



Central Bank of Nigeria Communiqué No. 93 of the Monetary Policy Committee Meeting of Monday 20 and Tuesday 21 January, 2014

The Monetary Policy Committee (MPC) met on January 20 and 21, 2014 against the backdrop of uncertainties in the global economy, especially arising from the commencement of the QE3 tapering by the Fed. In attendance were eight (8) out of the ten (10) members following the retirement of Mr. Tunde Lemo, Deputy Governor, on January 11, 2014 and Mr. John Oshilaja, an external member of the MPC, who completed his term on December 31, 2013. The Committee reviewed key global and domestic economic developments in 2013 and re-assessed the short- to medium-term risks to inflation, domestic output and financial stability and the outlook for 2014.

International Economic Developments

The global economy is expected to continue recovering from the global financial crisis, as growth is projected to accelerate in 2014. The International Monetary Fund (IMF) projected global growth at 3.4 and 3.5 per cent in 2014 and 2015, respectively, up from 2.4 per cent in 2013. Some other sources, however, have produced less optimistic projections of global growth for 2014; for example, the United Nations Department for Economic and Social Affairs' (UNDESA) has projected 3 per cent growth. The decision by the US Federal Reserve to reduce its monthly asset purchases from USD85 billion to USD75 billion left most markets stable having already priced-in the development. The quantitative easing measures by the US Federal Reserve had helped to restore momentum to the US economy and also contributed to the improvement of the Eurozone economy in 2013.

Europe is forecast to return to growth in 2014 after two years of contraction. Greece, which has been at the centre of the

Bloc's banking and debt crisis, is expected to record its first economic expansion in six years. Emerging markets that were major beneficiaries of cheap money from the Fed stimulus could experience financial market instability as tapering begins, although the US authorities have made it clear that they remain sensitive to the impact of their domestic policies on global markets and will therefore aim to minimise disruptions.

Global inflation is projected to rise to 2.71 per cent in 2014, up from about 2.30 per cent in 2013. Favorable developments in food and fuel supply would moderate upward pressure on prices of major commodities, despite the expected acceleration in global activity. The US recorded inflation of 1.5 per cent in December, up from 1.2 per cent in November, 2013.

Most central banks maintained a cautious posture in 2013, retaining or varying policy rates only slightly. The financial markets expect monetary authorities to continue with policies

aimed at supporting growth in 2014. In effect, monetary conditions are likely to remain easy in key advanced economies over the short- to medium-term on the back of the forward guidance that monetary authorities in these economies have given, with regard to the conditions that must be met before any change in policy stance comes into effect.

Domestic Economic and Financial Developments

Output

The National Bureau of Statistics (NBS) estimated real Gross Domestic Product (GDP) growth rate of 7.67 per cent for the fourth quarter of 2013, which was higher than the revised figure of 6.81 and 6.99 per cent recorded in the third quarter, and the corresponding period of 2012, respectively. Overall, growth rate for fiscal 2013 was estimated at 6.87 per cent up from 6.58 per cent in 2012.

The non-oil sector remained the major driver of growth, recording 8.73 per cent in the fourth quarter of 2013. The growth drivers in the non-oil sector remained agriculture; wholesale and retail trade; and services which contributed 1.64, 2.34, and 2.66 per cent, respectively. The relatively robust growth performance despite sluggish global recovery reflected the continuing favourable climatic conditions for increased agricultural production, sustained outcome of banking sector reforms and macroeconomic stability.

Prices

The moderation in inflationary pressure, which began in the fourth quarter of 2012, continued in 2013. The year-on-year headline inflation fell consistently from 9.0 per cent in January to 8.6 and 8.4 per cent in March and June, respectively, before ending the year at 8.0 per cent. Also, food inflation, which constitutes 51.8 per cent of the CPI basket, declined from 10.1 per cent in January to 9.5, 9.6, 9.4 and 9.3 per cent in March, June, September, and December 2013, respectively. However,

core inflation initially declined to 7.2 and 5.5 per cent in March and June from 11.3 per cent in January, but rose during the second half of the year to 7.4 and 7.9 per cent in September and December, 2013, respectively. The moderation in domestic price level was largely due to the tight monetary policy stance coupled with the relatively stable exchange rate regime during the period, which resulted in single digit inflation in the three measures for the whole year. This is the first time the country has achieved this since 2007.

The Committee noted with satisfaction that the year-on-year headline inflation remained within the indicative target range of 6-9% in the second half of 2013. However, the Committee noted the underlining pressure on core inflation, which may not be unconnected with the widening spread between official and BDC exchange rates. In order to head off the spectre of rising inflation in 2014, concrete actions will be needed to stabilize

the currency and minimize the divergence between the two segments of the foreign exchange market.

Monetary, Credit and Financial Market Developments

Broad money supply (M2) contracted by 4.82 per cent in December 2013 over the level at end-December 2012, in contrast to the growth of 16.39 per cent in the corresponding period of 2012. M2 was also below the growth benchmark of 15.20 per cent for 2013. Aggregate domestic credit (net) grew by 11.11 per cent in December 2013, over the end-December 2012 level. The aggregate domestic credit (net) at end-December 2013 was, however, below the provisional benchmark of 22.98 per cent for 2013. The decline in M2 was due mainly to the decrease in Net Foreign Assets by 5.86 per cent.

