. The improvement in activity was due largely to modest recovery in crude oil prices, improved sovereign risk of the country and reduced pace of US monetary policy normalization.

5.3.5.4 Overall Analysis of the Nigerian Capital Market

The value of FGN bonds decreased by 2.62 per cent to ₦6.32 trillion at end-June 2016 from ₦6.49 trillion at end-December 2015, and by 31.94 per cent when compared with the level at end-June 2015. FGN bonds accounted for 37.0 per cent of aggregate market capitalization as at end-June 2016. The value of state/municipal bonds, corporate bonds and supranational bonds were ₦535.08 billion, ₦224.91 billion and ₦24.95 billion, accounting for 3.0, 1.3 and 0.1 per cent of aggregate market capitalization, respectively. The equity market constituted 58.5 per cent of aggregate market capitalization at end-June 2016, while the combined shares of FGN bonds, state/municipal bonds, corporate bonds and supranational bonds accounted for the balance of 41.5 per cent (Figure 5.16).

Figure 5.16
Structure of the Nigerian Capital Market (June, 2016)



5.4 Global Financial Market Developments

In the review period, the global financial market was characterized by uncertainties, arising from the expectation of further US rate hike, the ongoing rebalancing of the Chinese economy,especially following the Chinese stock market turmoil earlier in the year, and general instability in global financial markets.. The unexpected outcome of the Brexit referendum also led to high market volatility and subdued global activity and trade. These developments heightened global market risks, particularly in the advanced economies due to elevated uncertainty, weakened confidence and persisting growth slowdown. These developments impacted on financing conditions in the emerging market and developing economies. Persistently low commodity prices, in particular crude oil, and slowing economic activity, elevated risks in emerging market and developing economies. In most advanced economies, monetary policy remained largely accommodative, as the ECB, BoE and BoJ sustained their quantitative easing programmes. Consequently, the currencies of emerging market and developing economies continue to depreciate, owing to the sustained appreciation of the dollar and dollar denominated assets. These developments created an environment of subdued market confidence resulting in a mixed performance of major global stock markets.

5.4.1 Money Market and Central Bank Policy Rates

Global liquidity conditions were largely shaped by the monetary policy stance of the advanced economies. In the US, monetary policy remained largely accommodative, as the Fed refrained from further rate hikes in response to developments in the domestic and global economies. Similarly, the ECB extended its QE programme to March 2017, and the Bank of England sustained its QE programme with a commitment to support the British economy in the buildup to the BREXIT referendum. In addition, the Bank of Japan (BoJ) continued its QE programme while

considering additional strategies such as *helicopter money* to help lift the economy out of deflation. Another development that affected global liquidity conditions was the sell-off in the Chinese stock market earlier in the review period, which depressed asset prices across major markets.

In view of the above developments, central banks in the advanced economies kept their policy rates unchanged except in the euro area, where the ECB reduced its policy rate from 0.05 per cent to 0.00 per cent in March 2016. In the emerging market and developing economies, rates were also held constant in China and Brazil and lowered moderately in Russia and India. The policy action in Russia reflected early signs of recovery from the long standing recession, while Brazil continued to grapple with political issues in addition to its recession. In Kenya, the policy rate was lowered to accommodate growth while it was held constant in Ghana. In Nigeria, the policy rate was raised slightly to curtail inflationary pressure and slow down capital outflows.

Table 5.8
Policy Rates of Selected Countries July 2015 - June 2016

Country	Jan. 16	Feb. 16	Mar. 16	Apr. 16	May 16	June 16
USA	0-0.25	0.25-0.5	0.25-0.5	0.25-0.5	0.25-0.5	0.25-0.5
UK	0.50	0.50	0.50	0.50	0.50	0.50
Euro Area	0.05	0.05	0.00	0.00	0.00	0.00
Japan	0-0.10	0-0.10	0-0.10	0-0.10	0-0.10	0-0.10
S. Africa	6.75	6.75	7.00	7.00	7.00	7.00
Kenya	11.50	11.50	11.50	11.50	11.50	10.50
Ghana	26.00	26.00	26.00	26.00	26.00	26.00
Russia	11.00	11.00	11.00	11.00	11.00	10.50
China	4.35	4.35	4.35	4.35	4.35	4.35
India	6.75	6.75	6.75	6.50	6.50	6.50
Brazil	14.25	14.25	14.25	14.25	14.25	14.25
Indonesia	7.50	7.00	6.75	6.75	6.75	6.50
Nigeria	11.00	11.00	11.00	12.00	12.00	12.00

5.4.2 Capital Market

Major global stock exchanges recorded mixed performance during the review period. In Europe, the UK FTSE 100 and Russian MICEX indices increased by 4.2 and 7.4 per cent, respectively, while the French CAC 40 and German DAX indices declined by 8.6 and 9.9 per cent, respectively. In North America, the United States S&P 500, Canadian S&P/TSX Composite and Mexican Bolsa indices increased by 2.7, 8.1 and 7.0 per cent, respectively.

In Asia, the Indian BSE Sensex index increased by 3.4 per cent, while the Japanese Nikkei 225 and Chinese Shanghai SE indices declined by 18.2 and 17.2 per cent, respectively. In Africa, the Nigerian NSE All-Share and South African JSE All-Share indices increased by 3.3 and 3.0 per cent, respectively, while Kenyan Nairobi NSE 20, Egyptian EGX CASE 30 and Ghanaian GSE All Share indices declined by 9.9, 0.9 and 10.4 per cent, respectively.

Table 5.9
Selected International Stock Market Indices as at June 30, 2016

Country	Index	End-June, 2015	End-December, 2015	End-June, 2016	% Change Dec 15 - Jun 2016
AFRICA					
Nigeria	ASI	33,456.83	28,642.25	29,597.79	3.3
South Africa	JSE African AS	51,806.95	50,693.76	52,217.72	3.0
Kenya	Nairobi NSE 20	4,906.07	4,040.75	3,640.61	-9.9
Egypt	EGX CSE 30	8,371.53	7,006.01	6,942.52	-0.9
Ghana	GSE All Share	2,352.23	1,994.91	1,787.50	-10.4
NORTH AMERICA					
US	S&P 500	2,063.11	2,043.94	2,098.86	2.7
Canada	S&P/TSX Composite	14,553.33	13,009.95	14,064.54	8.1
Mexico	Mexico Bolsa (IPC)	45,053.70	42,977.50	45,966.49	7.0
SOUTH AMERICA					
Brazil	Bovespa Stock	53,080.88	43,349.96	51,526.93	18.9
Argentina	Merval	11,656.81	11,675.18	14,683.49	25.8
Colombia	COLCAP	1,331.35	1,153.71	1,313.18	13.8
EUROPE					
UK	FTSE 100	6,520.98	6,242.32	6,504.33	4.2
France	CAC 40	4,790.20	4,637.06	4,237.48	-8.6
Germany	DAX	10,944.97	10,743.01	9,680.09	-9.9
Russia	MICEX	1,654.55	1,761.36	1,891.09	7.4
ASIA					
Japan	NIKKEI 225	20,235.73	19,033.71	15,575.92	-18.2
China	Shanghai SE A	4,479.90	3,704.29	3,066.50	-17.2
India	BSE Sensex	27,780.83	26,117.54	26,999.72	3.4

Source: Bloomberg

5.4.3 Commodities

Globally commodity prices recorded modest recovery in the first half of 2016 from their declines in the second half of 2015, due to improved market sentiment as supply tightened. The largely accommodative monetary policy in the advanced economies and a firming of oil prices generally improved market sentiment. In addition, the supply disruptions due to wildfires in Canada, militant attacks on oil infrastructure in Nigeria, reduced supply of shale oil, especially in the US, and the geopolitical tensions in the Middle East led to a modest recovery in oil and other commodity prices.

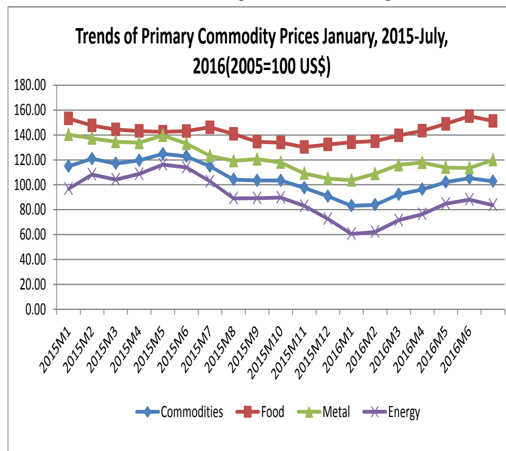
The Energy Price Index rose by 21.19 per cent to 88.03 points in June 2016 from 72.64 points in December 2015. The average price of oil was $47.70 per barrel in the second quarter of 2016, which was 37.0 per cent above its first quarter average. This development reflected supply disruptions in a number of oil producing countries such as Canada, Nigeria, Kuwait, Iraq and Libya.

Non-fuel commodity price index also rose by 10.79 percent to 134.80 points in June 2016 from 121.67 points in December 2015, owing to improved global demand. Metals prices rose by 8.10 per cent to113.57 points in June 2016 from 105.06 points in December 2015. Precious metals prices rose 8.0

percent due to strong investor demand prompted by growing concerns about global growth.

The Food and Agriculture Organization (FAO) Food Price Index rose by 6.84 per cent from 153.40 in December 2015 to 163.90 in June 2016. All the sub-indices of meat, dairy, vegetable oil and sugar rose, while cereals fell during the review period. Overall, the commodity index rose by 16.05 per cent from 90.73 points in December 2015 to 105.29 points in June 2016.

Figure 5.17
Indices of Primary Commodity Prices June 2015 – June 2016 (2005=100 US$)



Source: IMF

5.4.4 Foreign Exchange market

During the first half of 2016, most currencies appreciated against the US dollar, due to a slowdown in output in the United States in the first quarter, as private consumption expenditure (PCE) and non-residential fixed investments declined. In addition, the firming of oil and other commodity prices, improved market sentiment and waning effects of the ongoing transition of the Chinese economy to a balanced growth path, helped to strengthen most currencies against the US dollar. Consequently, the euro, Canadian dollar and Japanese yen appreciated against the US dollar by 2.22, 6.15 and 16.48 per cent, respectively, while the British pound depreciated by 9.33 per cent, largely due to the BREXIT referendum.

