The Nigerian Economic Summit Group

MONETARY POLICY UPDATE

Wednesday, 28 January 2015

UPDATE ON THE MONETARY POLICY COMMITTEE MEETING (19-20 January, 2015)

On 19 and 20 January 2015, the Central Bank of Nigeria (CBN) Monetary Policy Committee (MPC) held its first meeting for the year. The decisions taken at the meeting were as follows:

- Retain the Monetary Policy Rate (MPR) at 13.0%;
- Retain the Cash Reserve Ratio (CRR) on Private Sector deposits at 20.0%;
- Retain the Cash Reserve Ratio (CRR) on Public Sector deposits at 75.0%; and
- Retain the Liquidity Ratio at 30.0%.

In arriving at these decisions, the MPC considered the country's economic conditions against the backdrop of the global economic environment. The committee's considerations and our outlook are summarised below.

Global economy shows signs of weaker growth prospects. The global economy grew by 3.3% in 2014, occasioned by mild recovery of the US economy and falling crude oil prices. However, continued stagnation in the Eurozone and weaker activities in emerging markets constrained global growth when compared to pre-crisis level. In January 2015, the IMF revised downwards its global growth projection for 2015-16 at 3.5% and 3.7%, due to reassessment of activities in China, Japan, Eurozone and some major oil exporting countries.

Non-oil sector continues to drive growth of the Nigerian economy. According to the National Bureau of Statistics (NBS), the Nigerian economy grew by 6.2% (year-on-year) in Q3-2014, a marginal decline from the 6.5% in Q2. Growth was mainly driven by strong performance in the non-oil sector, fuelled by crop production (17.5%), trade (17.4%), textile, apparel and footwear (8.0%), telecommunications (7.6%) and real estate (7.2%). The MPC noted the continued poor contribution of the oil sector to growth (-6.6%), which was further reinforced by the decline in crude oil prices. It further highlighted insecurity in some parts of the country as a major risk factor that could limit growth in the short term.

Inflation rate remains stable although concerns of inflationary pressures persist. Following the increase in MPR from 12% to 13% in November 2014, inflation rate ended the year at 8.0% in December and remained within the targeted benchmark of 6-9% through the year. Inflation rate averaged 2014 at 8.0%, a decline from 8.5% in 2013 and 12.2% in 2012. The committee considered upside risks to inflation to include higher import prices arising from the depreciating naira and the possibility of food supply shortages due to insecurity and insurgency in major agricultural areas in the country.

We believe that these upside risks would be cushioned in the first half of the year by possible reduction in government spending in 2015 owing to lower revenue projections as well as the recent drop in fuel price from ₦97 per litre to ₦87, which may result in lower transportation and production costs. We expect inflation to stay within the targeted benchmark of 6-9% in the first half of 2015.

Exchange rate pressure continues even as CBN moves band. In order to reduce the pressure on the naira arising mainly from the fall in crude oil prices, the CBN, in its November 2014 MPC meeting intervened to stabilize the exchange rate by adjusting the midpoint to ₦168/US$ from ₦155/US$ and expanding the corridor to +/-5% from +/-3%. Despite this move, the naira has continued to face pressure closing the year at ₦180/US$ and ₦191.5/US$ at the interbank market and bureau de change segment respectively. The naira further depreciated to ₦208/US$ at the bureau de change on January 23, largely as a result of high demand for imports and low dollar inflows. Similarly, gross external reserves has also trended downwards closing the year 2014 at US$34.25 billion, a 20% drop from its position (US$42.85 billion) in 2013.

We are of the opinion that a long term solution to Nigeria's currency depreciation is to increase non-oil export earnings particularly for manufactured goods and enhance the country's fiscal buffers- the Excess Crude Oil Account and the Sovereign Wealth Fund- to limit the negative impact of declining oil prices in the medium term.

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Interest rates environment would remain high in the medium term amidst recovery and positive outlook of the US economy. The gradual recovery of the United States' economy stirs concerns on the moderation of quantitative easing in the country. The IMF recently updated its World Economic Outlook (WEO) for 2015-16 with a higher growth projection for the US economy at 3.6% in 2015 compared with 3.1% projection in its previous WEO in October 2014. With the US economy having experienced a robust growth of 3.9% in Q3-2014 according to the Bureau of Economic Analysis, it is likely that this unconventional monetary policy would end, thus, raising further concern on volatility in the Nigerian capital market and naira exchange rate.

