CENTRAL BANK OF NIGERIA

MONETARY POLICY REVIEW

FEBRUARY, 2015

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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 in the second half of 2014 faced uncertainties following the exit of the US Federal Reserve from quantitative easing, continued weakness and debt issues in the Euro Area, as well as decline in crude oil prices, stemming from the shale oil technology revolution and geo-political tensions across many countries like Russia and Ukraine. These were compounded by sustained pressure on the exchange rate and continued depletion in external reserves. Nevertheless, the economy remained resilient, growing by 5.94 per cent in the fourth quarter of 2014 from 6.23 per cent in the preceding quarter, driven largely by the performance of the non-oil sector. Headline inflation moderated to 8.0 from 8.2 per cent during the period, owing largely to improved agricultural harvest and sustained tight monetary policy stance.

The continued incidence of banking system liquidity surfeit created perverse incentives in banks. The huge liquidity which should have been channeled to the real economy was used to speculate in the foreign exchange market. Bold and proactive measures were taken to check this unwholesome practice of market operators. Accordingly, the Bank raised the monetary policy rate (MPR) by 100 basis points; cash reserve requirement (CRR) on private sector deposits by 500 basis points; midpoint of the official foreign exchange band from N155/US$ to N168/US$; and widened the band by 200 basis points from +/-3 per cent to +/-5 per cent.

These measures calmed the financial markets and sustained stability in the banking system. As a result, interbank and open buy back rates remained within the policy rate corridor of MPR +/-200 basis points in the review period. Also, the decline in the capital market moderated.

Outlook for the domestic economy over the short- to medium-term indicates that inflation would increase moderately but remain within the single digit target. The moderate rise would be due to the anticipated liquidity impact of the 2015 election spending, depreciation of the naira and its pass-through to consumer prices, as well as continued disruption of supply and distribution chain by insurgency in some parts of the country. Monetary policy will remain proactive and dynamic to sustain price stability conducive to growth.

Godwin I. Emefiele
Governor, Central Bank of Nigeria
February 2015

CHAPTER 1

OVERVIEW

CHAPTER 1

1.0 OVERVIEW

Monetary policy in the second half of 2014 focused on achieving the objective of price and exchange rate stability. Accordingly, the Bank sustained a tight policy stance with a view to ensuring that electioneering spending did not result in uptick in inflation. Headline inflation remained within single digit, and fluctuated between 7.9 and 8.5 per cent in the review period, due to the combined effects of the declines in the prices of clothing and footwear; and transport components as well as the relative stability in the price of education in response to the tight policy measures taken at the July, September, and November 2014 MPC meetings.

The benign inflation environment enabled the economy to sustain a modest growth trajectory. Data from the National Bureau of Statistics (NBS) showed that the real Gross Domestic Product (GDP) grew by 5.94 per cent in the fourth quarter of 2014, down from 6.77 per cent in the corresponding quarter of 2013 and the 6.23 per cent in the third quarter of the year. The services and agricultural sectors were the largest contributors to GDP in the fourth quarter, with services contributing 53.48 per cent, while agriculture contributed 23.86 per cent. The growth in the agricultural sector was attributed to impressive harvest of farm produce, while services and industrial sectors remained relatively stable.

The exchange rate experienced significant pressure during the review period, due largely to the impact of the US Fed quantitative easing (QE) tapering, declining oil prices, depletion in the foreign reserves, and the absence of fiscal buffers. As a response, the Bank moved the exchange rate mid-point from ₦155/US$ to ₦168/US$ and widened the band around the midpoint from +/-3.0 to +/-5.0 per cent.

The financial market was generally stable for most of the second half of 2014, although, significant fluctuations were noticed towards the end of the year. A number of policy instruments were deployed to achieve price and financial system stability, with a view to boosting investor confidence and reducing concerns about declining foreign reserves. The instruments were: the Monetary Policy Rate (MPR), Open Market Operations (OMO), Discount Window Operations, Cash Reserve Ratio (CRR) and Foreign Exchange Trading Position (FTP) limit. During the period, the MPC raised the MPR by 100 basis points from 12.0 to 13.0 per cent and maintained the symmetric corridor of +/- 200 basis points. The CRR on private sector deposits was raised by 500 basis points from 15.0 to 20.0 per cent, while CRR on public sector deposits was retained at 75.0 per cent. The MPC also retained the Liquidity

Ratio at 30.0 per cent, in order to address liquidity surfeit in the banking system.

OMO was principally used to mop up or inject liquidity into the system as a strategy of monetary management by the Bank. OMO auctions in the review period increased over the corresponding period of 2013 as a result of injections into the system from the maturity of FGN Bonds, NTBs and AMCON bonds. In the period under review, the economy continued to experience fluctuations in liquidity levels. To compliment OMO, the CRR was used to smoothen the liquidity cycle, and reduce pressure on the naira exchange rate. Reserve money and its components trended upwards relative to the levels in the first half of 2014. Compared with the end-June 2014 level, the broad measure of money supply trended upwards, while narrow money decreased, reflecting the liquidity surfeit attributable to cyclical Federal Accounts Allocation Committee (FAAC) disbursements and increased spending towards the 2015 general elections.

The money market remained active in the second half of 2014, with trading in CBN bills and government securities. The improvement in liquidity conditions in the financial sector continued to influence market activities, alongside the demand pressure in the foreign exchange market. The interbank call and open buy back (OBB) rates remained within the retained policy rate corridor of +/-200 basis points around the MPR in the review period, except in December, 2014. Despite the rebound in the activities of the uncollateralized segment of the money market, transactions in OMO and standing facilities dominated the market. The daily Nigerian Interbank Offered rates (NIBOR) were generally stable but experienced occasional spikes, reflecting periods of liquidity tightness.

The performance of the capital market declined in the second half of 2014, relative to the first half of the year and the corresponding period of 2013. The All Share Index (ASI) fell by 18.42 per cent to 34,657.15 at end-December 2014, from its level of 42,482.48 at end-June 2014, and by 16.14 per cent, when compared with 41,329.19 recorded at end-December 2013. The development was due largely to the dampening effects of external factors such as the recovery in some developed economies and the conclusion of the US Federal Reserve QE. Other macroeconomic developments that affected equities included the declining oil prices, depletion in external reserves, insurgency, and the uncertainties surrounding the 2015 general elections.

In the fixed income market, FGN bonds continued to dominate, with fewer transactions recorded in the State/Local Government and Corporate Bond segments.

Activities in the global financial markets were characterized by uncertainties about economic recovery. Growth rebounded in the USA and the UK, while the Euro area, Japan, and emerging and developing market economies continued to be constrained by a number of old and new fragilities. Accordingly, the exchange rate of major international currencies experienced mild fluctuations, including regional currencies such as the Ghanaian cedi, Kenyan shilling, the South African rand and the Egyptian pound.

The inflation outlook indicates that the economy may experience a gradual rise in consumer prices but within single-digit target in the first half of 2015. This may be attributable to increased spending in the run up to the 2015 general elections, depreciation of the naira and the pass-through to domestic prices. These would be exacerbated by security concerns, disruption of agricultural activities and poor harvest in some areas of the northern axis of the country affected by insurgency. Headline inflation is therefore, projected to oscillate around 8.6 and 9.4 per cent in the first half of 2015, and could rise to 10.8 per cent by year end. This outlook is premised on the assumption that the reduction in the pump price of refined fuel is expected to ameliorate domestic prices and that the Bank will continue to pursue a tight monetary policy stance.

Output growth in the fourth quarter of 2014 was 5.94 per cent down from 6.23 per cent in the third quarter. Output is projected to grow by 5.5 per cent in 2015 (FGN 2015 Budget) down from 6.22 per cent in 2014. The lower growth forecast is conservative, compared with the 7.3 per cent projection by the IMF (Oct 2014 WEO). The lower growth forecast is due to emerging developments such as falling crude oil prices, security challenges and infrastructural constraints. With declining oil prices and production challenges in an oil-dependent economy, achieving the growth projection requires improved coordination of fiscal and monetary policies to support the non-oil sector.

CHAPTER 2

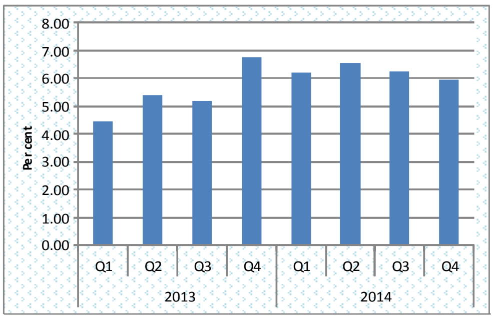
OUTPUT IN THE DOMESTIC ECONOMY

CHAPTER 2

2.0 OUTPUT IN THE DOMESTIC ECONOMY

The Nigerian economy continued its robust growth trajectory in the second half of 2014. Real GDP grew by 6.23 per cent in the third quarter before slowing to 5.94 per cent in the fourth quarter. The observed growth in the third quarter was higher than the 5.17 per cent in the corresponding quarter of 2013 but lower than 6.54 per cent in the preceding quarter. The performance in the fourth quarter was lower than the 6.77 per cent in the corresponding period of 2013 and 6.23 per cent in the preceding quarter. The major drivers of growth in the third quarter were services (2.53%), agriculture (1.21%), trade (1.08%) and industry (1.04%), while that of fourth quarter were services (2.45%), industry (1.30%), agriculture (0.87%) and trade (0.87%). Within the industrial sector, the manufacturing sub-sector contributed 1.44 and 1.17 per cent to growth in the third and fourth quarters, respectively, while crude oil and natural gas declined by 0.41 per cent in the third quarter but rose by 0.11 per cent in the fourth quarter. Overall, output growth in 2014 was 6.22 per cent compared with 5.49 per cent in 2013.

Figure 2.1
Real GDP Growth (%)
2013Q1 – 2014Q4



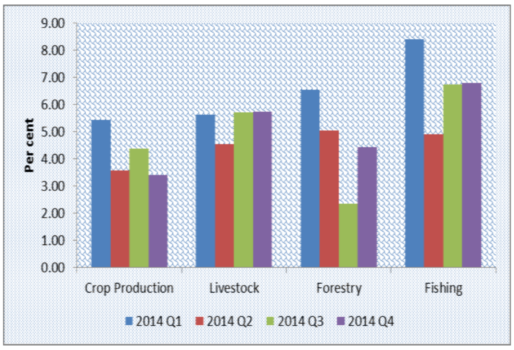
2.1 Domestic Economic Activities

Overall, output continued to be driven largely by activities in the non-oil sector with performance of the oil sector dampening growth. At 7.51 per cent, the non-oil real GDP in the third quarter of 2014 was higher than 6.71 per cent in the preceding quarter, but lower than 8.46 per cent in the corresponding period of 2013. The non-oil sector growth was driven by activities in the crop production (1.09%); textile, apparel and footwear (0.50%); telecommunications (0.47%) and real estate (0.45%) sub-sectors.

In the fourth quarter, the non-oil sector slowed to 6.44 per cent, compared with 8.78 per cent in the corresponding period of 2013. As in the preceding quarter, non-oil sector growth in the fourth quarter was driven by activities in the crop production (0.75%); textile, apparel and footwear (0.50%); and real estate (0.50%) sub-sectors.

The oil sector, however, declined by 3.6 per cent in the third quarter of 2014 in contrast to the 5.47 per cent growth in the preceding quarter. This was due to production challenges in the sector, which lowered average daily production of crude oil to 2.15 million barrels per day (mbd), from 2.26 mbd in the corresponding quarter of 2013 and 2.21 mbd in the second quarter of 2014. In the fourth quarter, crude oil output grew by 1.18 per cent with average daily production level of 2.18 mbd, from 2.16 mbd in the corresponding quarter of 2013. The production challenges were exacerbated by declining crude oil prices in the second half of 2014.

Figure 2.2
Quarterly Growth Rates of the Oil and Non-Oil Sectors in 2014



2.2 Sectoral Analysis

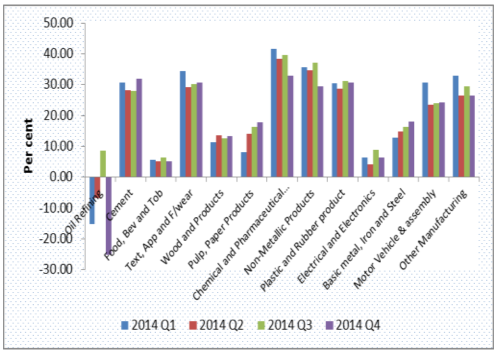
This section analyses the performance of each sector of the economy, highlighting key institutional factors that influenced domestic output in the review period.