In the emerging market and developing economies, the Russian ruble, Brazilian real and Colombian peso appreciated against the US dollar by 13.93, 23.36 and 8.70 per cent, respectively, while the Chinese yuan, Indian rupee, Mexican peso and Argentine peso depreciated by 2.41, 2.04, 6.71 and 14.09 per cent, respectively. In sub-Saharan Africa, the South African rand and Kenyan shilling appreciated against the US dollar by 6.32 and 1.19 per cent, respectively, while the Nigerian naira, Egyptian pound and Ghanaian cedi depreciated by 30.39, 11.92 and 3.54 per cent, respectively(see table 1a).

Table 5.10
Exchange Rates of Selected Countries (Value in currency units to US$)

	Currency	31-Dec-15	30-Jun-16	End-December, 2015 - End-Jun, 2016
AFRICA				
Nigeria	Naira	197.00	283.00	-30.39
South Africa	Rand	15.48	14.56	6.32
Kenya	Shilling	102.30	101.10	1.19
Egypt	Pound	7.83	8.89	-11.92
Ghana	Cedi	3.81	3.95	-3.54
NORTH AMERICA				
Canada	Dollar	1.38	1.30	6.15
Mexico	Peso	17.23	18.47	-6.71
SOUTH AMERICA				
Brazil	Real	3.96	3.21	23.36
Argentina	Peso	12.93	15.05	-14.09
Colombia	Peso	3174.50	2920.35	8.70
EUROPE				
UK	Pound	0.68	0.75	-9.33
Euro Area	Euro	0.92	0.90	2.22
Russia	Ruble	72.85	63.94	13.93
ASIA				
Japan	Yen	120.20	103.19	16.48
China	Yuan	6.49	6.65	-2.41
India	Rupee	66.15	67.53	-2.04
Source: bloomberg				

BREXIT – THE REFERENDUM BY THE UNITED KINGDOM TO EXIT THE EUROPEAN UNION

The United Kingdom of Great Britain and Northern Ireland is a political union of four countries, England, Scotland, Wales and Northern Ireland. Great Britain is made up of these three original countries, England, Scotland and Wales. The political union is a parliamentary democracy of equals, with each country headed by a First Minister and the entire Union headed by a Prime Minister who is the Head of Government and sits in England, the capital of the Union. The Queen of England is the overall Ceremonial Head of the political union, having jurisdiction over all machineries of government in all four countries.

The United Kingdom joined the European Union (EU) in 1973, forty three years ago. European integration is stratified into three distinct layers, the outermost European Economic Community (EEC), the inner European Union (EU) and the nucleus or core European Monetary Union (EMU). Members of the EMU have a common monetary policy conducted by the European Central Bank (ECB) and also use a single currency, the euro. These countries are bound by the Maastricht treaty which is the legal document establishing the ECB and the single currency. The EU comprises of all the members of the EMU plus other European countries subscribing to access the European single market but not adopting the euro as their currency. These group of countries are bound by the Lisbon treaty which is the legal document setting up the single market. Members of the EU commit to free movement of labor, goods and services across their borders for citizens of member countries. The EEC comprises of all EU members and all other European countries with a less binding trade agreement and limited access to the single market.

On 23rd June, 2016, citizens and residents of the United Kingdom voted in a European Union membership referendum. In 1975, just two years after joining the EU, the British public voted in a similar referendum, resulting in a 'remain' vote of over 68 per cent. In the 23rd June, 2016 vote however,the 'leave' camp won by a majority of 51.9 per cent, while the 'remain' camp had 48.1 per cent of the votes.
In the wake of the victory of 'leave' referendum, the then British Prime Minister, David Cameron announced his resignation and departure from government before the Conservative Party Conference in October 2016, to make way for a new Prime Minister to lead the country through the negotiations with the European Council (EC) on Britain's final exit from the EU. The Party leadership hinted that a new Prime Minister and government will be in place by the first week of September 2016. In order to commence the negotiations for final exit, article 50 of the Lisbon treaty must be triggered by the new British Prime Minister. This action will signal to

the European Council, a member's intention to start the two year process of exit from the Union.

A huge controversy however erupted in the wake of the referendum; Scotland, the second largest economy in the Union voted with a 68 per cent majority to remain in the EU. Northern Ireland also voted with a majority to remain in the EU while Wales voted with a narrow margin to leave the EU. In England the capital of the Union, the overall vote was in favor of leaving the EU. In London, the capital city of England, home to the country's major financial markets and institutions, there was an overwhelming vote to remain in the EU. The Scottish First Minister, Nicola Sturgeon and Leader of Sinn Fein, Northern Ireland's majority party, Gerry Adams, both called for a disintegration of the United Kingdom of Great Britain and Northern Ireland to allow their people continue their desired membership of the EU, should the government in Westminster decide to trigger article 50 of the Lisbon treaty. Scotland is proposing to go as an independent nation, to enable it continue its membership of the EU while Northern Ireland is proposing to join borders with Ireland which is currently a member of the European Monetary Union. This implies that Northern Ireland and Scotland may eventually join the EMU and adopt the euro as their currency.

The likely consequence, therefore, of eventual exit from the EU include but is not limited to: a much smaller United Kingdom without Scotland and Northern Ireland; a weakened London financial market as jobs may be exported to continental Europe; withdrawal of Britain's access to the European single market, leading to more expensive imports and exports; considerable weakening of the British housing market as a sizeable number of immigrant population expected to leave the country; increased taxes as the economy's tax base reduces due to EU migrants leaving the UK; weakening of the pound sterling as investors sell off pound sterling assets; decline of the FTSE 100 and other related stock market indices; and likely recession over the next few months. In a similar manner, prospective investors in UK assets are likely to hold off investment in such assets until the BREXIT storm looming over the United Kingdom calms down. For example, a major investment deal to take over the UK steel company, TATA, has been suspended until the investment horizon clears up. The negotiations following the trigger of article 50 may likely persist for a few years to come as a minimum period of two years is required after the trigger before a country finally exits the EU. Negotiations could however drag on for upward of five years, creating further uncertainty and economic slowdown.

Following these likely consequences, the credit rating of the United Kingdom was downgraded from AAA to AA and may face further downgrade as developments unfold.

After 'day one' of the announcement of the outcome of the referendum, financial markets across the globe recorded a total loss of over two trillion United States dollars. The pound sterling, which appreciated against the U.S dollar in the days before the referendum, (selling at GBP1.00:USD1.55) experienced a sharp fall to GBP1.00:USD1.30 in the hours and days after the announcement, losing a total of 12 per cent of its value, the lowest value recorded in the last thirty one years. Analysts were initially of the view that If the attack on the pound sterling continued, the Bank of England (BoE) may be forced to raise its policy rate at a time that inflation and GDP were performing well below expectation. The UK being a country of home owners is very sensitive to interest rate movements as it causes home mortgages to become considerably more expensive. The likely outcome of this development will be the beginning of a long and deep recession with far reaching consequences for the global economy. Simultaneously raising of tax rates and the policy rate is expected to further slowdown economic activities while deepening the recession and driving the economy into deflation. On Monday 27th June, 2016, HSBC and the Royal Bank of Scotland lost 12 and 14 per cent respectively of their market capitalization amongst other significant losses on the stock exchange. The 5 per cent loss provision in stock value was therefore triggered on the London Stock Exchange (LSE) to halt trading in several stocks as the market tumbled aggressively.

Because the referendum did not record a 60 per cent majority on either side [48.1(Remain) versus 51.9(Leave)], the likelihood that those who voted to remain in the EU may call for another referendum, remains a possibility. In addition, the Scottish First Minister has signaled strongly of her intentions to commence negotiations with the EU, for Scotland to remain in the EU as an independent nation and is working with the Scottish Parliament to pave way for an independence referendum for Scotland to leave the United Kingdom. Pockets of crisis have also erupted in the British Labour Party, Britain's leading left wing opposition party, where calls have gone out to the party leader, Jeremy Corbyn to step down for fresh leadership as members of this left wing party were of the view that their leader failed to deliver victory to their populist 'remain' agenda and may thus not be in a position to lead the party to victory in the next general election before December 2016. Corbyn was however returned as the party leader with a bigger mandate in a recently conducted leadership referendum.

Across Europe and the United States of America, financial markets opened on Friday 24th June, 2016 looking southwards and continued after the ensuing weekend. The attack on the pound sterling showed very little sign of abating even after the UK Finance Minister and Chancellor of the Exchequer, George Osborne appealed to markets that the government had a robust plan to stem the turmoil. The Governor of the Bank of England (BoE), Mark Carney also hinted that the BoE was set to increase the quantum of the Bank's quantitative easing programme, by up to an additional 350 billion pounds sterling, to help provide some stability as he urged investors to remain calm. This was in addition to the 375 billion pounds quantitative easing program currently in progress. The BoE also responded to weakening fundamentals by lowering the policy rate from 0.5 per cent to an all-time low of 0.25 per cent. Given that Europe had slipped into deflation, and the euro remains weak compared to other major currencies, the euro area may also be confronted with a recession in the near future as the euro and euro area may also be faced with divestment challenges. This will likely depend on how well the leaders of the other 27 EU member countries handle the impending exit of the United Kingdom.

From all indications, BREXIT brings with it far reaching consequences for the United Kingdom, Europe and the global economy which is set to slow down further, if the crisis continues to be fuelled by uncertainty and speculative trading. Emerging Markets and Developing Economies may however be the medium to long term beneficiaries of capital flows if they align their macroeconomic and political environments to the unfolding developments in these advanced economies, bearing in mind that the US dollar may continue to appreciate as a result of the unfolding European crisis.