Interest rates in all segments of the money market reflected the liquidity conditions in the banking system. At the MPC meeting of November 18-19, 2013, the Monetary Policy Rate (MPR) was retained at 12.00 per cent with a symmetric corridor of +/- 200 basis points, thus effectively maintaining the SLF and SDF rates at 14.00 and 10.00 per cent, respectively. Alongside the existing Cash Reserve requirement (CRR) of 12.0 per cent, the 50.0 per cent CRR on public sector deposits was retained to address excess liquidity in the banking system. Consequently, both the weighted average inter-bank call and OBB rates opened at 11.73 per cent in December 2012 but closed at 10.86 and 10.46 per cent in December 2013, respectively.

The capital market continued its rally with the equities market providing the lead. The All-Share Index (ASI) increased by 47.2 per cent from 28,078.81 on December 31, 2012 to 41,329.19 on December 31, 2013. Market Capitalization (MC) increased by 47.4 per cent from N8.97 trillion to N13.23 trillion during the

same period. Improved earnings and investor confidence in macroeconomic management contributed to the rise in stock prices

External Sector Developments

The end-period exchange rate remained stable at the w/rDAS and interbank segments but depreciated significantly at the BDC segment. The exchange rate at the w/rDAS-SPT in 2013 opened at N157.33/US\$ (including 1% commission) and closed at N157.26/US\$, representing an appreciation of N0.07k or 0.04 per cent. The inter-bank selling rate opened at N156.25/US\$ and closed at N159.90/US\$, representing a depreciation of N3.65k or 2.34 per cent for the period. However, at the BDC segment of the foreign exchange market, the selling rate opened at N159.50/US\$ and closed at N172.00/US\$, representing a depreciation of N12.50k or 7.84 per cent.

Gross external reserves as at December 31, 2013 stood at US\$42.85 billion, representing a decrease of US\$ 0.98 billion or 2.23 per cent compared with US\$ 43.83 billion at end-December 2012. The Committee noted that the decrease in the reserves level resulted largely from a slowdown in portfolio and FDI flows in Q4 2013 resulting in increased funding of the foreign exchange market by the CBN to stabilize the currency. The Committee again expressed concern over the continued depletion of the Excess Crude Account (ECA) which balance stood at less than US\$2.5 billion on January 17, 2014 compared with about US\$11.5 billion in December 2012. This absence of fiscal buffers increased our reliance on portfolio flows thus, constituting the principal risk to exchange rate stability, especially with uncertainties around capital flows and oil price.

The Committee's Considerations

The MPC welcomed the sustained stability of the exchange rate and single digit inflation in 2013. It, however, identified four (4) key concerns for policy in the short- to medium-term:

1. Depletion of fiscal buffers following the continuing decline in oil revenue, rundown of reserves and depletion excess crude oil savings;
2. Falling portfolio and FDI inflows;
3. Widening gap between the official and the BDC exchange rates; and
4. Creeping increase in core inflation.

On the depletion of fiscal buffers, the Committee decried the continuous fall in revenue from oil despite stable price of oil and production in 2013. Although the Committee acknowledged output losses due to theft and vandalism, this could not wholly explain the magnitude of the shortfall in revenue. As a consequence, accretion to external reserves remained low while much of the previous savings have been depleted, thereby undermining the ability of the Central Bank to sustain exchange rate stability. The Committee therefore, urged the fiscal authorities to block revenue leakages and

rebuild fiscal savings needed to sustain confidence and preserve the value of the naira.

The MPC also noted the reduction in portfolio inflows driven by the commencement of the QE3 tapering by the Fed, transition concerns at the CBN and continued depletion of the ECA, thus dampening investor confidence. The reduction of the US stimulus especially, could in addition, trigger capital flow reversals and put greater pressure on the naira exchange rate. The Committee also expressed concern about the widening gap between the official and the BDC exchange rates, noting that this could precipitate speculation and round-tripping. Though, the BDCs represent a small component of the foreign exchange market, the widening spread appeared to have fed into creeping increases in core inflation.

The Committee re-affirmed its commitment to a stable exchange rate regime while urging the fiscal authority to provide support by reducing fiscal leakages, improving controls around oil revenues and reviewing terms around production

sharing agreements with oil companies, while awaiting the passage of the Petroleum Industry Bill (PIB). The Committee also noted the necessity for a complementary monetary policy response to ensure sustained exchange rate stability and convergence of rates in various segments. In the light of this, two options were considered:

- a) Allowing a depreciation of the currency to avoid further tightening and depletion of reserves; and
- b) Maintaining our commitment to currency stability while stressing that monetary policy is almost at its limits and needs support from the fiscal side in the form of excess crude savings if currency stability is to be maintained in the future.

The Committee decided that the costs of a weaker naira far outweigh the benefits to the Nigerian economy and the core mandate of the CBN. It therefore opted to maintain its commitment to currency stability. Furthermore, having looked at all the options, the Committee decided against excessive

reliance on external reserves to support the exchange rate and opted for monetary tightening until fiscal buffers are rebuilt.

Decision

Having considered all the issues above the Committee decided as follows:

- a) All members voted for an increase in CRR on public sector deposits from 50 per cent to 75 per cent with effect from February 4, 2014
- b) Five (5) members voted for a retention of CRR on private sector deposit at 12 per cent while three (3) voted for an increase in this component to 15 per cent
- c) One (1) member voted for allowing the currency to depreciate by either shifting the mid-point or widening the band.

The decision is therefore as follows:

1. MPR remains at 12 per cent +/- 200 basis points and liquidity ratio (LR) at 30 per cent
2. Public sector CRR increased from 50 per cent to 75 per cent
3. Private sector CRR retained at 12 per cent
4. The CBN to take immediate step to redress the supply-demand imbalance in the BDC segment while maintaining its focus on anti-money laundering (AML) activities.

Thank you for Listening

Sanusi Lamido Sanusi, *CON*

Governor

Central Bank of Nigeria

21st January, 2014