2.2.1 Agriculture

Agricultural output grew by 4.47 per cent in the third quarter, up from 3.44 and 3.68 per cent in the corresponding period of 2013 and the preceding quarter, respectively. This represented increases of 1.03 and 0.79 percentage points. At 6.72 per cent, activity in the fishing sub-sector was the main driver of growth, while livestock, crop production and forestry grew by 5.71, 4.38 and 2.36 per cent, respectively. This compares with the growth rates of 4.89, 4.54, 3.56 and 5.04 per cent recorded for fishing, livestock, crop production and forestry, respectively, in the second quarter. The relative contribution of agriculture to GDP dropped to 26.63 per cent in the third quarter, from 27.08 per cent in the corresponding quarter of the preceding year, but higher than the 20.89 per cent in the second quarter, 2014.

In the fourth quarter, agricultural output growth slowed by 0.83 percentage point to 3.64 per cent from the preceding quarter, which however represented an increase of 0.62 percentage point over the rate in the corresponding period of 2013. As in the preceding quarter, the fishing sub-sector at 6.78 per cent remained the main driver of growth in the sector.

Figure 2.3
Quarterly Growth Rate of Agricultural Sector Activity in 2014



2.2.1.2 Agricultural Policy and Institutional Support

The performance of the sector resulted from a number of policies and institutional support, which included the following:

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

The ACGS guaranteed a total of 36,909 loans valued at ₦7.07 billion between July and December, 2014.

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

The sum of ₦5.926billion was released under the scheme to eight (8) banks for eighteen (18) projects (13 new projects and 5 enhancements) between July and December, 2014.

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

Five (5) projects valued at ₦400.00 million were guaranteed in the review period.

- **Nigeria Incentive-Based Risk Sharing System for Agricultural Lending (NIRSAL)**

Eleven (11) credit risk guarantees (CRGs) valued at ₦3.089 billion were approved for eight (8) projects in the review period.

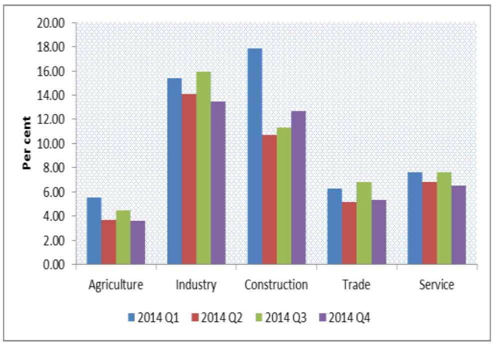
2.2.2 Industry

2.2.2.1 Industrial Production

The industrial sector grew by 15.94 per cent in the third quarter of 2014 up from 14.10 per cent in the preceding quarter, in contrast to a decline of 2.54 per cent in the corresponding period of 2013. At 16.0 and 11.79 per cent, activities in the manufacturing and solid minerals sub-sectors, respectively, were the main drivers of growth, while crude petroleum and natural gas declined by 3.6 per cent. This compares with their respective growth rates of 14.01, 20.95 and 5.14 per cent in the second quarter of 2014.

In the fourth quarter, the sector grew by 13.47 per cent compared with 15.94 per cent in the preceding quarter, and 4.3 per cent in the corresponding period of 2013. At 13.57 and 13.47 per cent, activities in the solid minerals and manufacturing sub-sectors, respectively, were the major drivers of growth. This was complemented by the marginal increase of 1.18 per cent in crude petroleum and natural gas.

Figure 2.4
Quarterly Growth Rate of Industrial Sector Activity in 2014



2.2.2.2 Industrial Policy and Institutional Support

The performance of the industrial sector during the period was driven by the continuation of existing and new reforms and incentives discussed below:

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

Of the N3.70 billion released under the scheme during the review period, ₦3.192 billion was for power and N0.508 billion for airline projects. This brings the total disbursements since inception to ₦236.36 billion in respect of 53 projects (38 power and 15 airline projects).

- **N200 Billion SME Restructuring/Refinancing Fund (RRF)**

Of the ₦200 Billion SME Restructuring/Refinancing Fund (RRF), ₦33.0 billion was disbursed during the review period, bringing the total disbursements since inception to ₦339.725 billion for 601 projects. The difference between the initial amount set aside and the cumulative disbursements under the scheme was accounted for by the re-investment of repayments.

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

As part of commitment to strengthen the real sector, the Bank in collaboration with the Ministries of Petroleum Resources and Power, the Nigerian Electricity Regulatory Commission (NERC), and the Nigerian National Petroleum Corporation (NNPC), established a CBN-Nigeria Electricity Market stabilization Facility (CBN-NEMSF). The NEMSF is aimed at providing a lasting solution to the challenges facing gas-to-power supply in Nigeria.

- **Micro, Small and Medium Enterprises Development Fund (MSMEDF)**

The Fund which was launched on August 15, 2013 commenced in June 2014, with a total provision of ₦220 billion, split into social (₦21.45 billion) and commercial (₦198 billion) components. As at December 2014, a total of ₦4.629 billion had been disbursed under the scheme.

2.2.3 Construction

The construction sector grew by 11.32 per cent in the third quarter of 2014 up from 10.7 per cent in the preceding quarter, but lower than the 13.78 per cent in the corresponding period of 2013. The sector grew by 12.66 per cent in the fourth quarter of 2014.

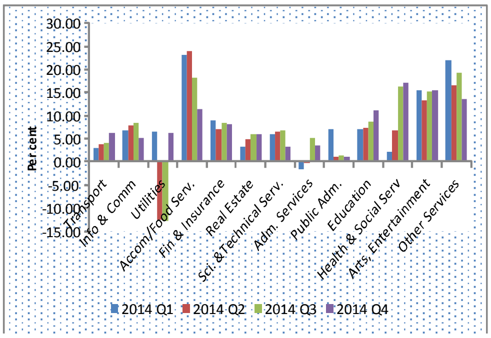
2.2.4 Trade

In the third quarter of 2014, activity in the trade sector increased by 6.81 per cent, up from 5.15 per cent in the preceding quarter, and 6.75 per cent in the corresponding period of 2013. Trade performance, however, slowed to 5.32 per cent in the fourth quarter of 2014. On an annual basis, the sector grew by 5.88 per cent in 2014 compared with 6.64 per cent in 2013.

2.2.5 Services Sector

In the period under review, the sector grew by 7.63 per cent in the third quarter of 2014 up from 6.82 per cent in the preceding quarter, but lower than the 10.53 per cent in the corresponding period of 2013. The major drivers in the sector were information and communication; real estate; finance and insurance; and education, with respective growth rates of 8.32, 5.90, 8.56 and 8.78 per cent. This development compares with their respective growth rates of 7.95, 4.95, 7.0 and 7.34 per cent in the second quarter of 2014. The services sector slowed to 6.52 per cent in the fourth quarter, largely driven by information and communication (5.21%); real estate (5.96%); finance and insurance (8.14%); and education (11.23%). Overall, the services sector grew by 7.12 per cent in 2014 compared with 9.38 per cent in 2013.

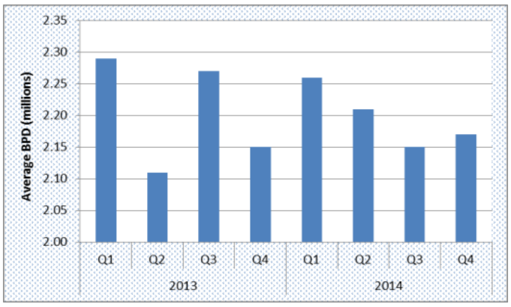
Figure 2.5
Quarterly Growth Rate of Services Sector Activity in 2014



2.2.6 Oil Sector

The average daily production of crude oil in the third quarter decreased to 2.15 million barrels per day (mbd) from 2.26 mbd in the third quarter of 2013 and 2.21 mbd in the second quarter. In the fourth quarter, production improved marginally to 2.18 mbd, from 2.16 mbd in the fourth quarter of 2013 and 2.15 mbd in the third quarter.

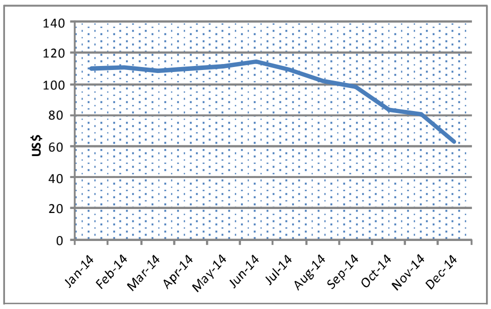
Figure 2.6
Crude Oil Production
2013Q1 – 2014Q4



The international price of Nigeria's reference crude, the Bonny Light (37^0 API), which ranged from US$109.47 to US$114.60 per barrel with an average of US$111.23 in the first half of 2014, fell to US$56.06 per barrel in December 2014. The development in the international oil market led to a significant fall in the price of oil which was below the budget-benchmark price of US$75 per barrel.

Factors that affected the performance of the oil sector included increased oil output in the United States of America from the shale oil technology, geo-political tension, OPEC's refusal to cut production and shore-up prices, and weak global demand.

Figure 2.7
Bonny Light Price January 2014 – December 2014 in US Dollars



BOX 2.0

NIGERIAN ELECTRICITY MARKET STABILIZATION FACILITY

One of the statutory functions of the CBN is to engage in developmental activities. A major development challenge is the provision of adequate power to support the real economy, whose funding needs became apparent following its privatization. Due to the long gestation period of power projects and their large-scale financing requirements, Nigerian banks were unable to meet the funding needs as they traditionally lend short term.

In 2010, the CBN initiated a major intervention in the sector by providing a long-tenored, single-digit interest facility to encourage investment in private power plants. Under the programme, known as the Power and Airlines Intervention Fund (PAIF), a total sum of N200 billion was earmarked for disbursement to independent power producers and large scale manufacturing firms to establish power plants. This was aimed at reducing reliance on the national grid and so far, the intervention has resulted in the generation of additional 840 megawatts to the national grid. Despite the intervention, low power generation remained a major feature of the sector, leading to large revenue shortfalls due to inadequate gas supply to power generating plants. Other counteracting factors included legacy debts inherited by the PHCN successor companies and the inability of distribution companies (DISCOs) to optimize revenue collections from electricity consumers. In October 2014, the CBN, in collaboration with the Ministry of Petroleum Resources, the Ministry of Power, the Nigerian Electricity Regulatory Commission (NERC), and the Nigerian National Petroleum Corporation (NNPC), initiated a financing scheme that would settle the legacy debts, and provide additional funds for the development of electricity market in the country. The fund, known as the Nigeria Electricity Market Stabilisation Facility (NEMSF) had a total financing provision of N213 billion for settling outstanding debts in the Nigerian Electricity Supply Industry (NESI) and guaranteeing the take-off of the Transitional Electricity Market ("TEM"). The interventions under the scheme are expected to add at least 370mmcf/day of gas and guarantee a generation capacity of at least 5000MW within 4-5 months.

Under the scheme, all major stakeholders are expected to fulfil their obligations. The Nigeria Electricity Regulatory Commission (NERC) has reset the Multi Year Tariff Order (MYTO) to make it cost-reflective and provide a margin for the loan repayment. On their part, the Ministry of Petroleum Resources/Nigeria National Petroleum Corporation have approved a new benchmark price of $2.50/mcf for gas supply and $0.80/mcf as transportation costs for new capacity. Other value chain stakeholders also committed to improve service delivery. Gas suppliers are to upgrade infrastructure and improve gas supply; generating companies (GENCOs) are to enhance capacity utilization, and the distribution companies (DISCOs) are to improve revenue collection through significant reductions in commercial and collection losses.

The features of the NEMSF include: (i) The facility shall be administered through deposit money banks; (ii) Funds are to be disbursed at an interest rate of 10% per annum with a ten-year tenor; (iii) Nigeria Electricity Regulatory Commission (NERC) is to reset the Multi Year Tariff Order (MYTO) to provide for the loan repayment; (iv) All parties that are licensed by the NERC to operate in the electricity market accepted to be bound by performance agreements signed with the relevant authorities including the Bureau of Public Enterprise (BPE); and (v) All parties are to be subjected to additional oversight mechanism to be developed by NERC and CBN to ensure business continuity. Overall, the policy measure is expected to enhance revenue collection by the DISCOS to ensure sustainability in the sector.

CHAPTER 3

PRICE DEVELOPMENTS

CHAPTER 3

3.0 PRICE DEVELOPMENTS

Domestic prices were largely subdued in the second half of 2014. Inflationary pressures moderated during the period primarily due to the sustained tight monetary policy stance of the Bank. On the supply side, there was a decline in food prices and core inflation was relatively stable during the period. Although headline inflation increased between July and August, it subsequently declined from October to December, 2014.