In Europe, the European Council, speaking through the Finance Ministers of the six (6) founding Member States has urged the British Government to speedily invoke *article 50* of the Lisbon treaty to enable a swift disengagement from the Union. Indications suggest that the EU leaders are set to cut a very raw severance deal for Britain in order to discourage other countries from leaving the Union. As part of the restructuring of the EU, the European Council stated that it will consider dropping English as the official language of the European Union in favor of another European language.

The British Prime Minister, David Cameron, attended the European Council Meeting in Brussels on 28th June, 2016 to formally inform the Council members of current developments before his final disengagement from government. The new Prime Minister, Theresa May, has reiterated her commitment to maintain the

position of the referendum and has commenced informal negotiations with European leaders while planning a strategy for disengagement.

IMPLICATIONS OF BREXIT TO THE NIGERIAN BANKING SECTOR

The implication of BREXIT to the Nigerian Banking Sector is best viewed through its impact on the real economy vis-a-vis the role of the banking sector in the transmission mechanism between central bank policy and developments in the real economy. Capital flows, inflation, market capitalization (stock, bond and money markets), the exchange rate (dollar, euro and pound sterling), accretion to external reserves, balance of payments, trade linkages (exports and imports) and GDP are aspects of the macro-economy that may be directly affected.

Foreign Direct Investment and Portfolio Capital Flows: In the aftermath of the UK-EU exit referendum, the pound sterling as demonstrated above has come under severe pressure as investors sell off pound sterling denominated assets in favor of US dollar denominated assets. This development has caused and will continue to fuel the appreciation of the US dollar, a situation which will result in the competitiveness of US exports and the subsequent dampening of its economic recovery. If the US maintains a low policy rate (slows down normalization of monetary policy) to allow its economy recover, investors will soon begin to look for alternative investment destinations such as emerging market economies with higher policy rates. Portfolio capital will thus likely flow into the stock and money markets while foreign direct investment will flow into manufacturing and agriculture.

Inflation: For Nigeria to benefit from this redirection of investment capital flow, certain macroeconomic and structural fundamentals need to be adjusted in order to drive down the current high rate of inflation and reverse the ongoing negative real rate of interest. As has been previously identified, a significant component of the current high level of inflation is due to structural rigidities in the supply side of the real economy. Recent hikes in electricity tariff and the removal of subsidies on imported petroleum products have contributed significantly to the rising level of inflation. With inflation rising at its current trend, Nigeria will be in a difficult position to attract foreign direct or portfolio investment. Government must therefore direct its resources towards economic activities that can help breakdown these supply side constraints, such as the building of refineries to curb importation of fuels, building of roads to improve the transportation of goods and services and provision of incentives to help attract talents and capital to the agricultural sector.

Market Capitalization (Stock, Bond and Money Markets): An attractive array of instruments in the stock, bond and money markets will help attract investors divesting out of Britain and the United States to Nigeria. Policy must however ensure that the new influx of capital is not followed by a rapid reversal in the near future as was experienced between 2014 and 2015.

The Exchange Rate (dollar, euro and pound sterling): With a fast depreciating pound sterling and appreciating dollar, the naira is not likely to strengthen in the short term due to the newly introduced, foreign exchange market system. This will, however, depend on the size of the trade between Nigeria and UK. Going by the statement of the outgoing British Prime Minister on the future direction of trade for the UK, he noted that the country will begin to explore the renewal of trade linkages with members of its commonwealth as access to the European single market may become limited as soon as article 50 of the Lisbon Treaty is fully implemented. In the event of increased trade with the United Kingdom, a weak naira will therefore be more favorable to exports from Nigeria to the UK. This implies that we revamp our export sector in order to fully benefit from the emerging opportunities.

Accretion to External Reserves and Adjustment of Balance of Payment Accounts: Capital flows into Nigeria will simultaneously improve the accretion to external reserves and the Balance of Payments (BOP) as investors move capital into the Nigerian economy. Once again, policy must be able to address key issues like the exchange rate, entry and exit barriers (such that the economy derives a real benefit from these capital inflows) and most importantly, friendliness of the investment climate for longer term foreign direct investment. For example, attraction of capital into the Nigerian steel industry is essential at a time that steel investors are divesting out of the United Kingdom. For Nigeria to be able to redirect this investment over the two year period of uncertainty that article 50 of the Lisbon Treaty will impose on UK markets, both monetary and fiscal policy must be well positioned to provide the enabling environment for such investments.

Improved Trade Linkages (exports and imports): One of the overriding arguments by British Eurosceptics is that the fast pace of growth of emerging market economies implies that there is a bigger market for Britain to key into, if it frees itself from the regulatory shackles posed by membership of the European Union. With the fast pace of growth in these emerging market economies, the proportion of British trade outside the EU will no doubt rise in the event of a fully implemented BREXIT, as Britain will be free to negotiate more trade deals as a sovereign State.

Trade with the United Kingdom can blossom in the area of agricultural exports to the UK. Agricultural products like oranges, pineapples, potatoes etc. previously imported from the EU can now be imported from Nigeria and other countries. Other raw materials such as mineral resources can also be exported to the EU to fill up the gap left by the United Kingdom. In the area of manufacturing, technological knowledge transfers can be encouraged between Nigeria, the United Kingdom, the European Union and the United States. Under this model, these countries will be encouraged to set up manufacturing plants specific to their product needs, to take advantage of the cheaper labor in Nigeria. Goods ranging from small household utensils to heavy consumer goods like cars can be produced through this technology transfer scheme thus boosting domestic growth, rapidly lowering unemployment and raising the skill level of the workforce. These goods will then be exported back to the country that shared technological knowledge with Nigeria. Over the years, Nigerian workers will gain expertise in these technologies thus providing the opportunity to expand the Nigerian market to other regions such as the ECOWAS single market. This is the basic model China adopted in developing its manufacturing capacity. Nigerian products may however require some improvement in quality to meet UK importation standards.

Conclusion

One fact we must acknowledge is that BREXIT has brought with it, a permanent change to the international financial architecture, direction of trade and relevance of some world currencies. As it stands, uncertainty will loom over the future of the United Kingdom as an investment and export destination due to its impending exit from the EU single market and the likelihood of disintegration if Scotland and Northern Ireland decide to remain in the EU.

The Nigerian banking sector is therefore expected to experience an upsurge in liquidity in the medium term as capital flows into emerging markets and developing economies in the likely event that the US Federal Reserve Bank fails to raise its policy rate in response to the appreciating dollar, driven by divestments from pound sterling and euro denominated assets.

Deposit money banks exposed to the Eurobond market will see an improvement in their statements of financial position (balance sheets) considering that the depreciating pound and euro will minimize their obligations in this market. Benefiting from these developments depends on how quickly the Nigerian policy environment is strategically re-tuned to attract foreign investors.

CHAPTER 6
ECONOMIC OUTLOOK

6.1 OVERVIEW

The global economic growth in 2016 was revised downwards to 3.1 per cent from its earlier projection of 3.2 per cent by the International Monetary Fund (WEO Report, July 2016). The revised estimate was unchanged from the growth of 3.1 per cent recorded in 2015. The downward revision to global growth was due largely to the impact of weak aggregate demand, sustained fall in crude oil and other commodity prices, US monetary policy normalization, macroeconomic weakness in the euro area as well as China's transition to a balanced growth path.

In advanced economies, growth was projected at 1.8 per cent in 2016 from 1.9 per cent in 2015. This development was driven largely by slowdown in consumer demand in the US as well as the impact of BREXIT. Growth in the United States declined to 2.2 per cent in 2016 from 2.4 per cent in 2015. In the Euro area, growth was projected at 1.6 per cent in 2016 from 1.7 per cent in 2015, driven by sustained private consumption, supported by exchange rate depreciation, quantitative easing, and lower oil prices.

In emerging markets and developing economies, growth was projected to rise to 4.1 per cent in 2016 from 4.0 per cent in 2015, due to improved consumer and business confidence, especially in countries previously in deep recession. Among the emerging markets, growth in China was projected at 6.6 per cent in 2016 from 6.9 per cent in 2015. The Russian economy was projected to record a milder contracted of 1.2 per cent in 2016 from a contraction of 3.7 per cent in 2015, this will, however, weaken the performance of other economies in the Commonwealth of Independent States (CIS). In Latin America and the Caribbean, growth in Brazil was projected to contract by 3.3 per cent in 2016 compared with a contraction of 3.8 per cent in 2015.

In sub-Saharan Africa (SSA), growth was projected to decline to 1.6 per cent in 2016 from 3.3 per cent in 2015. The slowdown reflected the continued adjustment to lower commodity prices, currency depreciations and weak aggregate demand as tighter external financing conditions persist. In Nigeria, the economy was projected to contract by 1.8 per cent in 2016 from 2.7 per cent in 2015, owing to continued weakness in oil price as well as production challenges. In South Africa, growth was projected to decline to 0.1 per cent in 2016 down from 1.3 per cent in 2015, due to continuing challenges in electricity supply and labour market, and weakening business confidence.

6.2 Outlook for Global Output

Growth outlook for global economy for the rest of the year and 2017 is expected to remain weak and uneven in most advanced economies, with output gaps gradually closing across countries. Growth in the emerging and developing economies is expected to improve, with India and China leading growth, while Brazil and Russia are expected to record significant improvement in their growth outcomes. However, the slow recovery in prices of global commodities, uncertainties surrounding the Brexit as well as the rebalancing of the Chinese economy will continue to weigh on global outlook in 2016 and 2017. As a result, the global economy is forecast to grow at 3.1 per cent in 2016 and 3.4 per cent in 2017. This growth is expected to be driven by gradual recovery in the advanced economies, improved labour market conditions in the US and euro area, rising consumption as well as persisting lower energy costs.