In view of this, we may continue to experience tight monetary policy stance by the CBN to defend the naira and prevent huge capital outflows. While the high interest rate may be good for investment yields, it remains detrimental to real sector output growth and could undermine credit to the private sector. A positive trend noticed at the MPC meeting is the 9.9% increase in credit to the private sector in 2014 (2013 - 9%; 2012- 6.8%) and the decline in credit to the government despite lower revenue projections. This, we believe, is a trend that should be sustained in order to increase real sector growth in the medium term.

Figure 1: Monetary Policy Rate and Inflation Rate (Jan. 2007- Dec.2014)

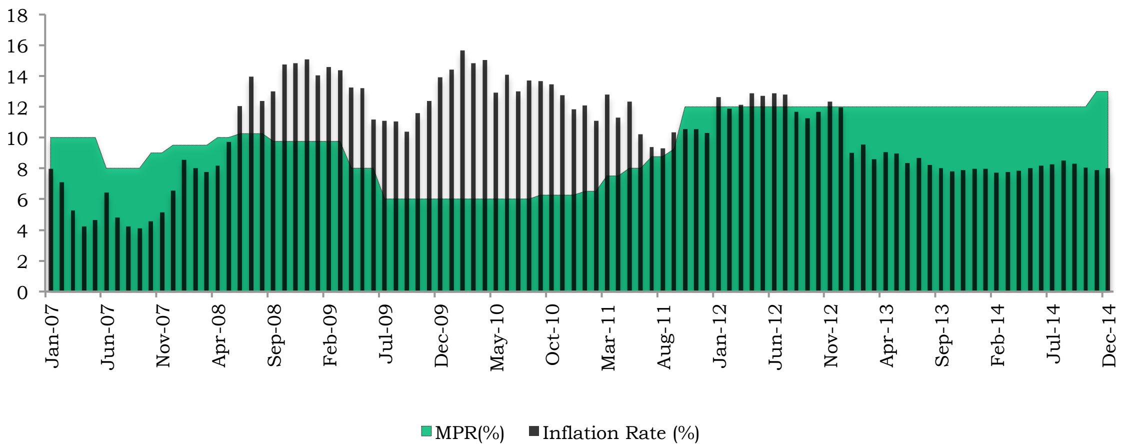
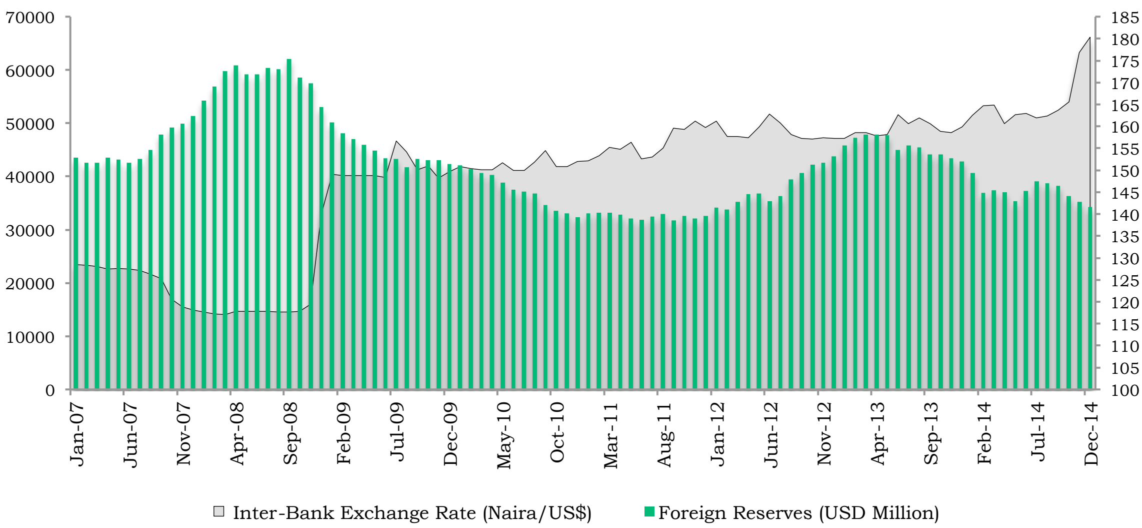


Figure 2: Foreign Reserves and Exchange Rate (Jan. 2007- Dec.2014)



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