The exchange rate was relatively stable between July and September 2014. However, from October 2014, it depreciated substantially in all segments of the foreign exchange market. In response, the Monetary Policy Committee (MPC) in November moved the midpoint of the official exchange rate from ₦155/US$ to ₦168/US$ and widened the band around the midpoint. The depreciation was driven primarily by demand pressures arising from reversal of capital inflows due to normalization of US monetary policy as well as reduced supply of foreign exchange occasioned by lower accretion to reserves from falling oil prices.

In the money market, the inter-bank call and Open Buy Back (OBB) rates remained relatively stable and oscillated largely around the standing facilities corridor, reflecting liquidity conditions in the banking system during the period.

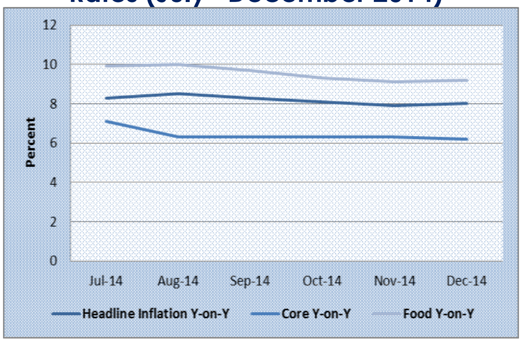
3.1 Trends in Inflation

*I*nflation moderated during the second half of 2014 owing largely to the tight monetary policy stance of the Bank. The core and food measures of the CPI increased from 157.70 and 162.50 in July 2014 to 163.10 and 168.40 in December 2014, respectively. Food inflation (year-on-year) declined from 9.90 per cent in July to 9.20 per cent in December 2014. Core inflation (year-on-year) also declined from 7.10 to 6.20 per cent during the same period. Consequently, headline inflation decreased to 8.0 per cent in December 2014 from 8.30 and 8.50 per cent in July and August 2014, respectively. In effect, food inflation exerted greater pressure on headline inflation (Table 3.1 and figure 3.1).

Table 3.1
Inflation Rates, January – December 2014

Year/ Month	Headline Inflation			Core Inflation			Food Inflation		
	CPI	Y-on-Y	12MA	CPI	Y-on-Y	12MA	CPI	Y-on-Y	12MA
Jan-14	153.26	8.00	8.40	153.31	6.70	7.30	155.52	9.30	9.60
Feb-14	154.03	7.70	8.30	154.06	7.20	7.00	156.45	9.20	9.50
Mar-14	155.23	7.80	8.20	154.66	6.80	7.00	158.02	9.30	9.50
Apr-14	156.19	7.90	8.10	155.32	7.50	7.00	159.27	9.40	9.40
May-14	157.41	8.00	8.00	156.33	7.70	7.20	160.56	9.70	9.40
Jun-14	158.60	8.20	8.00	157.40	8.10	7.40	161.90	9.80	9.50
Jul-14	159.70	8.30	8.00	157.70	7.10	7.40	163.10	9.90	9.50
Aug-14	160.40	8.50	8.00	158.40	6.30	7.30	164.01	10.00	9.50
Sep-14	161.31	8.30	8.00	159.40	6.30	7.20	165.00	9.70	9.50
Oct-14	162.10	8.10	8.00	160.30	6.30	7.10	165.80	9.30	9.50
Nov-14	163.10	7.90	8.00	161.30	6.30	7.00	166.80	9.10	9.50
Dec-14	164.40	8.00	8.00	162.50	6.20	6.90	168.40	9.20	9.50

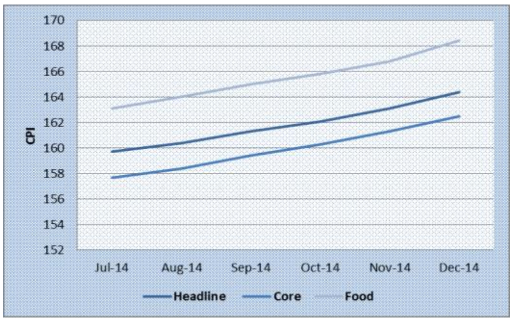
Figure 3.1
Headline, Core and Food Inflation Rates (July –December 2014)



Food continued to be the major driver of headline inflation in the second half of 2014. Other factors included housing; water; electricity; transport; clothing and foot wear, furnishing, household equipment; and education.

In the second half of 2014, all measures of food price inflation experienced a decline unlike in the first half of the year when there was a general increase. Processed food component recorded the largest reduction in prices, declining by 0.22 percentage point to 4.68 per cent in December 2014 from 4.90 per cent in July (Table 3.4).

Figure 3.2
CPI Headline, Core and Food (July-December 2014)



Prices of other components also declined over the period, namely: farm produce (0.50%); yam, potatoes and other tubers (0.03%); meat (0.04%); vegetables (0.05%); fish and sea food (0.04%).

3.1.1 Headline Inflation

The moderation in the major components of headline inflation explained the downward trend in prices during the second half of 2014. Food and non-alcoholic beverages which continued to exert the greatest influence on headline inflation, declined to 4.78 per cent in December from 5.12 per cent in July 2014. This was followed by housing, water, electricity, gas and other fuels, whose price declined to 1.06 from 1.08 per cent over the same period (Table 3.2 and Figure 3.4).

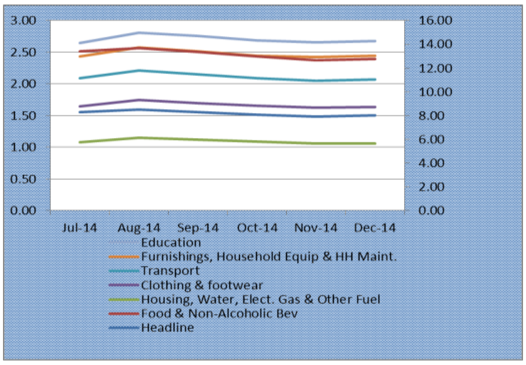
Overall, headline inflation moderated due to the combined effects of the decline in the prices of food and non-alcoholic beverages; housing; water, electricity, gas and other fuels; and transport. However, the prices of clothing and foot wear; furnishing, household equipment and maintenance; and education rose in the review period.

The moderation in inflation was attributable to the sustained tight monetary policy stance such as the maintenance of public sector CRR at 75.0 per cent, the additional increase in the CRR on private sector deposits by 500 basis points to 20.00 from 15.00 per cent as well as the increase in the MPR by 100 basis points from 12.00 to 13.00 per cent in November 2014.

Table 3.2
Major Components of Headline Inflation
(Y-on-Y), July-December 2014

Date	Headline	Food & Non-Alcoholic Bev	Housing, Water, Elect. Gas & Other Fuel	Clothing & footwear	Transport	Furnishings, Household Equip & HH Maint.	Education
Jul-14	8.30	5.12	1.08	0.57	0.44	0.34	0.22
Aug-14	8.50	5.18	1.15	0.59	0.47	0.36	0.24
Sep-14	8.30	5.03	1.12	0.58	0.45	0.37	0.24
Oct-14	8.10	4.86	1.09	0.57	0.43	0.36	0.24
Nov-14	7.90	4.77	1.06	0.57	0.42	0.37	0.24
Dec-14	8.00	4.78	1.06	0.58	0.43	0.37	0.24

Figure 3.4
Major Components of Headline Inflation
(Y-on-Y), July-December 2014

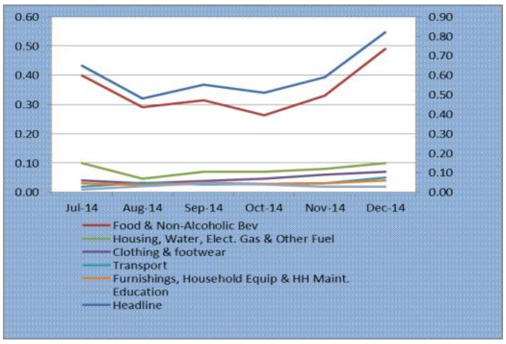


On a month-on-month basis, headline inflation trended upwards during the review period in contrast to its year-on-year level. It rose from 0.65 per cent in July to 0.82 per cent in December 2014. The major component responsible for the increase was the price of food and non-alcoholic beverages, which fluctuated between 0.26 and 0.49 per cent during the period (Table 3.3 and Figure 3.5).

Table 3.3
Major Components of Headline Inflation (M-on-M), July-December 2014

Date	Headline	Food & Non-Alcoholic Bev	Housing, Water, Elect. Gas & Other Fuel	Clothing & footwear	Transport	Furnishings, Household Equip & HH Maint.	Education
Jul-14	0.65	0.40	0.10	0.04	0.02	0.03	0.01
Aug-14	0.48	0.29	0.05	0.03	0.03	0.02	0.02
Sep-14	0.55	0.31	0.07	0.04	0.03	0.03	0.03
Oct-14	0.51	0.26	0.07	0.05	0.03	0.03	0.03
Nov-14	0.59	0.33	0.08	0.06	0.03	0.03	0.02
Dec-14	0.82	0.49	0.1	0.07	0.05	0.04	0.02

Figure 3.5
Major Components of Headline Inflation (M-on-M), July-December 2014



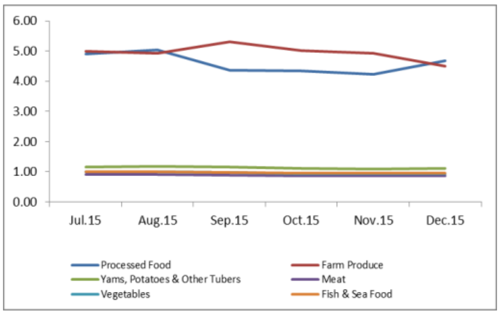
3.1.2 Food Inflation

Food inflation (year-on-year) trended downwards from 9.90 per cent in July to 9.20 per cent in December 2014, due to decline in the indices of its components; namely processed food and farm produce. The price of processed food declined to 4.70 from 4.90 per cent, and that of farm produce to 4.50 from 5.00 per cent during the review period. Of the 0.70 percentage point decline in food inflation, farm produce contributed a larger share of 0.50 percentage point, while processed food contributed 0.20 percentage point. The key drivers of the decline in the farm produce category were vegetables, which declined by 0.05 percentage point; and yam, potatoes and other tubers by 0.03 percentage point. This was due to good harvests during the period (Table 3.4 and Figure 3.6).

Table 3.4
Major Components of Food Inflation (Y-on-Y), July - December 2014

Item/Date	Jul.14	Aug.14	Sep.14	Oct.14	Nov.14	Dec.14	Change btw Jul and Dec 2014
FOOD	9.90	10.00	9.68	9.34	9.14	9.20	-0.70
Processed Food	4.90	5.03	4.37	4.34	4.22	4.70	-0.20
Farm Produce	5.00	4.93	5.31	5.01	4.92	4.50	-0.50
Yams, Potatoes & Other Tubers	1.15	1.18	1.15	1.11	1.08	1.12	-0.03
Meat	0.90	0.91	0.89	0.86	0.86	0.86	-0.04
Vegetables	0.99	1.00	0.98	0.93	0.93	0.94	-0.05
Fish & Sea Food	1.00	1.00	0.97	0.96	0.95	0.96	-0.04

Figure 3.6
Major Components of Food Inflation (Y-on-Y), July - December 2014

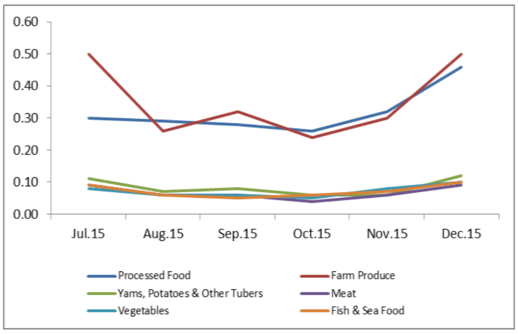


On a month-on-month basis, food inflation increased from 0.80 per cent in July to 1.0 per cent in December 2014, in contrast to its year-on-year trend. The price of processed food increased to 0.50 from 0.30 per cent, while farm produce stabilized at 0.50 per cent during the review period. Accordingly, the 0.20 percentage point increase in food inflation was majorly traced to processed food. The key driver of the increase in the processed food category was fish and sea food, which rose by 0.01 percentage point (Table 3.5 and Figure 3.7).