In advanced economies, growth is forecast to moderate to 1.8 per cent in 2016 and 2017 from 1.9 per cent in 2015, due largely to the impact of Britain's exit from the European Union. The UK economy is projected to slow to 1.7 and 1.3 per cent in 2016 and 2017, respectively, from 2.2 per cent in 2015. This development will be as a result of increased uncertainties following BREXIT which is expected to weaken domestic demand. In the US, growth is forecast to decline to 2.2 per cent in 2016 from 2.4 per cent in 2015, and rebound to 2.5 per cent in 2017. The rebound is expected to be driven by improvement in private consumption and labour market conditions. Growth in the euro area is forecast to moderate to 1.6 and 1.4 per cent in 2016 and 2017, respectively, from 1.7 per cent in 2015. The moderation is expected from increased uncertainties and weak consumer and business confidence following BREXIT referendum. Similarly, growth in Japan is forecast to slow to 0.3 and 0.1 per cent in 2016 and 2017, respectively, from 0.5 per cent in 2015, as domestic demand remains weak.

Growth in emerging markets and developing economies (EMDEs) is forecast to rise to 4.1 and 4.6 per cent in 2016 and 2017, respectively, from 4.0 per cent in 2015, driven by China and India as well as the expected improvement in economic conditions in Russia and Brazil. In China, growth is forecast to moderate to 6.6 and 6.2 per cent in 2016 and 2017, respectively, from 6.9 per cent in 2015, reflecting slow investment growth as the economy continues to transit to a more balanced growth path. Growth in India is forecast to moderate to 7.4 per cent in 2016 and 2017 from 7.6 per cent in 2015, owing to slow investment growth. In Brazil, growth is projected to rise to 0.5 per cent in 2017 from contractions of 3.8 and 3.3 per cent in

2015 and 2016 respectively, due to expected recovery in commodity prices and the gradual improvement in consumer and business confidence.

In sub-Saharan Africa, growth is, however, projected to decelerate to 1.6 per cent in 2016 from 3.3 per cent in 2015, reflecting macroeconomic challenges in the group's largest economies, as they adjust to low commodity receipts. In 2017, however, growth is expected to strengthen to 3.3 per cent. Growth in South Africa is forecast to slow to 0.1 per cent in 2016, but rise to 1.0 per cent in 2017, from 1.3 per cent in 2015. Nigeria's economy, however, is projected to contract by 1.8 per cent in 2016 and rebound to 1.1 per cent in 2017, from a growth of 2.7 per cent in 2015.

Growth in the Middle East and North Africa (MENA) region is forecast at 3.4 and 3.3 per cent in 2016 and 2017, respectively, from 2.3 per cent in 2015, driven by expected recovery in oil prices and continuing fiscal consolidation (Table 6.1).

6.3 Downside Risks to Global Outlook

Risk to global outlook include uncertainties surrounding Brexit, protracted financial market turbulence, rising global risk aversion, absence of sizeable fiscal adjustments in some emerging market and developing economies in the face of lower commodity prices as well as geopolitical tensions. Global economic growth will be affected if these headwinds and other developments are not appropriately managed. In the euro area, the uncertainties surrounding the outcome of the Brexit vote, which accentuated global risk aversion, weakened business confidence and tightened financing conditions, are expected to affect growth negatively.

The continuing normalization of the US monetary policy, added to the policy divergence that has been created in the advanced economies, remain a threat to growth, especially in the emerging market and developing economies. This development could heighten capital reversals from EMDEs and further weaken their currencies. Although global crude oil prices have recovered modestly, oil and other commodity exporters continue to grapple with the task of undertaking sizeable fiscal adjustments given lower commodity revenues. In addition, geopolitical tensions in Middle East and other parts of the world remain a major threat to business confidence and global growth.

In order to mitigate the risks to global outlook, the IMF suggests the need for policy makers in the UK and the EU to ensure smooth transition to a new set of agreements in the post-exit trading and financial environment that will be mutually beneficial. There is also a

strong recommendation for policy makers to exploit greater synergy among available policy tools, as central banks alone do not have the suite of policies required to mitigate current and potential threats to the global economy. In addition, the legacy issues in the euro area banking sector, especially in Italy and Portugal, which are largely responsible for financial sector vulnerabilities in the area must be tackled. In particular, policies are needed to strengthen country defenses against possible global financial turbulence. To further enhance global business confidence, advanced economies with policy space need to implement measures to stimulate domestic demand and reduce global imbalances. Emerging markets and developing economies need to adopt sizeable fiscal adjustments in the face of softening commodity prices, declining foreign exchange receipts and weakening currencies.

Table 6.1
Global Output and Inflation Outlook

	2014	2015	2016	2017
A. World Output				
World Output	**3.4**	**3.1**	**3.1**	**3.4**
Advanced Economies	**1.9**	**1.9**	**1.8**	**1.8**
USA	2.4	2.4	2.2	2.5
Euro Area	0.9	1.7	1.6	1.4
Japan	0.0	0.5	0.3	0.1
UK	3.1	2.2	1.7	1.3
Canada	2.5	1.1	1.4	2.1
ıdvanced Economies	2.8	2.0	2.0	2.3
Emerging & Developing Economies	**4.6**	**4.0**	**4.1**	**4.6**
Commonwealth of Independent States	1.1	-2.8	-0.6	1.5
Latin America and the Caribbean	1.3	0.0	-0.4	1.6
Middle East and North Africa	2.7	2.3	3.4	3.3
Sub-Saharan Africa	5.1	3.3	1.6	3.3
B. Commodity Prices (US' Dollars)				
Oil	-7.5	-47.2	-15.5	16.4
Non-fuel	-4.0	-17.5	-3.8	-0.6
C. Consumer Prices				
Advanced Economies	1.4	0.3	0.7	1.6
Emerging & Developing Economies	4.7	4.7	4.6	4.4

Source: IMF WEO Update, July 2016

6.5 Global Inflation Outlook

Global inflation is expected to remain subdued in 2016, due primarily to persistent softening of oil and other

commodity prices on account of the strong pass-through to consumer prices. In advanced economies, inflation is projected to rise but below central banks' targets in 2016, owing to slack in commodity prices. In emerging markets and developing economies, inflation outlook remains diverse. While oil importing countries would continue to experience low inflation, owing to low oil and other commodity prices, oil exporters would largely be confronted with higher inflation as their currencies depreciate.

In advanced economies, inflation is projected to rise to 0.7 and 1.7 per cent in 2016 and 2017, respectively from 0.3 per cent in 2015, due to the expansion of quantitative easing programmes in the euro area, the UK and Japan as well as the delayed implementation of the US rate hikes.

In the United States, inflation is projected to rise to 0.8 per cent in 2016, from 0.1 per cent in 2015. In the euro area, headline inflation is projected to rise to 0.4 per cent in 2016 from 0.2 per cent in 2015 and to further increase to 1.1 per cent in 2017. In Japan, the consumer price index is expected to fall by 0.2 per cent in 2016, from 0.7 per cent in 2015, driven by the impact of lower energy prices and the appreciation of the yen.

In the emerging market and developing economies, inflation is projected to fall to 4.6 and 4.4 per cent in 2016 and 2017, respectively from 4.7 per cent in 2015. In China, inflation is forecast to remain low at 1.8 per cent in 2016, from 1.5 per cent in 2015, reflecting the effects of modest recovery in oil and other commodity prices. In India, inflation is forecast to rise to 5.5 per cent in 2016 from 5.4 per cent in 2015. In Brazil, average inflation is projected to fall slightly to 8.7 per cent in 2016 from 9.0 per cent in 2015, as the effects of the large administered price adjustments and currency depreciation in 2015 wears off. In Russia, inflation is expected to decline to 8.4 per cent in 2016 from 15.5 per cent in 2015.

In sub-Saharan Africa, inflation is projected to rise to 7.3 per cent in 2016, from 6.9 per cent in 2015, driven by strong pass-through of currency depreciations to domestic prices.

Outlook for Domestic Output Growth

Domestic output in the first half of 2016 began a negative trend. According to the National Bureau of Statistics (NBS), Gross Domestic Product (GDP) contracted 0.36 per cent (year-on-year) in real terms in first quarter of 2016, 2.47per cent points lower than the figure recorded in the preceding quarter and 4.32per cent points lower than in the corresponding quarter of 2015. In the second quarter, GDP contracted further by 2.06 per cent from -0.36 per cent in the preceding quarter and growth of 2.35

per cent in the corresponding quarter of 2015.

The contraction in growth has been attributed to decline in oil prices and oil production, hence decline in oil revenue which remains a major source of government revenue. As a share of the economy, the Oil sector contributed 10.29 and 8.26 per cent in the first and second quarter of 2016, respectively, of total real GDP, lower than in the corresponding periods of 2015. The contraction in GDP growth was further due to declines in Manufacturing, Financial Institutions, and Real Estate.

The economy is projected to return to growth path in the third and fourth quarters of 2016 with less robustness than it did in the corresponding period of 2015. The relatively weak growth outlook is based largely on the current low oil price which is projected to continue over the medium to long term with the attendant implications for government oil revenue. The International Monetary Fund cut its forecasts for global economic growth as the unexpected U.K. vote to leave the European Union creates a wave of uncertainty amid already-fragile business and consumer confidence. Growth projections were revised down substantially in sub-Saharan Africa, reflecting challenging macroeconomic conditions in its largest economies, which are adjusting to lower commodity revenues. Consequently, Nigeria's GDP growth projection for 2016 was revised downward to -1.8per cent from the earlier forecast of 2.3 per cent in April 2016, before the Brexit vote.

Given the current macroeconomic fundamentals, economic activity in Nigeria is projected to contract in 2016, as the economy adjusts to foreign currency shortages as a result of lower oil receipts. The naira has weakened sharply since the Central Bank allowed the currency to freely float in the foreign exchange markets in June 2016. The value of the Naira depreciated from N199 per USD to N282 by half year 2016, in the Inter-bank market and is expected to remain under pressure given the severe distress in the oil sector occasioned by weak global oil prices and security challenges to oil production in Nigeria.

The 2016 outlook tend towards slow economic recovery as some of the reforms begin to take effect and measures to boost the economy, such as increased spending on infrastructure, are implemented. Specific reforms pursued by the new administration to lay a foundation for renewed growth include the rationalisation of the public sector in order to cut the cost of governance; enforcement of the single treasury account to block financial leakages; renewed efforts at enforcement of tax compliance; preparation for zero-budgeting starting in 2016; and

increasing the ratio of capital to recurrent spending.

The risk to the outlook continues to be developments in the external environment, particularly the weak global economic recovery, declining demand for Nigeria's crude oil and slow accretion to reserves. However, the renew focus of the recently approved budget by the Federal Government in favour of capital expenditure and the commitment towards timely release of funds for capital projects will spur economic activities in the short-to-medium term.

Outlook for Domestic Inflation

Headline inflation sustained its upward trend in the first half of 2016. It remained above the upper band of the Bank's inflation threshold of 6 - 9 per cent, despite the Bank's overall tight monetary policy stance. Prior to February 2016, headline inflation (year-on-year) was within the single digit range.

Headline inflation increased significantly from 9.6 per cent in January to 16.5 per cent in June, 2016, indicating an increase of 6.9 percentage points. The Bank's major focus, however, remains subduing inflation to a single digit, given current global imbalances.
The IMF forecasts inflation to rise to 17.1 per cent in 2017 from 15.4 per cent in 2016 (WEO, October 2016). The CBN projects year-on-year headline inflation to remain in double digits throughout 2016, closing at 16.83 per cent in December 2016. The anticipated increase would be due, primarily, to the effects of exchange rate depreciation owing to the introduction of greater flexibility in foreign exchange management, as well as the increases in prices of petroleum products and energy, on account of recent policy reforms.

The low global inflation continues to moderate the influence of import costs on domestic prices. The Bank's tight monetary policy stance, added to its use of a number of administrative measures, is expected to help manage excess liquidity and rein-in on domestic prices.

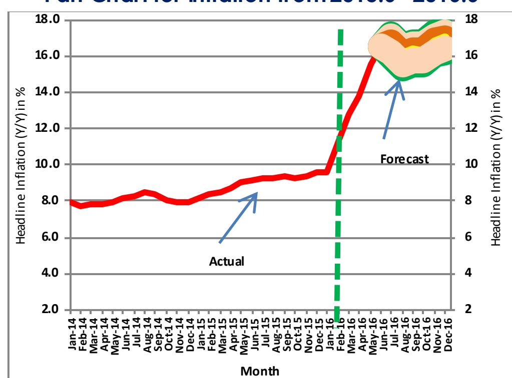
Table 6.2
Inflation Forecasts (Staff Estimates)

YEAR-ON-YEAR INFLATION RATE

Status	Month	Headline inflation	Food inflation	Core inflation
Actual	Jan-16	9.62	10.64	8.80
	Feb-16	11.38	11.35	11.00
	Mar-16	12.77	12.74	12.17
	Apr-16	13.72	13.19	13.35
	May-16	15.58	14.86	15.05
	Jun-16	16.48	15.30	16.22
Forecast	Jul-16	16.59	15.53	16.37
	Aug-16	15.95	15.18	16.19
	Sep-16	16.15	15.31	16.28
	Oct-16	16.15	14.94	16.56
	Nov-16	16.67	16.55	16.44
	Dec-16	16.83	16.54	16.71

Source: CBN Statistics Dept.

Figure 6.1
Fan Chart for Inflation from 2015:6 -2016:6



Outlook for Monetary Policy in 2016

On-going macroeconomic imbalances especially the recent "BREXIT" referendum has created significant uncertainty and challenges to the global economy. Britain leaving the EU is expected to dampen growth in the near term, particularly in the UK, but with repercussions also for Europe and elsewhere. In Nigeria, declining oil prices have impacted sharply on revenue and public expenditure resulting in lower than expected growth figures. Unemployment and under-employment continue to pose serious concerns. The trend in International oil market pose a great challenge to monetary policy management in Nigeria as oil receipt has strong implications for external reserves, fiscal position, and price level. Robust monetary and financial policy measures are, therefore, necessary to checkmate the after effects of such shocks.

Near-term risks to monetary policy environment in 2016 include low potential output growth in both advanced and emerging market economies, the continued divergence of monetary policy in the advanced economies, weakening of fiscal positions following the slide in oil prices. With the continued rise in domestic inflation, policy focus may continue to shift from growth to inflation thus stifling growth further in the face of rising inflation. Others challenges to monetary policy include: exchange rate volatility, financial market instabilities, constrained credit growth, rising trade imbalance and declining external reserves. These issues will continue to demand close attention and monitoring for monetary policy management in the second half of 2016.

Appendices

Central Bank of Nigeria Communiqué' No. 105 of the Monetary Policy Committee Meeting of Monday and Tuesday, January 25 and 26, 2016

The Monetary Policy Committee met on 25th and 26th January, 2016 against the backdrop of weakening global economic prospects as well as increased risks in the domestic economic environment. In attendance at the meeting were 10 out of the 12 members. The Committee reviewed the ensuing international and domestic economic and financial environments in 2015 as well as the outlook for the first half of 2016.

On the global front, uncertainties and geopolitical tensions have increased in the Middle East, leading to a major standoff between two major oil producers; Saudi Arabia and Iran, in the face of improving relations between the United States (US) and Iran. In the global oil market, both Iran and the US are emerging as new suppliers while OPEC appears to have shifted from protecting price to defending market share. These developments underscore the conclusion that the current global oil prices would remain for a much longer period. Widespread stock market weaknesses and worsening macroeconomic conditions in China have further exacerbated the already stifling global economic challenges. These uncertainties have blended well with domestic vulnerabilities to affect the monetary policy environment in Nigeria.

The Monetary Policy Committee (MPC) met on January 19 and 20, 2015 against the backdrop of challenging external conditions and downside risks in the domestic economic environment. In attendance were all the eleven members of the Committee. The Committee reviewed key external developments as well as domestic economic and financial conditions and outlook for 2015.

International Economic Developments

The Committee noted the considerable divergence in global output recovery in 2015, as growth picked-up in the most advanced countries compared with slowdown in majority of emerging and developing economies. Following the slowdown in the emerging market economies, the IMF in its January 2016 World Economic Outlook (WEO), revised its global growth estimate from 3.4 to 3.1 per cent and 3.4 per cent in 2015 and 2016, respectively.

In the United States, growth has remained relatively firm with 2015 third quarter growth rate revised to 2.1 per cent from an earlier estimate of 1.5 per cent. The country's overall growth in 2015 is expected to be the strongest since the post-crisis recovery began in 2010. Likewise, 2016 growth rate has been projected at 2.6 per cent. The

major drivers of this growth remained improvements in consumption spending supported by a robust labor market recovery; low inflation stemming from soft global crude oil prices; massive and dynamic investments in the non-oil private sector, improved foreign investment demand due to the recent normalization of monetary policy by the Fed, as well as housing market recovery.

Japan's recovery in 2015 remained fragile despite the continuous policy stimulus by the Bank of Japan. The Bank's asset purchase program injects ¥6.7 trillion ($56.71 billion) monthly into the economy, with the possibility of expansion. However, this has done little to restart growth which is estimated at 0.8 per cent in 2015. Private consumption and investment spending remained modest in 2015, worsened by rising skill shortages. Japan's outlook for 2016 remains dampened by the feeble response of the economy to monetary and fiscal stimuli.

In the Euro area, weakening fiscal consolidation and improving labor market conditions generated 1.5 per cent growth in 2015 with prospects for achieving 1.7 per cent in 2016. The European Central Bank (ECB) further eased its monetary policy stance in December 2015, despite the Bank's continuous monthly asset purchase of €60 billion ($64.8 billion), as both inflation and wage growth remained subdued. In the same vein, the Bank of England continued its accommodative monetary policy through its £375 billion ($540 billion) asset purchase program, even as it announced a decision to reinvest another £6.3 billion ($9.07 billion), being the proceeds of redemption of the December 2015 gilt (government securities) held in the Asset Purchase Program. The Bank also maintained its core rate at 0.5 per cent in an attempt to herd inflation towards its target rate. Growth in the emerging markets and developing economies (EMDEs) decelerated to 4.0 per cent in 2015, the lowest since 2009, as both external and domestic challenges continued; owing to low commodity prices, financial market volatility, slowing productivity, policy uncertainty and eroding policy buffers as well as weak global trade. The slowdown in the majority of EMDEs has also been attributed to spillovers from weaknesses in major emerging economies, diminishing capital inflows, rising borrowing costs and other geopolitical factors.

The stance of monetary policy in the advanced economies is expected to remain largely accommodative in 2016, except for the United States where monetary policy normalization has commenced. Against the background of suppressed commodity prices and slow recovery, global inflation is expected to remain moderate through 2016.

Domestic Economic and Financial Developments Output

Domestic output growth in 2015 remained moderate. According to the National Bureau of Statistics (NBS), real GDP grew by 2.84 per cent in the third quarter of 2015, almost half a percentage point higher than the 2.35 per cent recorded in the second quarter. However, third quarter expansion remained substantially below the 3.96 and 6.23 per cent in the first quarter of 2015 and corresponding period of 2014, respectively. The major impetus to growth continued to come from the non-oil sector which grew by 3.05 per cent compared with the growth of 3.46 per cent posted in the preceding quarter. The major drivers of expansion in the non-oil sector were Services, Agriculture and Trade; contributing 1.42, 1.03 and 0.79 percentage points, respectively. The outlook for the fourth quarter of 2015, based on staff estimates, suggests further improvements over the third quarter growth level.

The economy is expected to continue on its growth path in the first quarter 2016, albeit less robust than in the corresponding period of 2015. This expectation is predicated on the current low global oil price trend which is projected to hold low over the medium-to long term, and with attendant implications for government revenue and foreign exchange earnings. Other downside risks to growth in 2016 include: capital flow reversal, high lending rates, sluggish credit to private sector and bearish trends in the equities market.

However, the Committee remains optimistic about a gradual recovery in economic activity due to notable improvements in power and supply of refined petroleum products, improved policy recalibration aimed at improving the flow of financing resources to the real sector and suppression of internal insurgencies, which will boost general agricultural activity.