Table 3.5
Major Components of Food Inflation (M-on-M), July-December 2014

Item/Date	Jul.14	Aug.14	Sep.14	Oct.14	Nov.14	Dec.14	Change btw Jul. and Dec. 2014
FOOD	0.80	0.60	0.60	0.50	0.62	1.00	0.20
Processed Food	0.30	0.29	0.28	0.26	0.32	0.50	0.20
Farm Produce	0.50	0.26	0.32	0.24	0.30	0.50	0.00
Yams, Potatoes & Other Tubers	0.11	0.07	0.08	0.06	0.06	0.12	0.01
Meat	0.09	0.06	0.06	0.04	0.06	0.09	0.00
Vegetables	0.08	0.06	0.06	0.05	0.08	0.10	0.02
Fish & Sea Food	0.09	0.06	0.05	0.06	0.07	0.10	0.01

Figure 3.7
Major Components of Food Inflation (M-on-M), July-December 2014



3.1.3 Core Inflation

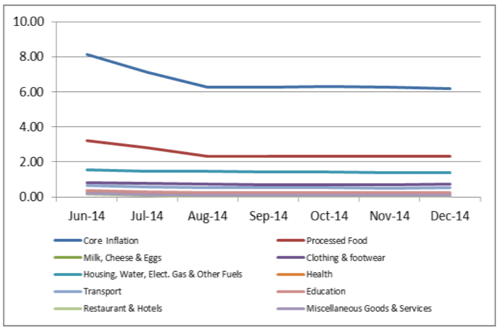
Core inflation (year-on-year) declined by 0.91 percentage point from 7.11 in July to 6.20 per cent in December 2014. Of the 0.91 percentage point decline in core inflation, processed food contributed the largest share of 0.50 percentage point, followed by housing, water, electricity, gas and other fuels (0.10 percentage point); and clothing and footwear (0.07 percentage point). The major contributors to the decline in core inflation were processed food (2.80 to 2.30%); housing, water, electricity, gas and other fuel (1.47 to 1.37%); clothing and footwear (0.77 to 0.72%); and transport (0.59 to 0.52%) (Table 3.6 and Figure 3.8).

In the processed food category, the key drivers of the decline were meat which fell from 0.62 to 0.53 per cent, fish & sea foods (0.69 to 0.60%), milk, cheese & egg (0.13 to 0.07%), and oil & fats (0.40 to 0.28%). A major driver of the decrease in core inflation especially in the latter part of the second half of 2014 was the decline in energy prices.

Table 3.6
Major Components of Core Inflation (Y-on-Y) July-December 2014

Item/Date	Jul-14	Aug-14	Sep-14	Oct-14	Nov-14	Dec-14	Change btw Jul & Dec 2014
Core Inflation	7.11	6.26	6.27	6.30	6.26	6.20	-0.91
Proc Food	2.80	2.34	2.34	2.34	2.30	2.30	-0.50
Clothing & Footwear	0.77	0.71	0.71	0.70	0.71	0.72	-0.05
Housing, Water, Elect. Gas & Other fuels	1.47	1.47	1.44	1.42	1.38	1.37	-0.10
Health	0.24	0.18	0.19	0.19	0.20	0.20	-0.04
Transport	0.59	0.54	0.53	0.52	0.51	0.52	-0.07
Education	0.29	0.23	0.25	0.25	0.26	0.25	-0.04
Restaurant	0.10	0.02	0.03	0.04	0.04	0.04	-0.06
Miscellaneous	0.14	0.07	0.08	0.08	0.09	0.08	-0.06

Figure 3.8
Major Components of Core Inflation (Y-on-Y) July-December 2014

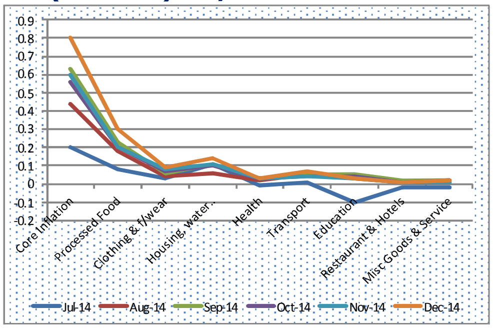


On a month-on-month basis, core inflation rose from 0.20 per cent in July to 0.80 per cent in December, 2014. Processed food remained the major driver of core inflation, increasing from 0.08 to 0.30 per cent in the review period. Other drivers were: housing, water, electricity, gas & other fuels which increased from 0.11 to 0.14 per cent; education (-0.10 to 0.03 per cent); clothing & footwear (0.03 to 0.09 per cent); and transport (0.01 to 0.07 per cent) (Table 3.7 and Figure 3.9).

Table 3.7
Major Components of Core Inflation (M-on-M) July-December 2014

Item/Date	Jul-14	Aug-14	Sep-14	Oct-14	Nov-14	Dec-14	Change btw Jul and Dec 2014
Core Inflation	0.2	0.44	0.63	0.56	0.6	0.8	0.6
Processed Food	0.08	0.18	0.23	0.2	0.2	0.3	0.22
Clothing & f/wear	0.03	0.04	0.06	0.07	0.08	0.09	0.06
Housing, water..	0.11	0.06	0.11	0.1	0.11	0.14	0.03
Health	-0.01	0.02	0.03	0.03	0.03	0.03	0.04
Transport	0.01	0.05	0.05	0.04	0.04	0.07	0.06
Education	-0.1	0.03	0.05	0.04	0.03	0.03	0.13
Restaurant & Hotels	-0.02	0.01	0.02	0.01	0.01	0.01	0.03
Misc Goods & Service	-0.02	0.01	0.02	0.02	0.01	0.02	0.04

Figure 3.9
Major Components of Core Inflation (M-on-M) July-December 2014



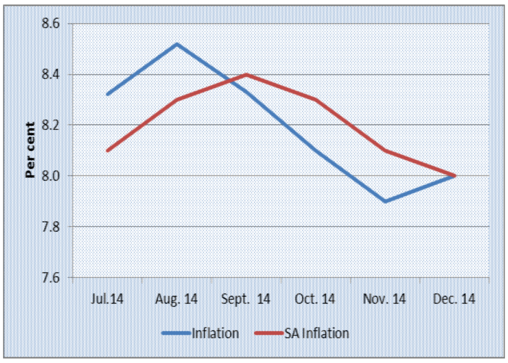
3.1.4 Seasonally-Adjusted Inflation

Actual and seasonally-adjusted headline inflation trended downwards during most of the second half of 2014 (Table 3.8 and Figure 3.14). Both actual and seasonally-adjusted inflation rates recorded upward movements between July and September 2014. While the actual began on a downward path in August, that of seasonally-adjusted inflation started in September. The higher inflation rates during these months were largely due to hikes in food prices as a result of the depletion of existing stock of farm produce from previous year's harvests. However, since September, both measures of inflation were largely on a downward trend till the end of the year. This trend reflected the dampening effects of the harvest season on food prices. There was, however, an uptick in actual inflation in December largely due to increased consumption spending, associated with festive and social celebrations during the period.

Table 3.8
Actual and Seasonally Adjusted Headline Inflation July -December 2014

Date	Inflation	S-A Inflation
Jul 14	8.30	8.10
Aug 14	8.50	8.30
Sep 14	8.30	8.40
Oct 14	8.10	8.30
Nov 14	7.90	8.10
Dec 14	8.00	8.00

Figure 3.14
Actual and Seasonally Adjusted Headline Inflation July - December 2014



3.2 Key Factors that Influenced Domestic Prices

The year-on-year headline and core measures of inflation were at single digit, with food inflation trending downwards during the second half of 2014, reflecting the sustained tight monetary policy. However, there were fluctuations in all measures of inflation during the period as a result of both domestic and global economic conditions. These include amongst others: excess liquidity in the banking system, insurgency in the North Eastern part of the country as well as decline in crude oil prices.

3.2.1 Demand-Pull Factors

The pre-election spending, additional expenditure on security, and the depreciation in the exchange rate of the naira, combined to exert pressure on consumer prices. In addition, the relatively high oil prices in the first half of the year was accompanied by an increase in public expenditure; this was not followed by a cut in spending during the second half of the year when international crude oil prices fell. This sustained the level of aggregate demand pressure; however, the tight monetary policy stance of the Bank stabilized headline inflation at single digit.

3.2.2. Cost-Push Factors

Security challenges particularly insurgency in the north east affected the production and distribution of agricultural products thus accentuating the rise in food prices. In addition, the Ebola epidemic during the review period affected the production, distribution and service channels of several activity sectors in the economy, thereby feeding into prices. Additionally, the wide premium between the interbank and BDC exchange rates continued to pass through to domestic prices.

3.2.3 Moderating Factors

The main moderating factor to domestic prices in the second half of 2014 included the continued tight monetary policy stance of the Bank.

The ongoing government reforms aimed at stimulating real sector activities, in addition to other incentives for micro, small and medium scale enterprises (MSMEs) helped lower production costs. The rehabilitation of railways and improvements in the nationwide supply of fuels moderated energy costs with salutary effects on price developments.

CHAPTER 4

MONETARY POLICY AND LIQUIDITY MANAGEMENT

CHAPTER 4

4.0 MONETARY POLICY AND LIQUIDITY MANAGEMENT

Monetary policy in the second half of 2014 reflected uncertainties regarding the exit of the US from QE and the attendant risks to monetary policy and financial stability. Added to these were the continued crisis and fragility in Europe, the geo-political tensions in the Middle East as well as the Russian-Ukrainian stand-off. The downside risks to growth from softening commodity prices and the drop in revenues of oil exporting countries as well as capital flow reversals exerted pressure on emerging market exchange rates.

On the domestic front, the major policy challenges included banking system liquidity surfeit and the associated cost of liquidity management; loss of fiscal buffers due to dwindling external reserves; widening gap between the official and BDC exchange rates; anticipated increase in spending towards the 2015 general elections and the possible effects of US tapering on the domestic market. These developments and the desire to consolidate on the achievement of price and exchange rate stability provided the context for monetary policy decisions in the second half of 2014.

4.1.0 Decisions of the Monetary Policy Committee (MPC)

The decisions of the Monetary Policy Committee (MPC) in the second half of 2014 were influenced by major developments in the domestic and global economy. The key domestic challenges during the period included: liquidity surfeit in the banking system, speculative attacks on the naira, depletion of and slower accretion to foreign reserves occasioned by falling oil prices, lower output growth, gradual uptick in inflation and high unemployment, among others. On the global front, the risks posed by sluggish global recovery, the continued fragility in Europe, geo-political tensions in the Middle East and a number of emerging and developing economies, were key concerns that influenced MPC decisions during the period.

4.1.1 July 2014 MPC Meeting

The July 2014 MPC reviewed developments in the monetary policy environment and expressed satisfaction with the relative stability in the macro-economy as reflected in impressive output growth rates, stable consumer prices and exchange rate as well as robust external reserves. The Committee was, however, concerned about the weak translation of stability to microeconomic gains in employment and access to finance especially by small and medium scale businesses. It, therefore, emphasized the need for MPC decisions to take into account the long-run impact of stable macroeconomic indicators on employment level, wealth creation and growth of businesses.

The Committee noted the potential of the power sector to stimulate output growth and investment with spill-over effects on employment generation if the challenges confronting the sector were properly addressed. Specifically, it observed that gas-to-power remained a binding constraint to realizing the benefits of the recently-concluded power sector reforms, while urging the government, private investors and the banks to collectively resolve the problem. The Committee further expressed concern about the liquidity level and the uptick in inflation, which may not be unconnected with the poor harvest in some agricultural producing areas, particularly the north eastern and central states of the country. Others included the underlying pressure from food inflation and the likely risks from increase in aggregate spending in the run-up to the 2015 general elections.

The Committee was also worried about the effects of the on-going US QE3 tapering on inflows and external reserves. It noted the volatile and non-employment generating nature of portfolio flows which were, however, essential in the absence of adequate external reserves and fiscal buffers. It, however, welcomed the moderation in the rate of depletion in external reserve in recent months, noting that reserves accretion needed to improve much faster to provide a strong and more resilient buffer to fiscal operations. The MPC urged a gradual reduction in the country's import bills through domestic production of some of the major food imports as a key element in the overall strategy to stem reserve depletion.

The Committee recognized the necessity of balancing the objective of sustaining a stable naira exchange rate with the need for a low interest rate regime. Overall, the Committee indicated that the policy direction on inflation, exchange rate and interest rate must be seen not only in the context of price and financial stability but also in promoting employment and enhancing the quality of life of Nigerians.

In view of these developments, the Committee decided to retain the MPR at 12.0 per cent, with the symmetric corridor of +/- 200 basis points around the midpoint. The MPC also retained the Liquidity Ratio at 30.0 per cent, public sector Cash Reserve Ratio at 75.0 per cent and private sector Cash Reserve Ratio at 15.0 per cent.