Prices

The Committee noted the slight uptick in year-on-year headline inflation to 9.6 per cent in December, from 9.4 per cent in November and 9.2 per cent in October, 2015. The increase in headline inflation in November 2015 reflected an increase in the food component, even though the core component remained unchanged at 8.70 per cent. Core inflation declined for the third consecutive month to 8.70 per cent in November and December from 8.74 per cent in October 2015, while food inflation inched up to 10.32 per cent from 10.13 and 10.2 per cent over the same period. Consistent with its primary mandate, the Committee would continue to monitor consumer price developments with a view to formulating policies that will keep inflation in check.

Monetary, Credit and Financial Markets Developments

Broad money supply (M2) rose by 5.90 per cent in December 2015, over the level at end-December 2014, although below the growth benchmark of 15.24 per cent for 2015. Net domestic credit (NDC) grew by 12.13 per cent in the same period, but remained below the provisional benchmark of 29.30 per cent for 2015. Growth in aggregate credit reflected mainly growth in credit to the Federal Government by 151.56 per cent in December 2015 compared with 145.74 per cent in the corresponding period of 2014. The renewed increase in credit to government may be partly attributable to increased government borrowing to implement the 2015 supplementary budget.

During the period under review, money market interest rates generally reflected the level of liquidity in the banking system. Average inter-bank call and OBB rates, which stood at 1.00 and 1.50 per cent on 25 November 2015, closed at 4.75 and 4.50 per cent, respectively, on January 21, 2016. Between the November 2015 and end-December 2015, interbank call and OBB rates averaged 0.81 and 0.98 per cent, respectively.

The Committee noted the bearish movement in the equities segment of the capital market during the review period. The All-Share Index (ASI) decreased by 13.15 per cent from 27,435.56 on November 30, 2015 to 23,826.50 on January 22, 2016. Similarly, Market Capitalization (MC) fell by 13.06 per cent from N9.42 trillion to N8.19 trillion during the same period. However, relative to end-December 2014, the indices declined by 31.25 per cent and 28.66 per cent, respectively. This development reflected capital flow reversals accentuated by soft commodity prices and monetary policy normalization in the United States.

External Sector Developments

The Committee noted the ongoing activities in the informal segment of the foreign exchange market, which led to the stoppage of dollar sales to BDCs, even as the average naira exchange rate remained relatively stable at the inter-bank segment during the review period. The exchange rate at the interbank market opened at N197.00/US$ and closed at N197.00, with a daily average of N196.99/US$ between November 23 and January 11, 2015. The Committee underscored the necessity of improving the supply of foreign exchange to the market, especially from autonomous sources. It also reiterated its commitment to maintaining stability in the naira exchange rate.

Committee's Considerations

The Committee observed that the last episode of low oil prices in 2005 lasted for a maximum period of 8 months.

However, the current episode of lower oil prices is projected to remain over a very long period. Consequently, it is imperative to brace up for a longer period of low government revenues from oil sources, which would necessitate hard and uncomfortable choices as the economy transits to more sustainable sources of revenue, consistent with the economic realities and strategic objectives of the country. In the circumstance, certain tradeoffs must be envisaged and duly accommodated.

In view of the foregoing, the imperative for consistently sound and coordinated macroeconomic policy has become inevitable. In the medium term within which monetary policy is cast, the need to allow policy to produce the desired outcomes becomes a key consideration in the policy mix. Consequently, the Bank is fine-tuning the framework for foreign exchange management with a view to ensuring a more effective and liquid foreign exchange market, taking into account Nigeria's strategic development priorities; with the policies being designed within an environment of regularly ensuring consistency with monetary and fiscal policies.

The Committee noted that at its November 2015 meeting, it eased monetary policy with a view to increasing the liquidity of the banking system. This was aimed at moderating domestic interest rates so as to encourage indigenous businesses to borrow. While the objective of stabilizing the financial system in the aftermath of the Treasury Single Account (TSA) withdrawals and J. P. Morgan delisting of Nigeria have been largely achieved, the goal of increasing lending to key sectors of the economy is yet to be achieved as the Bank continues to adopt moral suasion to encourage the DMBs to support targeted lending to the real sector including agriculture, solid minerals and SMEs sub-sectors of the Nigerian economy.

Despite current challenges, the Committee remains guided by evidence underpinned by credible data in its holistic evaluation of the emerging scenario and in its assessment of policy choices. Consequently, the Committee believes that given sound and properly coordinated monetary, fiscal, and external sector policies, there is wide room for optimism about the medium to long term macroeconomic prospects for the Nigerian economy, especially, given the clarity in the policy direction of the administration, the various interventions in the real sector; gradual rovement in the power sector, and the reinvigorated fight against corruption.

The Committee also believes that the effect of the softer monetary policy stance adopted at the last MPC,

should start crystalizing soon through expansion of credit to critical sectors of the economy. In addition, the unveiling of the Federal budget, oriented towards socioeconomic and infrastructural development is expected to provide the necessary impetus for growth. The Committee acknowledged the continuous liquidity surfeit in the system stemming partly from the recent growth-stimulating monetary policy measures, as well as the tendency of the banks to invest excess reserves in government securities, rather than extend credit to the needed sectors of the economy. To this end, the Committee once again urged the deposit money banks to improve lending to the real sector, as part of their patriotic obligations to the country and enjoined the Management of the Bank to continue to explore ways of incentivizing lending to employment- and growth-generating sectors, particularly SMEs. The MPC also emphasized the necessity of coordination between monetary and fiscal policies as a prerequisite for resolving the nation's economic problems, particularly, steering the economy away from oil dependency. In particular, the Committee stressed the need for the fiscal authorities to compliment the Bank's low interest rate policy orientation by properly coordinating its borrowing activities (and rates) with the Bank in order to push the common objective of stimulating banking system credit delivery at low interest rates to the key sectors of the Nigerian economy. It noted that given the current economic reality of dwindling oil revenue and the rather unclear outlook for commodity prices, there would be need for a recalibration of the fiscal strategy to increasingly explore opportunities in non-oil tax revenue.

Finally, the Committee reiterated its unyielding commitment towards achieving a stable exchange rate regime to ensure more flexibility for sustainable inclusive economic growth in the medium to long term.

The Committee's Decisions

The Committee, in consideration of the headwinds in the domestic economy and the uncertainties in the global environment decided by a unanimous vote to retain the Monetary Policy Rate (MPR), Cash Reserve Requirement (CRR), Liquidity Ratio (LR) and the asymmetric corridor of +2/-7 around the MPR.

In summary, the MPC voted to retain:
(i) The CRR at 20.0 per cent;
(ii) MPR at 11.0 per cent;
(iii) Liquidity Ratio at 30 per cent;
(iii) The asymmetric corridor at +200 basis points and -700 basis points.

Thank you for listening.

Godwin I. Emefiele, *CON*
Governor, Central Bank of Nigeria
26th January, 2016

Central Bank of Nigeria Communiqué No. 106 of the Monetary Policy Committee Meeting of Monday and Tuesday, March 21 and 22, 2016

The Monetary Policy Committee met on 21st and 22nd March 2016 amidst uncertain global economic prospects and continuing challenges in the domestic economy. In attendance were 8 out of the 12 members. The Committee appraised the international and domestic economic and financial environments in the first two months of 2016 as well as the outlook for the rest of the year.

International Economic Developments

The Committee noted with concern the further decline in global output at the end of 2015, which grew at 2.3 per cent, year-on-year in Q4, its slowest in three years, representing a 0.3 percentage point decline compared with 2.6 per cent in Q3. This deceleration stemmed from the continuous slowdown of growth in the emerging market economies, worsened by deteriorating conditions in the Euro area and China as well as key emerging market economies. Other factors include sustained pressure in global financial markets arising from US monetary policy normalization, depressed global oil market and persistently weakened global aggregate demand.

The slowdown in growth in the United States to 1.0 per cent in Q4 from 2.0 per cent in Q3 was attributed to slowdown in private consumption expenditure (PCE) and non-residential fixed investments. In Japan, output declined by 1.4 percentage points in Q4, 2015 in contrast to the 1.3 per cent growth recorded in Q3. The Bank of Japan's monthly asset purchase program of ¥6.7 trillion ($56.71 billion) remains substantially sub-optimal, as the economy continues to lurch between contraction and expansion, with the adoption of a negative interest rate policy in January 2016.

In the Euro area, GDP grew by 1.5 per cent in Q4 of 2015, and projected to grow at 1.7 per cent in 2016. The European Central Bank (ECB), at its meeting on 10th of March, 2016 eased monetary policy by further reducing its refinancing rate to 0.0 per cent and deposit rate to -0.4 per cent. The Bank also expanded its monthly asset purchase program from €60 billion ($65.4 billion) to €80 billion ($87.2 billion) to further stimulate output growth and move inflation towards its long term objective of 2.0 per cent.

On the other hand, the Bank of England (BoE) sustained its stock of assets purchase, financed through the issuance of reserves at £375 billion ($536.25 billion), while retaining its policy rate at 0.5 per cent. The BoE further committed to investing £8.4 billion ($12.01 billion) of cash flows associated with redemption of the January 2016 government securities held in the Asset Purchase Facility, with

a commitment to bring inflation closer to the 2.0 per cent target, reducing unemployment and promoting growth. Uncertainties and geo-political tensions in the Middle East, including a negotiated ceasefire agreement in Syria and Iran's re-entry into mainstream international oil market may have further redefined conditions in the oil market. The market witnessed some uptick in prices following the resolve of the Organization of the Petroleum Exporting Countries (OPEC) and some non-OPEC members to pursue a higher anchor price, coupled with smaller-than-anticipated build-up in stocks at the Cushing Oklahoma delivery hub for United States crude futures.

The Emerging markets and developing economies (EMDEs) were forecast to grow at 4.3 per cent in 2016, an improvement over the 4.0 per cent recorded in 2015. However, external and domestic challenges have persisted, stemming from low commodity prices, troubled financial markets, tepid global demand, policy uncertainty as well as continuously feeble growth in global trade. In addition, weaknesses in major emerging market economies, diminished capital inflows, rising borrowing costs and geopolitical factors have been identified as possible deterrents to growth in the EMDEs. In the environment of suppressed inflation, slow growth, weak global demand and volatile financial markets, the stance of monetary policy in the advanced economies is expected to remain accommodative in 2016, while in the EMDEs, it is expected to be underpinned by currency adjustments and other complementary policies.

Domestic Economic and Financial Developments Output

The Bank had adopted accommodative monetary policy since July 2015 in the hope of addressing growth concerns in the economy, effectively freeing up more funds for DMBs by lowering both CRR and MPR, with excess liquidity arising from the lower CRR warehoused at the CBN. DMBs were to access these funds by submitting verifiable investment proposals in the real sector of the economy. The funds have not impacted the market yet because the CBN was still processing some of the proposals submitted by the DMBs. In the first episode of easing which resulted in injecting liquidity into the Banking system, DMBs did not grant credit as envisaged. Moreover, the delay in passage of the 2016 Budget has further accentuated the difficult financial condition of economic agents as output continues to decline due to low investment arising from weak demand. The cautious approach to lending by the banking system underpinned by a strict regulatory regime conditioned by the Basel Committee in the post global financial crisis era has further alienated investors

from access to credit as banks prefer to build liquidity profiles in anticipation of government borrowing.

In the light of these developments, domestic output growth in 2015 remained subdued as reported by the National Bureau of Statistics (NBS). Consequently, real GDP grew by 2.11 per cent in the last quarter of 2015, more than half a percentage point lower than the 2.84 per cent recorded in the third quarter and 3.83 percentage points in the corresponding period of 2014. Overall, growth in 2015 was estimated at 2.79 per cent, compared with 6.22 per cent in 2014. The major impetus for growth continued to come from the non-oil sector which grew by 3.14 per cent in Q4, 2015 compared with 3.05 per cent in the preceding quarter. The key drivers of growth in the non-oil sector were Services, Agriculture and Trade; contributing 1.23, 0.83 and 0.76 percentage points, respectively.

The Committee noted that the sluggish growth in output was directly attributable to certain fiscal uncertainties, which inadvertently hampered movement of labor and goods; fuel scarcity, increased energy tariffs, foreign exchange scarcity as well as slow growth in credit to private sector in preference to high credit growth to the public sector. The Committee noted that many of these factors were outside the control of monetary policy and given these limitations, in the absence of complementary fiscal and structural policies, the only option was to continue with the existing measures. The MPC believes that complementary fiscal and structural policies are essential for reinvigorating growth.

Prices

The Committee noted the increase in year-on-year headline inflation to 11.38 per cent in February 2016, from 9.62 per cent in January and 9.55 per cent in December, 2015. The increase in headline inflation in February reflected increases in both food and core components of inflation. Core inflation rose sharply for the first time to 11.00 per cent from 8.80 per cent in January after a lull of three consecutive months at 8.70 per cent through December, 2015. Food inflation also inched up to 11.35 per cent from 10.64 per cent in January and 10.59 per cent in December, 2015. The rising inflationary pressure was traced to the lingering scarcity of refined petroleum products, exchange rate pass through from imported goods, seasonal factors and increase in electricity tariff. The Committee noted that the factors responsible for rising inflation were more structural in nature than monetary, but reaffirmed its commitment to monitor the developments closely and to work with the relevant authorities to address the underlying drivers of the upward price movements.

Monetary, Credit and Financial Markets Developments

Broad money supply (M2) grew by 2.29 per cent in February, 2016 in contrast to 1.69 and 0.25 per cent in January 2016 and February 2015, respectively. When annualized, M2 grew by 13.74 per cent in February 2016 against the provisional growth benchmark of 10.98 per cent for 2016. Net domestic credit (NDC) grew by 3.71 per cent in the same period, annualized, at 22.26 per cent. At this rate, the growth rate of NDC was below the provisional benchmark of 17.94 per cent for 2016. Credit to the private sector grew by 1.45 per cent in February 2016, which annualized to a growth of 8.70 per cent, below the benchmark growth of 13.28 per cent. The Committee noted with concern, the dismal performance of growth in credit to the private sector, noting that even at that, credit went primarily to low employment elasticity sectors of the economy. This had a significant negative impact on output growth.

Money market interest rates reflected the liquidity situation in the banking system. Average inter-bank call and OBB rates, which stood at 0.5 and 2.77 per cent on 25 January 2016, closed at 4.00 and 5.00 per cent, respectively, on March 9, 2016. Between January 25th and end-February 2015, interbank call and OBB rates averaged 1.43 and 2.68 per cent, respectively. This was traced to liquidity surfeit in the banking system. The deposit money banks were, however, reluctant to grant new credit because of rising non-performing loans (NPLs), mainly in the oil sector, amongst other reasons.

The Committee also noted the slight improvement in the equities segment of the capital market during the review period. The All-Share Index (ASI) rose by 8.1 per cent from 23,916.15 on January 29, 2016 to 25,853.58 on March 14, 2016. Similarly, Market Capitalization (MC) rose by 8.02 per cent from N8.23 trillion to N8.89 trillion during the same period. However, relative to end-December 2015, the indices declined by 9.73 per cent and 9.74 per cent, respectively.

External Sector Developments

The average naira exchange rate remained stable at the inter-bank segment of the foreign exchange market during the review period. The exchange rate at the interbank market opened at N197.00/US$ and closed at N197.00/US$, with a daily average of N196.99/US$ between January 25 and March 14, 2016. The Committee reiterated its commitment to maintaining a stable naira exchange rate. The MPC took note of the level of activity in the autonomous foreign exchange market as well as the rising demand in the interbank market but observed that the data on demand for foreign exchange, was being overshadowed by speculative demand. However, the Committee charged the Bank to speed up reforms

of the foreign exchange market to improve certainty and eliminate noise and opportunities for arbitrage.

The Committee's Considerations

The Committee noted the weakening macroeconomic environment, reflected particularly in foreign exchange shortages, slowing GDP growth rate and rising inflation. Overall economic growth slowed significantly in 2015, particularly in Q4. Apparently, the conditions responsible for the slowdown – uncertainty around fiscal policy, adverse external environment, security challenges in some parts of the country affecting production and distribution of agricultural produce, low electricity supply, fuel shortages, and sluggish growth in credit to the private sector – have continued in the first quarter of 2016. On the monetary side, contrary to the notion of liquidity overhang in the financial system, the wider economy appears starved of the needed liquidity to spur growth and employment. Recent performance of the monetary aggregates lends credence to this fact. With the exception of credit to government, growth in all the monetary aggregates remained largely below their indicative benchmarks, yet; headline inflation spiked to 11.38 per cent in February 2016, substantially breaching the policy reference band of 6 - 9 per cent. Apart from liquidity, the increase in inflation was driven by structural factors such as fuel scarcity, increased electricity tariff, persistent insecurity, exchange rate pass through and seasonality of agricultural produce. The conflicting signals from slowing growth and rising inflation present a difficult policy challenge. Though mindful of the limitations of monetary policy in influencing the drivers of the current price spiral, the Committee stressed the need to urgently address the key sources of the pressures. In this regard, the Committee reaffirmed its commitment to closely monitor the development while encouraging relevant authorities to address the structural bottlenecks.

From the monetary data, the Committee noted that the excess liquidity in the banking system was contributing to the current pressure in the foreign exchange market with a strong pass-through to consumer prices. The Committee further noted that previous efforts to reflate the economy in order to spur growth did not elicit the required response from DMBs, hence; the surfeit of liquidity in the interbank market. Obviously, the attendant low rates at that market have not transmitted to the term structure of interest rates. Concerned about the need for low interest rates to support growth and employment, the Committee urged the CBN to explore innovative ways of ensuring the unhindered flow of credit at low cost to key growth sectors even as monetary policy has to, under the circumstance, address the liquidity surfeit in the banking system as well as the pressure

on exchange rate and consumer prices. The Committee hopes that fiscal and other structural policies would soon be deployed to strengthen the overall response of macroeconomic policy to the shocks.

The Committee was also concerned that with headline inflation at 11.38 per cent, noting that the policy rate had become negative in real terms. This development has the potential of keeping both foreign and domestic investments on hold. As part of measures to address the supply constraint in the foreign exchange market, yields on domestic instruments have to be competitive to attract the much needed foreign inflows.

On the administrative side, this will have to be complemented by a comprehensive reform of the foreign exchange market which is currently being undertaken. For the avoidance of doubt, the Bank would continue to allow domiciliary account holders unfettered access to funds in their accounts. The Committee also urged speedy passage of the 2016 Budget in order to halt the depressing effect of the uncertainty that engulfs the waiting period, hoping that the implementation of the budget would go a long way in boosting business confidence, and reinvigorating the financial markets. In the circumstance, the Committee urged the Bank to continue to upscale its surveillance of the financial system with the aim of promptly detecting and managing vulnerabilities to ensure sustained stability.

Finally, the Committee remains committed to price stability across the range of consumer prices, exchange rate and interest rate, which is fundamental to reviving economic growth and employment generation. In the meantime, the Bank would continue to leverage its development finance policy to support critical sectors of the economy. The MPC also stressed the need to sustain, deepen and speed up reforms designed to ensure focused coordination of monetary and fiscal policies.

The Committee's Decision

The Committee, in its assessment of relevant internal and external indices, came to the conclusion that the balance of risks is tilted against price stability. The MPC therefore, voted to tighten the stance of monetary policy. One member voted to retain the CRR at 20.00 per cent while another member voted to retain the current width of the asymmetric corridor.

In summary, the MPC voted to:

(i) Raise MPR by 100 basis points from 11.00 per cent to 12.00 per cent;

(ii) Raise CRR by 250 basis points from 20.00 to 22.50 per cent;

(iii) Retain Liquidity Ratio at 30.00 per cent; and

(iv) Narrow the asymmetric corridor from +200 and -700 basis points to +200 and -500 basis points

Thank you for listening.