4.1.2 September 2014 MPC Meeting

At the September 2014 meeting, the MPC expressed satisfaction with the relative stability in the economy while noting the risks ahead. The risks included: the possibility of capital reversals as the US Fed's QE was to be concluded in October, 2014; dwindling oil output and prices, domestic security challenges and upward trending headline inflation. The Committee also expressed concern about banking system liquidity surfeit and its potential effects on inflation and the exchange rate. Consequently, the policy challenge was sustaining the stability of the naira exchange rate against the backdrop of managing the vulnerability to capital flow reversals, building fiscal buffers, managing inflation and exchange rate expectations, and the buildup of election-related spending for the 2015 general elections.

The Committee welcomed the efforts by government to address some of the constraints and risks to economic activity like the insurgency in the North-East and the Ebola Virus epidemic. It noted that progress in these areas as well as in improving power supply and SME financing, would brighten growth prospects and moderate upward pressure on prices. The Committee further noted that the restrictive stance of monetary policy provided important defenses against structural liquidity in the banking system and reaffirmed willingness to manage expectations around the exchange rate and inflation.

The Committee was, however, concerned that banks were holding large excess reserves averaging over ₦300 billion even when there were ample opportunities for productive and profitable lending to the real sector of the economy. The concern was further aggravated by the reality of the impending injection of additional N866 billion into the system through the redemption of maturing AMCON bonds in October, 2014. Given the apathy to lending, the Committee reasoned that banks may be inclined more to place these new funds at the Standing Deposit Facility (SDF) window, acquire treasury instruments or use it to increase pressure on the exchange rate. The MPC, therefore, advised the Bank to explore ways of encouraging commercial banks to lend such excess reserves to the real sector.

In the light of the foregoing, the Committee weighed the merits of retaining the current stance of monetary policy against the consequence of further tightening. The MPC, however, decided to maintain the current tight monetary stance and voted to retain: the MPR at 12.0 per cent with a corridor of +/- 200 basis points around the midpoint; the public sector Cash Reserve Requirement at 75.0 per cent; and the private sector Cash Reserve Requirement at 15.0 per cent, and liquidity ratio at 30.0 per cent.

4.1.3 November 2014 MPC Meeting

The November 2014 MPC expressed satisfaction with the deceleration in all the three measures of inflation since September 2014, a development which provided headroom for policy flexibility. The Committee felt that the robust output expansion amidst strong headwinds from weakening international oil market provided credence to the efficacy of macroeconomic policy. It also observed that unlike in previous episodes, the current downturn in oil prices appears to be permanent, being a product of advancement in oil exploration technology. As at the fourth quarter of 2014, the US which used to be Nigeria's major oil export destination now obtains about 80 per cent of its domestic oil demand from local shale oil production and exports over 8 million barrels of crude oil daily.

The Committee was of the view that the softening crude oil prices could provide leverage for the fiscal authority to reduce budgetary outlay on fuel subsidy and channel the savings to growth-enhancing sectors of the economy. In this regard, the MPC noted the supportive fiscal stance and public sector commitment to take advantage of the low oil price, to reduce fuel subsidy spending and liberalize prices as done in many emerging economies. Given the not too impressive fiscal revenue outlook, the Committee urged sub-national governments to seize the opportunity to reduce reliance on allocations from the Federation Account. To this end, the MPC commended the efforts of state governments that recorded significant growth in their internally generated revenues (IGRs) in 2013.

The Committee, being fully aware of the short run implications of a tight monetary policy stance on lending and growth, reiterated its commitment to the goal of promoting inclusive growth through lower interest rates in the medium- to long-term. The Committee also noted the gradual improvement in labor market conditions which resulted in the creation of additional 349,343 jobs in the third quarter of 2014.

A major issue considered by the Committee was the declining level of external reserves, which arose from adverse demand and supply forces. On the supply side, falling oil prices led to a considerable lowering of foreign exchange earnings, resulting in low accretion to external reserves. The demand side reflected the funding to stem demand pressure in the foreign exchange market. The pressure was exacerbated by capital reversals and drop in the flow of easy money to emerging markets, following the gradual normalization of US monetary policy and tepid recovery in some advanced economies. The current situation demands that the Bank confronts the issue of declining external reserves head-on in order to strengthen the value of the domestic currency. Consequently, stabilizing prices and maintaining exchange rate stability and charting a sustainable path for medium to long-term growth remained the top priorities.

The Committee was worried that pressures in the foreign exchange market were aided by excess liquidity in the banking system and speculative activities. The MPC expressed dissatisfaction that improvement in liquidity conditions in the banking system, designed to enhance its resilience and stability, has not translated to increased credit to the real sector for inclusive growth and employment. This development rather led to an upward pressure in the foreign exchange market and increased patronage of the SDF, with banks continually exhibiting a cautious approach to lending. The MPC viewed the challenge as requiring bold policy moves in both monetary policy and foreign exchange management.

In the Committee's opinion, a more flexible naira in the face of almost nonexistent fiscal buffers was the most viable policy option at a time of heightened demand for foreign exchange and falling oil prices. The Committee reasoned that failure to proactively take appropriate policy actions, could lead to the market dictating the path of policy in the area of exchange rate management.

In the light of the above considerations, the MPC decided to: increase the MPR by 100 basis points from 12.00 to 13.00 per cent; increase the CRR on private sector deposits by 500 basis points from 15.00 to 20.00 per cent; move the exchange rate midpoint from ₦155/US$ to ₦168/US$; widen the band around the official foreign exchange midpoint by 200 basis points from +/-3.00 to +/-5.00 per cent; retain public sector CRR at 75.00 per cent; maintain a symmetric corridor of +/- 200 basis points around the MPR; and retain the net open foreign exchange trading position limit at 1.00 per cent.

4.2.0 Instruments of Liquidity Management

The choice of monetary policy instruments was guided by the objectives of price stability and overall macroeconomic management. The MPC, therefore, deployed a range of monetary policy instruments including: the MPR, CRR, Open Market Operations (OMO) and Discount window operations in the review period.

4.2.1 Monetary Policy Rate (MPR)

The Bank's benchmark policy rate, the MPR, continued to be the prime instrument for monetary policy, with a symmetric corridor (standing lending/deposit facility rates). The sustained decline in oil prices and its impact on accretion to foreign reserves, coupled with the liquidity surfeit in the banking system, led the

MPC to embark on further tightening of monetary policy in November, 2014 by raising the MPR to 13.0 from 12.0 per cent.

4.2.2 Open Market Operations (OMO)

Open Market Operations (OMO) remained the key tool of liquidity management in the review period. During the second half of 2014, actual OMO sales amounted to ₦3,937.76 billion, compared with ₦4,485.17 billion in the first half of 2014 and ₦3,348.39 billion in the corresponding period of 2013. This represented a decrease of 12.20 per cent below the level in the first half of 2014 but an increase of 17.60 per cent over the corresponding period of 2013. Cumulatively, total sales declined by 19.38 per cent from ₦10,447.93 in 2013 to ₦8,422.93 in 2014 (Table 4.1).

Table 4.1
OMO Bills Auction
(January 2013 – December 2014)
(₦'million)

Date	2013	2014	% Change
Jan	1,756.66	1,091.49	
Feb	1,351.59	307.40	
Mar	1,265.25	714.80	
Apr	1,516.69	285.94	
May	127.40	905.99	
Jun	81.95	1,179.54	
1st Half	7,099.54	4,485.17	-36.82
Jul	508.14	810.92	
Aug	91.72	654.53	
Sep	150.51	989.58	
Oct	1,206.86	652.50	
Nov	791.09	830.23	
Dec	599.47	0.00	
2nd Half	3,348.39	3,937.76	17.60
Cumulative Figure	10,447.93	8,422.93	-19.38

4.2.3 Reserve Requirements

The MPR is often complemented by OMO and other macroprudential instruments of liquidity management such as the cash reserve ratio (CRR) and liquidity ratio (LR). During the period under review, the MPC increased CRR on private sector deposits by 500 basis points from 15.0 to 20.0 per cent and retained the CRR on public sector deposits at 75.0 per cent. It also retained the liquidity ratio at 30.0 per cent. These measures were taken to curb continued liquidity surfeit in the banking system.

4.2.4 Standing Facilities

Deposit money banks (DMBs) and discount houses (DH) continued to access the standing facilities window (lending/deposit) to meet their daily liquidity requirements in the second half of 2014. The request for Standing Lending Facility (SLF), however, declined by 17.67 per cent from ₦2,021.19 billion in the first half of 2014 to ₦1,664.00 billion in the second half of 2014. The volume of SLF at end-December 2014 represented a decrease of 75.97 per cent compared with the corresponding period of 2013 (Table 4.2). The significant decrease in the volume of SLF transactions reflected the liquidity surfeit that persisted in the banking system arising from FGN Bonds, NTBs and AMCON bond maturities in the review period.

The Standing Deposit Facility (SDF) window witnessed substantial increase in the volume of deposits during the period. The cumulative volume of deposits stood at ₦29,410.96 billion in the second half of 2014, representing 9.49 per cent increase over ₦26,862.21 billion recorded in the corresponding period of 2013 (see Table 3). The level of deposit in the SDF as at end-December 2014, represented a 36.75 per cent decrease from the level at the end of the first half of 2014. The increase in the overall volume of SDF deposits reflected increased system-wide liquidity in the review period.

Table 4.2
CBN Standing Lending Facility
(January 2013 – December 2014)
(₦'billion)

Date	2013	2014	% Change
Jan	**669.75**	**615.59**	
Feb	**1,115.64**	**653.74**	
Mar	**993.47**	**560.27**	
Apr	**778.7**	**50.29**	
May	**796.89**	**44.88**	
Jun	**894.25**	**96.42**	
1st Half	**5,248.70**	**2,021.19**	**-61.49**
Jul	**793.07**	**96.42**	
Aug	**2,465.79**	**55.46**	
Sep	**2,407.54**	**133.80**	
Oct	**263.36**	**23.84**	
Nov	**314.22**	**224.59**	
Dec	**679.88**	**1,129.89**	
2nd Half	**6,923.86**	**1,664.00**	**-75.97**
Total	**12,172.56**	**3,685.19**	**-69.73**

Table 4.3
CBN Standing Deposit Facility
(January 2013 – December 2014)
(₦'billion)

Date	2013	2014	% Change
Jan	2,132.70	13543.87	
Feb	3,047.91	4953.72	
Mar	6,101.42	5844.76	
Apr	2817	8190.69	
May	1718.53	8061.09	
Jun	1667.22	5902.5	
1st Half	**17,484.78**	**46,496.63**	**165.93**
Jul	6,341.59	7,049.30	
Aug	5,282.96	4,309.30	
Sep	2,905.72	6,734.45	
Oct	8,328.91	7,436.35	
Nov	5,321.54	2,804.84	
Dec	4,003.03	1,076.73	
2nd Half	**26,862.21**	**29,410.96**	**9.49**
Total	**44,346.99**	**75,907.59**	**71.17**

4.2.5 Foreign Exchange Intervention

The Bank continued its interventions in the foreign exchange market to sustain the stability of the naira in the review period. Total supply of foreign exchange declined by 8.95 per cent to US$16,263.03 million in the second half of 2014, from US$17,861.69 million in the corresponding period of 2013. This also represented a decline of US$4,488.98 million (21.63%) compared with US$20,752.01 million supplied in the preceding half year (Table 4.4).

The decrease in the supply of foreign exchange reflected the Bank's desire to stem the depletion of foreign reserves and encourage BDCs and other participants in the foreign exchange market to seek alternative sources.

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

Date	2013			2014		
	Sales to rDAS	Sales to BDC	Total Supply (RDAS + BDC)	Sales to rDAS	Sales to BDC	Total Supply (RDAS + BDC)
Jan	713.5	303.48	1016.98	2989.43	556.3	3545.73
Feb	1072.82	299.25	1372.07	3101.87	567.05	3668.92
Mar	1801.54	365	2166.54	3151.59	560.95	3712.54
Apr	2154.47	381.04	2535.51	2663.92	712.8	3376.72
May	2318.7	487.62	2806.32	2928.49	619.84	3548.33
Jun	2650	427.23	3077.23	2398.55	501.22	2899.77
1st Half	**10,711.03**	**2,263.62**	**12,974.65**	**17,233.85**	**3,518.16**	**20,752.01**
Jul	3000	575.36	3575.36	2494.76	184.94	2679.7
Aug	2437.08	466.52	2903.6	3201.1	169.08	3370.18
Sep	2297.82	480.45	2778.27	2598.45	143.24	2741.69
Oct	2274.38	598.35	2872.73	3498.48	178.86	3677.34
Nov	2796.47	522.7	3319.17	2296.93	145.71	2442.64
Dec	2007.76	404.8	2412.56	1241.13	110.35	1351.48
2nd Half	**14,813.51**	**3,048.18**	**17,861.69**	**15,330.85**	**932.18**	**16,263.03**
Total	25,524.54	5,311.80	30,836.34	32,564.70	4,450.34	37,015.04

4.3.0 Developments in the Monetary Aggregates

The weak performance of the monetary aggregates continued in the second half of 2014, indicating the tight monetary policy stance of the Bank and reluctance of deposit money banks to extend credit to the real sector. Accordingly, the decline in most monetary aggregates was moderated leading to an overall slight increase in the money stock.

4.3.1 Broad Money (M2)

Broad Money (M2) grew by 4.1 per cent to ₦16,833.24 billion at end-December 2014 from ₦16,171.62 billion at end-June 2014. Compared with the end-December 2013 figure of ₦15,688.96 billion, M2 increase by 3.07 per cent, which was below the growth benchmark of 15.02 per cent for 2014.

Figure 4.4
Money Supply (M1) and (M2) (December 2013 – December 2014)

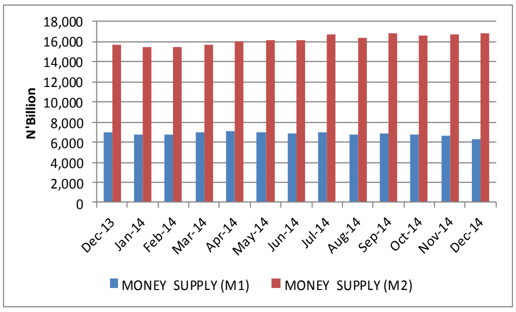
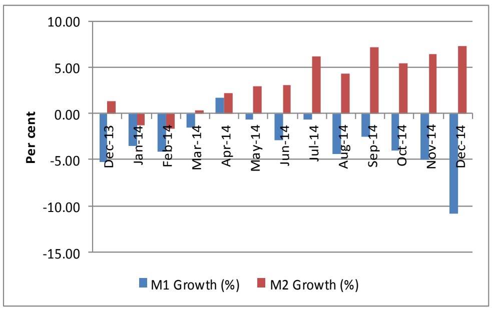


Figure 4.5
Growth in Money Supply (M1) and (M2) (December 2013 – June 2014)



4.3.2 Narrow Money (M1)

Narrow Money (M1) decreased by 8.25 per cent to ₦6,266.69 billion at end-December 2014 from ₦6,830.53 billion at end-June 2014. Compared with the end-December 2013 figure of ₦7,032.84 billion, M1 declined by 10.89 per cent, which was below the growth benchmark of 16.23 per cent for 2014 (Figures 4.4 and 4.5).

4.4.0 Developments in the Major Monetary Aggregates

4.4.1 Net Foreign Assets (NFA)

The Net Foreign Assets (NFA) decreased by 6.1 per cent to ₦7,358.15 billion at end-December 2014 from ₦7,837.25 billion at end-June 2014. Compared with the end-December 2013 figure of ₦8,658.65 billion, NFA declined by 15.01 per cent, in contrast to the growth benchmark of 5.58 per cent for 2014. This development was due to increased capital outflows precipitated by the flight to quality owing to US monetary policy normalization, improvement in the US and UK economies. Consequently, the domestic economy was perceived as having a relatively high sovereign risk during the period. In addition the period witnessed a precipitous fall in crude oil prices which resulted in a decrease in foreign exchange earnings and de-accumulation of external reserves.

4.4.2 Net Domestic Assets (NDA)

The Net Domestic Assets (NDA) rose by 7.47 per cent to ₦16,129.49 billion at end-December 2014 from ₦15,008.41 billion at end-June 2014. Compared with the end-December 2013 figure of ₦14,535.20 billion, NDA increased by 10.97 per cent, which was below the growth benchmark of 23.60 per cent for 2014.

Figure 4.6
Net Domestic Asset (NDA)
(December 2013 – December 2014)

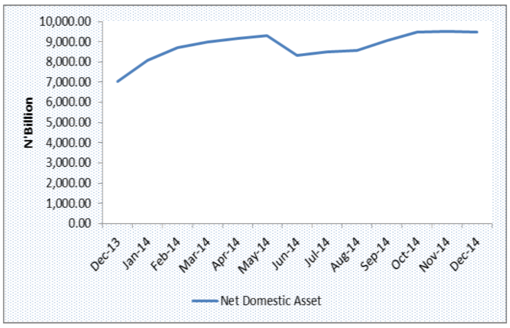
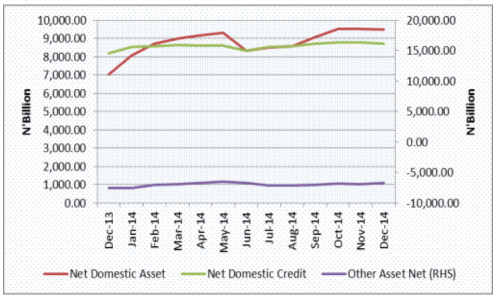


Figure 4.7
NDA, NDC and Other Assets (net)
(December 2013 – December 2014)



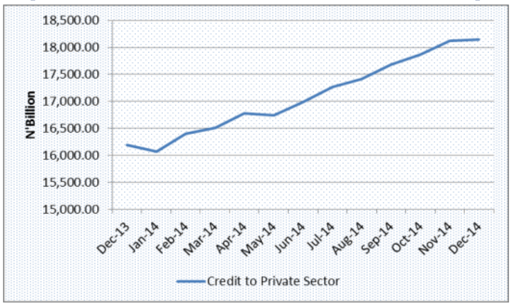
4.4.3 Credit to the Government (C_g)

Credit to government (Cg) contracted by 2.22 per cent to ₦2,017.54 billion at end-December 2014 from ₦1,973.60 billion at end-June 2014. When compared with the end-December 2013 figure of ₦1,656.27 billion, Cg contracted by 21.81 per cent, which was still below the growth benchmark of 31.55 per cent for 2014. In effect, the government sector was a net creditor to the banking system in 2014.

4.4.4 Credit to the Private Sector(Cp)

Credit to the private sector (Cp) increased by 6.8 per cent to ₦18,147.0 billion at end-December 2014 from ₦16,982.02 billion at end-June 2014. Compared with the end-December 2013 figure of ₦16,191.36 billion, Cp rose by 12.08 per cent, which was, however, below the growth benchmark of 23.07 per cent for 2014.

Figure 4.8
Domestic Credit to Private Sector (December 2013 – December 2014)



4.4.5 Reserve Money (RM)

Reserve Money (RM) grew by 24.61 per cent to ₦5,964.75 billion at end-December 2014 up from ₦4,786.36 billion at end-June 2014. The end-December figure was 17.18 per cent above the level in the corresponding period of 2013 and 1.8 per cent above the benchmark of ₦6,076.01 billion in 2014. This development was largely due to the increase in the CRR on private sector deposit by 500 basis points as well as increased spending on end-of-year festivities in the review period.

A summary of the major monetary aggregates and the provisional outcome as at end-December 2014 are shown in Table 4.5 below.

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

	2013	2014				Change in H1 2014	Change in H2 2014
	Actual Dec 2013	Actual June 2014	Actual Dec 2014	Benchmark 2014	Deviation (N'b)	Actual	Actual
M2 (N'b)	15,688.96	16,171.62	16,833.24	18,021.73	-1188.49	482.66	1850.11
M2 (%)	1.32	3.08	7.29	15.02	(6.59)	3.07	11.44
M1 (N'b)	7,032.84	6,830.53	6,266.68	8,625.44	-2358.76	(202.31)	(563.85)
M1 (%)	(5.23)	(2.88)	(10.89)	16.23	(27.35)	(2.87)	(8.25)
RM (N'b)	5,090.24	4,786.36	5,964.75	6,076.01	-111.25	(303.88)	1178.4
RM (%)	37.41	29.20	17.18	103.65	(1.83)	(5.96)	24.61
NDC (N'b)	14,535.20	15,008.41	16,129.97	19,312.77	-3182.80	473.21	1121
NDC (%)	14.47	3.26	10.97	28.40	(16.48)	3.25	7.46
Cg (N'b)	(1,656.27)	(1,973.60)	(2,017.54)	(1,005.37)	-1012.17	(317.33)	(43.94)
Cg (%)	32.50	(19.16)	(21.81)	31.55	(100.67)	(19.15)	(2.22)
Cp (N'b)	16,191.47	16,982.02	18,147.50	20,318.14	-2170.64	790.55	1165.48
Cp (%)	6.86	4.88	12.08	23.07	(10.68)	4.88	6.86
NFA (N'b)	8,658.65	7,837.25	7,358.15	9,463.60	-2105.45	(821.4)	(479.1)
NFA (%)	(4.26)	(9.49)	(15.02)	11.16	(22.25)	(9.49)	(6.11)

CHAPTER 5

DEVELOPMENTS IN THE FINANCIAL MARKETS

CHAPTER 5

5.0 DEVELOPMENTS IN THE FINANCIAL MARKETS

The Nigerian financial landscape was significantly influenced by global economic developments, such as the gradual normalization of the US monetary policy and the declining oil prices which began since the end of the first half of 2014. The tapering of QE3 and its conclusion in October 2014 led to a redirection of global capital flows out of emerging and developing markets owing largely to rising sovereign risk in these countries and the prospect of improved interest rate regime in the U.S.

The money market was active with improvements in banking system liquidity conditions. In the foreign exchange market, sustained pressure on the naira stemming from the reversals of capital flows resulted in substantial depreciation of the exchange rate in the face of declining external reserves. As a result, the capital market declined.

5.1 Money Market

The money market remained active with transactions in CBN bills and government securities in the second half of 2014. The improvement in liquidity conditions in the banking system continued to influence market activities along with demand pressure in the foreign exchange market and increase in private sector CRR. The interbank and OBB rates remained within the retained policy rate corridor of MPR +/-200 basis points in the review period. The continuing rebound of activities in the uncollateralized segment of the market, OMO and standing facilities dominated activities in the market. There were increased transactions in the interbank segment of the market. Previously, uncollateralized interbank transactions were moribund due to low patronage. Transactions in the repo segment of the market also remained low during the period.

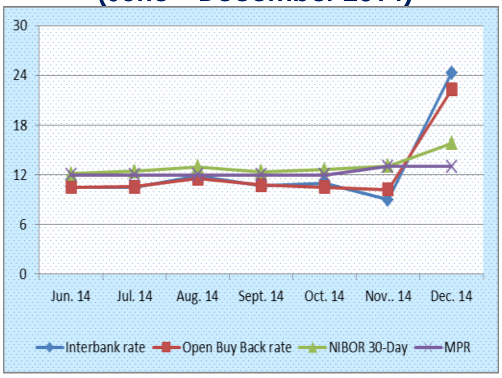
5.1.1 Short-term Interest Rate Developments

During the review period, money market interest rates remained largely stable but rose sharply following the November 2014 increase in the MPR by 100 basis points from 12.00 to 13.00 per cent. The Bank conducted a number of OMO auctions to contain the effects of liquidity surge associated with Federation Accounts Allocation Committee (FAAC) disbursements, and maturity of treasury securities. The average interbank call rate ranged between 10.50 and 26.15 per cent, while the OBB rate and 30-day NIBOR were between 10.52 and 23.46 per cent; and 12.15 and 15.79 per cent, respectively.

Table 5.1
Weighted Average Money Market Interest Rates (June – December 2014)

Months	Interbank rate	Open Buy Back rate	NIBOR 30-Day	MPR
Jun. 14	10.5	10.52	12.15	12.00
Jul. 14	10.5	10.58	12.42	12.00
Aug. 14	11.91	11.53	12.97	12.00
Sept. 14	10.73	10.76	12.37	12.00
Oct. 14	10.98	10.51	12.6	12.00
Nov.14	8.98	10.2	13.07	13.00
Dec. 14	26.15	23.46	15.79	13.00

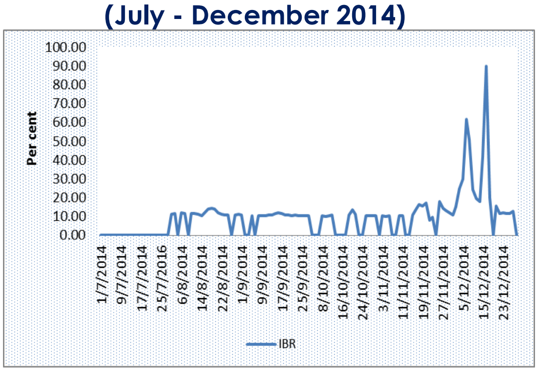
Figure 5.1
Weighted Average Money Market Interest Rates (June – December 2014)



(i) Interbank Call Rate

In the second half of 2014, the interbank call market witnessed a rebound in activity evidenced by more days of transactions which resulted in the call rate rising from 10.50 per cent in July to 11.91 per cent in August, 2014 before declining to 8.98 per cent in November. However, the rate rose significantly by 1565 basis points to 26.15 per cent in December 2014. This development was due to liquidity shortage in the interbank market following the implementation of the decisions of the MPC meeting of 24 – 25 November, 2014, which raised the MPR by 100 basis points and the CRR on private sector deposits by 500 basis points as well as the withdrawal of NNPC funds in preparation for FAAC meetings. The increase in activities at the interbank segment was attributed to: (i) availability of funds within the system through consistent maturities of OMO and NTBs; (ii) more confidence by DMBs in the uncollateralized segment of the market; (iii) better appreciation of the earlier introduced Real Time Gross Settlement System (RTGS) and the Scriptless Security Settlement System (S4) that transparently simplifies settlement of secured transactions; and (iv) liquidity from AMCON bond redemptions in November 2014 (Figure 5.2).