Godwin I. Emefiele
Governor, Central Bank of Nigeria
22nd March 2016.

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

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

International Economic Developments

The Committee noted with concern, the tapered growth and continued decline in global output since 2014. At an estimated 3.2 per cent, global output in 2016 was only 0.1 percentage point below the 3.1 per cent in the corresponding period of 2015. The sluggish global output was traced to weak fundamentals in both the advanced economies and Emerging Markets and Developing Economies (EMDEs), including increased volatility in global financial markets, sustained softness in commodity prices, sluggish global trade, resulting in persistent fragility, particularly in the EMDEs.

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

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

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

Weaknesses in major EMDEs, including low capital inflows, rising costs of funds and continuing geopolitical factors, have been identified as key constraints to growth. Adverse commodity prices continued to provide strong headwinds against growth, defining other economic and financial conditions in the EMDEs. Consequently, the IMF (WEO April 2016 Update) downgraded the 2016 growth forecast for this group of countries from 4.3 to 4.1 per cent.

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

Domestic Economic and Financial Developments Output

In the first quarter of 2016, the economy suffered from severe shocks related to energy shortages and price hikes, scarcity of foreign exchange and depressed consumer demand, among others. Consequently economic agents could not undertake new investments or procure needed raw materials. Shortage of foreign exchange arising from low crude oil prices manifested in low replacement levels for raw materials, other inputs as well as new investments. In addition, the energy crisis experienced in the first five months of the year, resulted in increased power outages and higher electricity tariffs, as well as fuel shortages; which led to factory closures in some cases. The prolonged budget impasse denied the economy the timely intervention of complementary fiscal policy to stimulate economic activity in the face of dwindling foreign capital inflows. Aggregate credit to the private sector remained highly tapered while credit to government grew beyond the programmed benchmark for the period. The Committee, however, noted that many of the prevailing conditions in the economy during the review period were outside the direct

control of monetary policy, but hopes that the implementation of the 2016 Federal Budget, supported by relevant sectoral policies and easing supply shocks in energy and critical inputs, would provide the needed boost to the economy.

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

Prices

The Committee noted a further increase in year-on-year headline inflation to 12.77 per cent and 13.72 percent in March and April 2016, respectively, from 11.38 per cent in February 2016. The increase in headline inflation in April reflected increases in both food and core components of inflation. Core inflation rose sharply for the third time in a row to 13.35 per cent in April from 12.17 per cent in March, 11.00 per cent in February and 8.80 per cent in January having stayed at 8.70 per cent for three consecutive months through December, 2015. Food inflation also rose to 13.19 per cent from 12.74 per cent in March, 11.35 per cent in February, 10.64 per cent in January and 10.59 per cent in December, 2015. The rising inflationary pressure continued to be traced to legacy factors including energy crisis reflected in incessant scarcity of refined petroleum products, exchange rate pass through from imported goods, high cost of electricity, high transport cost, reduction in food output, high cost of inputs and low industrial output.

The Committee observed that in an economy characterized by high import dependence, the shortage of foreign exchange provided some basis for price increases as currently being experienced. The Committee noted that the economy needed to aggressively earn and build up its stock of foreign reserves in order to avoid distortions when faced with severe shocks. The Committee further noted that the current inflation trend, being largely a product of structural rigidities and inadequate foreign exchange earnings would continue to be closely monitored, and in coordination with fiscal policy, with a view to addressing

the underlying drivers of the upward price movements.

Monetary, Credit and Financial Markets Developments

Broad money supply (M2) grew by 3.49 per cent in April 2016, a 1.29 percentage growth from the March level of 2.20 per cent and compared with the 3.67 per cent in April 2015. When annualized, M2 grew by 10.47 per cent in April 2016 against the provisional growth benchmark of 10.98 per cent for 2016. Net domestic credit (NDC) grew by 7.87 per cent in the same period and annualized at 23.61 per cent. At this rate, the growth rate of NDC was above the provisional benchmark of 17.94 per cent for 2016. The development in NDC essentially reflected the significant growth in credit to government of 35.97 per cent in the month, annualized to 107.91 per cent. Credit to the private sector grew by 3.52 per cent in April 2016, which annualized to a growth of 10.56 per cent, below the benchmark growth of 13.28 per cent.

The Committee observed with concern, the continuous dismal performance of growth in credit to the private sector, noting that in spite of the Bank's efforts, DMBs continued to direct credit largely to low employment elastic sectors of the economy, a phenomenon that had significantly contributed to the low performance of the economy.

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

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

External Sector Developments

The average naira exchange rate remained stable at the inter-bank segment of the foreign exchange market during the review period. The exchange rate at the interbank market opened at N197.00/US$ and closed at N197.00/US$, with a daily average of N197/US$ between March 25 and May 13, 2016. The Committee, therefore,

remains committed to its mandate of maintaining a stable naira exchange rate. The MPC noted the level of activity in the autonomous foreign exchange market especially, following the deregulation of the downstream petroleum sector with attendant increased demand in the interbank market, thus further exerting pressure on the naira.

The Committee recalls that over the last two consecutive meetings, it had signaled the imperative of reform of the foreign exchange market. In the intervening period, the Committee interrogated the issues around the current foreign exchange market regime, tracing them to the low foreign exchange earnings of the economy. Consequently, in the Committee's opinion, the key issue remains how to increase the supply of foreign exchange to the economy. The Committee observed that while the Bank has been working on a menu of options to ensure increased supply of foreign exchange, there was no easy and quick fix to the foreign exchange scarcity problem as supply remained essentially a function of exports and the investment climate.

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

The Committee was of the view that the current adverse global and domestic economic and financial conditions and the imperative imposed by the demand and supply shocks to the domestic economy and considering the express intensions of Government as enunciated in the 2016 budget, policy must respond appropriately as the market continues to demonstrate confidence in the Bank's ability to deliver a credible foreign exchange market. Accordingly, the MPC decided that the Bank should embrace some level of flexibility in the foreign exchange market. Given the imperative for growth, the Management of the Bank has been given the mandate to work out the modalities for achieving the desired flexibility that is in the overall interest of the Nigerian economy and when the implementation of the new framework would begin.

The Committee's Considerations

The Committee acknowledged the severely weakened macroeconomic environment, as reflected particularly in increased inflationary pressure, contraction in real output and rising unemployment. The Committee recalls that in July 2015, it had hinted on the possibility of the economy falling into recession unless appropriate complementary measures were taken by the monetary and fiscal authorities. Unfortunately the delayed passage of the 2016 budget constrained the much desired fiscal stimulus, thus edging the economy towards contractionary output. As a stop-gap measure, the Central Bank continued to deploy all the instruments within its control in the hope of keeping the economy afloat. The actions, however, proved insufficient to fully avert the impending economic contraction. With some of the conditions that led to the contraction in Q1, 2016 still largely unresolved, the weak outlook for growth which was signaled in July 2015 could extend to Q2. To this effect, today's policy actions have to be predicated on a less optimistic outlook for the economy in the short term, given that, even after the delayed budgetary passage in May 2016, the initial monetary injection approved by the Federal Government may not impact the economy soon, as the processes involved in MDAs finalizing procurement contracts before the disbursement of funds may further delay the much needed financial stimulus to restart growth.

The Committee noted that the CBN had implemented accommodative monetary policy from July 2015, with the hope of achieving growth, up until March 2016, when the MPC switched into a tightening mode. However, while the underlying conditions necessitating tight monetary policy remained largely in place, sundry administrative measures implemented by the Bank and recent macroeconomic conditions on the back of the 2016 Budget are expected to significantly dictate a key policy preference in the dilemma now faced by monetary policy - stagflation. Given the current limited policy space, it is imperative to balance stability with growth stance while working on options that in the short term, are certain to isolate seasonal and transient factors fuelling the current price spiral.

Other than credit to government, growth in all monetary aggregates remained largely below their indicative benchmarks, yet; headline inflation spiked in April 2016, far above the upper limit of the policy reference band. Inflation has continued to be driven mainly by supply side factors such as fuel scarcity, increase in tariff and deterioration in electricity supply, increase in the price of petrol, higher input costs as a result of scarcity of foreign exchange, persistent security challenges and exchange rate pass-

through to domestic prices of import. While the Committee believed that the recent deregulation of the downstream sector of the petroleum sector was in the right direction and would lead to increased supply, the pass-through effect of prices to other products has to be factored in policy considerations. Mindful of the limitations of monetary policy in influencing structural imbalances in the economy, the Committee stressed the need for policy coordination with the fiscal authorities in order to effectively address the identified pressure points. The Committee noted that the continued excess liquidity in the banking system was responsible for the low level of activity in the interbank market. This is in addition to contributing to the sustained pressure in the foreign exchange market. The Committee expressed hope that efficient implementation of the recently passed 2016 Federal Budget, especially; the capital expenditure portion, would help invigorate growth in the economy as business confidence rejuvenates.

The Committee expressed concern over sustained pressure in the foreign exchange market and the necessity of implementing reforms to engender greater flexibility of rate and transparency in the operation of the inter-bank foreign exchange market. Accordingly, the Committee noted that it was time to introduce greater flexibility in the management of the foreign exchange market. The Committee reaffirmed commitment towards maintenance of price stability and reiterated the need to reappraise the coordination mechanism between monetary and fiscal policy and initiate reforms, for the purpose of more efficient policy synchronization and management.

The Committee's Decisions

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

In summary, the MPC voted to:

(i) Retain the MPR at 12.00 per cent;

(ii) Retain the CRR at 22.50 per cent;

(iii) Retain the Liquidity Ratio at 30.00 per cent; and

(iv) Retain the Asymmetric Window at +200 and -500 basis points around the MPR

(v) Introduce greater flexibility in the inter-bank foreign exchange market structure and to retain a small window for critical transactions.

Thank you for listening.

Godwin I. Emefiele
Governor, Central Bank of Nigeria
24th May 2016