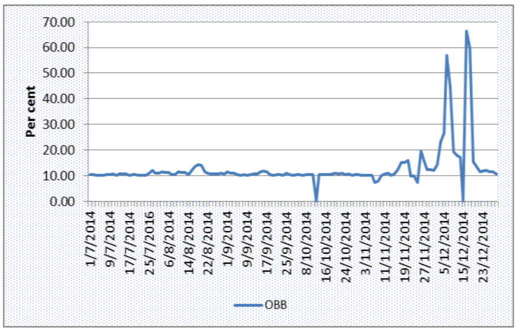
Figure 5.2
Daily Interbank Call Rate (July - December 2014)



(ii) Open Buy Back Rate

The weighted average OBB rate fell by 32 basis points to 10.20 per cent in November, 2014 from 10.52 per cent in June, 2014. The rate, however, rose significantly to 23.46 per cent in December, 2014, following a 500 basis points increase in the private sector CRR in November 2014 (Figure 5.3). Transactions in the OBB segment remained active and relatively stable in the review period. The relative stability was attributed to liquidity surfeit in the banking system, occasioned by the release of statutory revenue to the state and local governments as well as matured FGN bonds and CBN bills. Thus, between end-June and end-December 2014, OBB rose by 1294 basis points to 23.46 from 10.52 per cent.

Figure 5.3
Open Buy Back Rate
(July - December 2014)



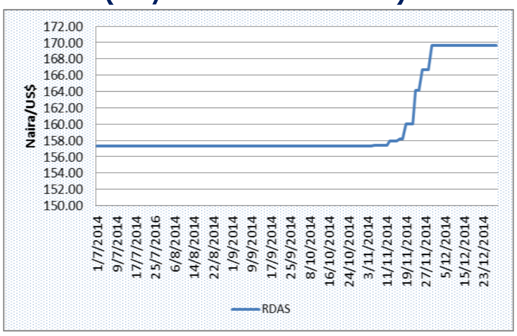
(iii) Nigeria Interbank Offered Rate (NIBOR)

Nigeria's reference rate, the NIBOR, was relatively stable across tenors in the review period with occasional spikes. The weighted average 30-day NIBOR, which was 12.42 per cent in July, fell to 12.37 in September, rising to 15.79 per cent in December 2014, owing primarily to the upward review of private sector CRR in the fourth quarter of the year (Table 5.1).

5.2 Foreign Exchange Market

The Bank's policy of maintaining an official exchange rate corridor of +/- 3.0 per cent around a mid-point of ₦155/US$ was difficult to sustain in the face of increasing pressure on the naira. The pressure was due to the effects of capital reversals induced by the Fed's QE3 tapering and speculative activities in the foreign exchange market. The Committee thus voted to move the mid-point to ₦168/US$, and widened the band to +/-5.0 per cent. The depreciation was targeted at stemming the dwindling reserves occasioned by falling oil prices and capital reversals as well as curbing the heightened demand for foreign exchange in the market.

Figure 5.4
Daily Naira-US Dollar Exchange Rate
(July - December 2014)



5.2.1 Average Exchange Rate

The rDAS spot rate depreciated by 1.62 per cent to an average of ₦159.86/US$ in the second half of 2014 from ₦157.30/US$ in the first half. Also, at the interbank foreign exchange market (IFEM), the exchange rate depreciated by 2.86 per cent to ₦167.21/US$ from ₦162.56/US$ during the same period. Similarly, the BDC rate depreciated by 2.3 per cent to ₦173.41/US$ from an average of ₦169.49/US$ in the first half of 2014. Compared with the average of ₦165.23/US$ recorded in the second half of 2013, the rate depreciated by 4.95 per cent in the review period (Table5.2).

Table 5.2
Average Monthly Spot Exchange Rates (July 2013 – December 2014) (₦/ US$)

Date	CBN	IFEM	BDC
Jul. - 13	157.32	161.12	162.43
Aug. - 13	157.31	161.15	162.28
Sept. - 13	157.32	161.96	163.14
Oct. - 13	157.42	159.83	165
Nov. - 13	157.27	158.79	167.14
Dec. - 13	157.27	159.05	171.4
Average	**157.32**	**160.32**	**165.23**
Jan. - 14	157.29	160.23	171.71
Feb. - 14	157.31	163.62	169.45
Mar. - 14	157.3	164.61	171.5
Apr. - 14	157.29	162.19	170.25
May. - 14	157.29	161.86	166.85
Jun. - 14	157.29	162.82	167.17
Average	**157.3**	**162.56**	**169.49**
Jul. - 14	157.29	162.25	167.71
Aug. - 14	157.29	161.99	170.36
Sept. - 14	157.3	162.93	168.64
Oct. - 14	157.31	164.64	169.43
Nov. - 14	160	171.1	175.85
Dec. - 14	169.68	180.33	188.45
Average	**159.86**	**167.21**	**173.41**

5.2.2 End-Period (Month) Exchange Rate

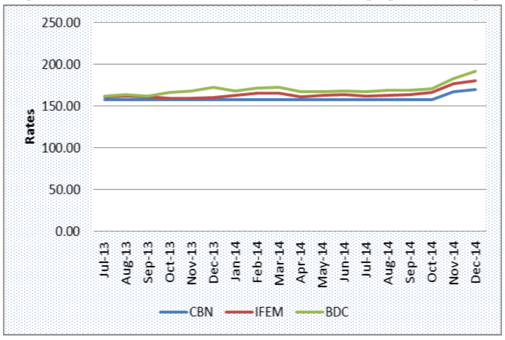
The naira depreciated in all the three segments of the foreign exchange market at end-December 2014, compared with end-December 2013. At the rDAS, the naira depreciated by 7.90 per cent to ₦169.68/US$ at end-December 2014 from ₦157.26/US$ at end-December 2013. When compared with the end-June 2014 figure of ₦157.29/US$, the naira depreciated by 7.88 per cent.

At the interbank market, the naira depreciated by 10.66 per cent from ₦162.95/US$ at end-June 2014 to ₦180.32/US$ at end-December 2014. At the BDC segment, the naira depreciated by 13.99 per cent from N168.00/US$ at end-June 2014 to N191.50/US$ at end-December 2014 (Figure 5.5 and Table 5.3).

Table 5.3
End-Month Exchange Rates
(January 2013 – December 2014)
(₦/US$)

Date	CBN	IFEM	BDC
13-Jul	157.32	160.55	162
13-Aug	157.32	161.9	163
13-Sep	157.31	160.65	162
13-Oct	157.36	158.85	166
13-Nov	157.28	158.52	168
13-Dec	157.26	159.9	172
14-Jan	157.31	162.5	168
14-Feb	157.31	164.7	171
14-Mar	157.3	164.9	172
14-Apr	157.29	160.63	167
14-May	157.29	162.73	167
14-Jun	157.29	162.95	168
14-Jul	157.29	161.9	167
14-Aug	157.29	162.4	169
14-Sep	157.31	163.7	169
14-Oct	157.32	165.55	170
14-Nov	166.65	176.8	182.5
Dec-14*	169.68	180.32	191.5

Figure 5.5
End-Month Exchange Rates
(July 2013-December 2014) (₦/US$)



The CBN interventions through spot and forward foreign exchange transactions at both rDAS and interbank segments continued to douse pressures on the exchange rate experienced in the second half of 2014.

5.2.3 Nominal and Real Effective Exchange Rates

The Nominal Effective Exchange Rate (NEER) appreciated by 0.73 per cent to 95.22 in the second half of 2014 from 95.92 in the first half. There was relative stability in the NEER as it also appreciated by 0.77 per cent when compared with the corresponding period of 2013. The Real Effective Exchange Rate (REER) appreciated by 3.43 per cent from 60.70 in the first half 2014 to 58.62 in the second half of 2014. When compared with the corresponding period of 2013, the average REER appreciated significantly by 19.20 per cent (Table 5.4). In general, the trend indicated that the naira appreciated minimally in nominal terms, but significantly in real terms relative to the currencies of Nigeria's major trading partners. This trend contrast with the depreciation of the naira against the US dollar, due to the effects of the bilateral exchange rate of the naira with currencies of other trading partners.

Table 5.4
Nominal and Real Effective Exchange Rates Indices (January 2013 – December 2014)

	NEER	REER
January '13	99.05	77.84
February '13	98.12	77.08
March '13	97.16	76.1
April '13	97.88	76.34
May '13	96.56	75.02
June '13	95.78	74.15
Average H1 2013	**97.43**	**76.09**
July '13	95.83	74
August '13	94.5	72.96
September '13	96.08	73.71
October '13	96.85	73.79
November '13	96.14	72.74
December '13	96.34	72.34
Average H2 2013	**95.96**	**73.26**
January '14	94.96	60.43
February '14	95.84	60.93
March '14	96.26	61.06
April '14	96.37	61.02
May '14	96.08	60.53
June '14	96.01	60.2
Average H1 2014	**95.92**	**60.7**
July '14	95.23	59.47
August '14	94.84	58.96
September '14	92.67	57.32
October '14	92.75	57.07
November '14	97.7	59.62
December '14	98.1	59.27
Average H2 2014	**95.22**	**58.62**

5.2.4 Demand and Supply of Foreign Exchange

Total demand for foreign exchange at the rDAS in the second half of 2014 rose marginally by 2.95 per cent to US$24,611.87 million at end-December 2014 from US$23,905.82 million at end-June. Compared with US$18,727.85 million in the corresponding period of 2013, it rose significantly by 31.42 per cent. This development was attributable to the effect of the tapering of QE3 and improving economic conditions in some advanced economies which encouraged net capital outflow during the period. The total supply of foreign exchange at the rDAS decreased significantly by 11.04 per cent from US$17,233.85 million in the first half of 2014 to US$15,330.85 million in the second half of the year. When compared with US$14,813.51million in the corresponding half of 2013, it decreased slightly by 3.49 per cent (Figure 5.6 and Table 5.5). Thus, during the review period, the demand-supply gap was US$9,281.02, which reflected the intensity of demand pressure in the market and the consequent depreciation of the naira exchange rate.

During the review period, the Bank continued to implement measures to moderate the demand pressure in the foreign exchange market. These measures included continued implementation of rDAS, cap on purchases by BDCs, prohibition of importation of foreign currency bills without prior CBN approval (by authorized dealers) and stringent returns requirement on forex utilization. The Bank introduced additional measures, which included the revival of the interbank foreign exchange forwards, and swaps among authorized dealers.

Figure 5.6
Demand and Supply of Foreign Exchange at rDAS

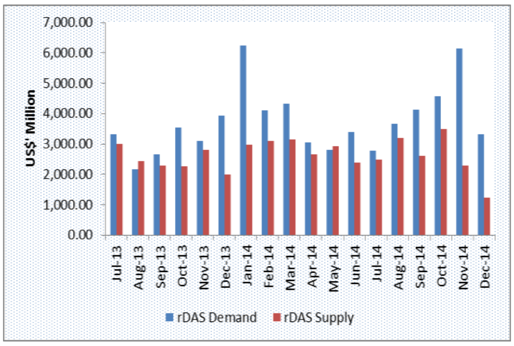


Table 5.5
Foreign Exchange Demand and Supply (January 2013 – December 2014) (US$'Million)

Date	rDAS Demand	rDAS Supply
Jul-13	3,325.56	3,000.00
Aug-13	2,179.38	2,437.08
Sep-13	2,660.13	2,297.82
Oct-13	3,541.93	2,274.38
Nov-13	3,095.32	2,796.47
Dec-13	3,925.53	2,007.76
2013: H2 Total	18,727.85	14,813.51
Jan-14	6,236.67	2,989.43
Feb-14	4,096.46	3,101.87
Mar-14	4,320.04	3,151.59
Apr-14	3,045.49	2,663.92
May-14	2,805.74	2,928.49
Jun-14	3,401.41	2,398.55
2014: H1 Total	23,905.82	17,233.85
Jul-14	2784.93	2494.76
Aug-14	3,661.36	3,201.10
Sep-14	4,132.26	2,598.45
Oct-14	4,570.64	3,498.48
Nov-14	6,148.84	2,296.93
Dec-14	3,313.84	1,241.13
2014: H2 Total	24,611.87	15,330.85

5.2.5 Foreign Exchange Flows through the CBN

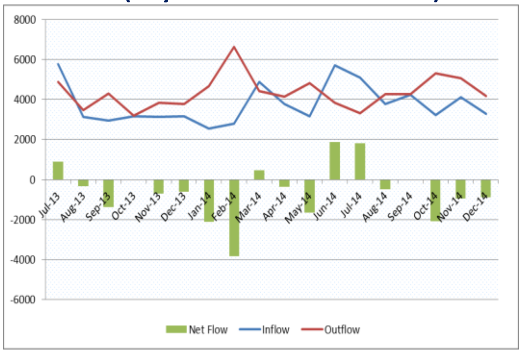
Gross foreign exchange inflows through the CBN rose by 3.67 per cent to US$23,728.32 million in the second half of 2014 from US$22,888.75 million in the first half. It rose by 11.28 per cent when compared with US$21,322.85 million in the corresponding period of 2013. On the other hand, gross foreign exchange outflows declined by 7.62 per cent to US$26,327.84 million in the second half of 2014, from US$28,501.98 million in the first half. When compared with US$ 23,456.99 in the corresponding half of 2013, it increased by 12.24 per cent.

Thus, in the review period, there was a net outflow of US$2,599.51 million, compared with the outflow of US$5,613.24 million in the first half of 2014. This development compares with the net outflow of US$2,134.04 million in the second half of 2013 (see Table 5.6 and Figure 5.7).

Table 5.6
Monthly Foreign Exchange Flows through the CBN (July 2013 – December 2014)

Date	Inflow	Outflow	Net Flow
Jul-13	5,778.32	4,891.29	887.02
Aug-13	3,132.99	3,467.97	-334.97
Sep-13	2,946.00	4,308.10	-1,362.00
Oct-13	3,175.31	3,177.75	-2.44
Nov-13	3,125.46	3,837.85	-712.39
Dec-13	3,164.77	3,774.03	-609.26
2013: H2 Total	21,322.85	23,456.99	-2,134.04
Jan-14	2,543.55	4,652.19	-2,108.65
Feb-14	2,797.57	6,612.99	-3,815.41
Mar-14	4,880.32	4,430.48	449.83
Apr-14	3,779.45	4,155.76	-376.31
May-14	3,171.28	4,819.22	-1,647.94
Jun-14	5,716.58	3,831.34	1,885.24
2014: H1 Total	22,888.75	28,501.98	-5,613.24
Jul-14	5,103.82	3,299.90	1,803.92
Aug-14	3,760.04	4,254.45	-494.41
Sep-14	4,230.38	4,250.56	-20.17
Oct-14	3,228.46	5,298.36	-2,069.90
Nov-14	4,120.82	5060.15	-939.33
Dec-14	3,284.80	4164.42	-879.62
2014: H2 Total	23,728.32	26,327.84	-2,599.51
2014: Total	46617.07	54829.82	-8212.75

Figure 5.7
Monthly Foreign Exchange Flows through the CBN (July 2013 – December 2014)



5.2.6 Foreign Exchange Flow through the Economy

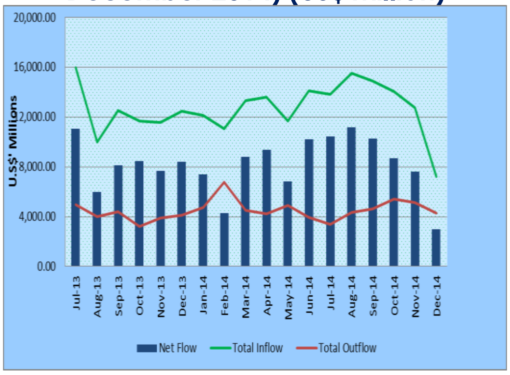
Gross foreign exchange inflow to the economy increased by 3.17 per cent to US$78,372.90 million in the second half of 2014 from US$75,966.99 million in the first half. When compared with US$74,234.57 million in the corresponding period of 2013, it rose by 5.57 per cent. Conversely, gross foreign exchange outflow declined by 6.64 per cent to US$27,161.04 million in the second half of 2014 from US$29,092.92 million in the first half. When compared with US$24,579.59 million in the second half of 2013, it rose by 10.50 per cent.

Thus, during the review period, total foreign exchange flows through the economy resulted in a net inflow of US$51,211.88 million compared with the net inflow of US$46,874.06 million in the first half of 2014 and US$49,654.99 million in the second half of 2013, representing increases of 9.25 and 3.14 per cent, respectively. The significant increase in the net inflow for the period reflected the positive impact of the new measures introduced by the Bank to mitigate the impact of capital flow reversal from the normalization of US monetary policy (Table 5.7 and Figure 5.8). Some of these measures included the decision by the MPC to move the midpoint of official exchange rate band from N155/US$ to N168/US$ and widening of the band from +/- 3.0 to +/- 5.0 per cent in the review period.

Table 5.7
Monthly Foreign Exchange Flows through the Economy
(January 2013 – December 2014) (US$ Million)

Date	Total Inflow	Inflow (CBN)	Inflow (Autonomous)	Total Outflow	Outflow (CBN)	Outflow (Autonomous)	Net Flow	Net Flow (CBN)	Net Flow (Autonomous)
Jul-13	15,980.58	5,778.32	10,202.27	4,941.04	4,891.29	49.75	11,039.54	887.02	10,152.52
Aug-13	10,007.30	3,132.99	6,874.31	4,020.74	3,467.97	552.77	5,986.57	(334.97)	6,321.54
Sep-13	12,506.90	2,946.00	9,560.80	4,397.00	4,308.10	88.90	8,109.90	(1,362.00)	9,471.90
Oct-13	11,704.37	3,175.31	8,529.07	3,236.63	3,177.75	58.89	8,467.74	(2.44)	8,470.18
Nov-13	11,549.56	3,125.46	8,424.10	3,880.79	3,837.85	42.94	7,668.77	(712.39)	8,381.16
Dec-13	12,485.86	3,164.77	9,321.09	4,103.39	3,774.03	329.36	8,382.47	(609.26)	8,991.73
2013: H2 Total	74,234.57	21,322.85	52,911.64	24,579.59	23,456.99	1,122.61	49,654.99	(2,134.04)	51,789.03
Jan-14	12,126.18	2,543.55	9,582.63	4,756.04	4,652.19	103.85	7,370.13	(2,108.65)	9,478.78
Feb-14	11,057.50	2,797.57	8,259.93	6,745.36	6,612.99	132.38	4,312.14	(3,815.41)	8,127.55
Mar-14	13,327.08	4,880.32	8,446.76	4,526.49	4,430.48	96.01	8,800.58	449.83	8,350.75
Apr-14	13,610.72	3,779.45	9,831.27	4,245.80	4,155.76	90.04	9,364.93	(376.31)	9,741.23
May-14	11,711.73	3,171.28	8,540.45	4,895.44	4,819.22	76.22	6,816.29	(1,647.94)	8,464.23
Jun-14	14,133.78	5,716.58	8,417.20	3,923.79	3,831.34	92.45	10,209.99	1,885.24	8,324.75
2014: H1 Total	75,966.99	22,888.75	53,078.24	29,092.92	28,501.98	590.95	46,874.06	(5,613.24)	52,487.29
Jul-14	13,837.28	5,103.82	8,733.47	3,377.44	3,299.90	77.54	10,459.85	1,803.92	8,655.93
Aug-14	15,536.52	3,760.04	11,776.48	4,342.52	4,254.45	88.07	11,194.01	(494.41)	11,688.42
Sep-14	14,887.17	4,230.38	10,656.78	4,606.46	4,250.56	355.90	10,280.71	(20.17)	10,300.88
Oct-14	14,086.97	3,228.46	10,858.51	5,400.97	5,298.36	102.61	8,686.00	(2,069.90)	10,755.90
Nov-14	12,781.36	4,120.82	8,660.54	5,152.69	5,060.15	92.54	7,628.67	-939.33	8,568.00
Dec-14	7,243.60	3,284.80	3,958.80	4,280.96	4,164.42	116.55	2,962.64	-879.62	3,842.25
2014: H2 Total	78,372.90	23,728.32	54,644.58	27,161.04	26,327.84	833.21	51,211.88	-2,599.51	53,811.38
2014: Total	154,339.89	46,617.07	107,722.82	56,253.96	54,829.82	1,424.16	98,085.94	-8,212.75	106,298.67

Figure 5.8
Monthly Foreign Exchange Flows through the Economy (July 2013 – December 2014) (US$ Million)



5.3 Capital Market

The performance of the capital market declined in the second half of 2014. This development was due largely to external factors such as the recovery in some developed economies and the effects of QE3 tapering. Several macroeconomic developments also contributed to the decline in market performance, including: (i) fall in crude oil prices and associated pressure on the naira; (ii) depreciation of the exchange rate; (iii) continued insurgency in the North-Eastern part of the country; (iv) uncertainty around the upcoming 2015 elections; and (v) weak corporate earnings. The level of uncertainty in the Nigerian capital market in the second half of 2014 led investors to adopt a 'flight to safety' strategy.

5.3.1 Equities Market

The All-Share Index (ASI) decreased by 18.42 per cent to 34,657.15 at end-December 2014, from its level of 42,482.48 at end-June 2014, and by 16.14 per cent, when compared with 41,329.19 recorded at end-December 2013. Market Capitalization (MC) of equities also decreased by 18.18 per cent to ₦11.48 trillion at end-December 2014 from ₦14.03 trillion at end-June 2014, and by 13.22 per cent when compared with the ₦13.23 trillion recorded at end- December 2013 (Table 4.8 and Figure 4.9).

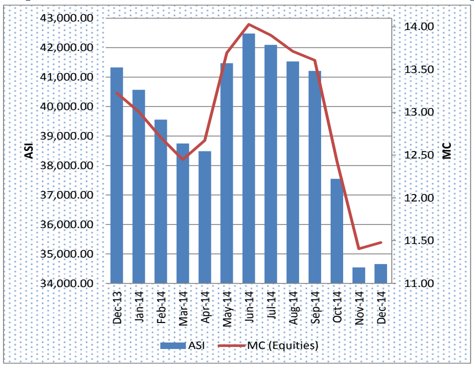
The ASI's 16.14 per cent year-on-year decrease was driven mainly by weak performance in the Banking, Consumer Goods and Insurance sectors which declined by 21.53, 17.88 and 2.11 per cent, respectively, over their levels at end-December 2013. The NSE Oil and Gas index, however, grew by 11.84 per cent.

Table 5.8
NSE All-Share Index (ASI) and Market Capitalization (MC)
(December 2013 – December 2014)

Date	ASI	MC (Equities) (N' Trillion)
Dec-13	41,329.19	13.23
Jan-14	40,571.62	13.01
Feb-14	39,558.89	12.71
Mar-14	38,748.01	12.45
Apr-14	38,485.48	12.67
May-14	41,474.40	13.69
Jun-14	42,482.48	14.03
Jul-14	42,097.46	13.90
Aug-14	41,532.31	13.71
Sep-14	41,210.10	13.61
Oct-14	37,550.24	12.44
Nov-14	34,543.05	11.40
Dec-14	34,657.15	11.48

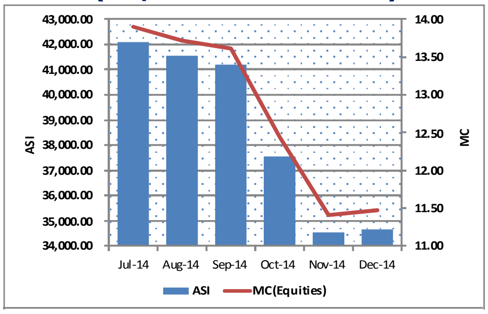
Source: NSE

Figure 5.9
NSE ASI and MC
(December 2013 – December 2014)



Source: NSE

Figure 5.10
NSE ASI and MC
(July – December 2014)



Source: NSE

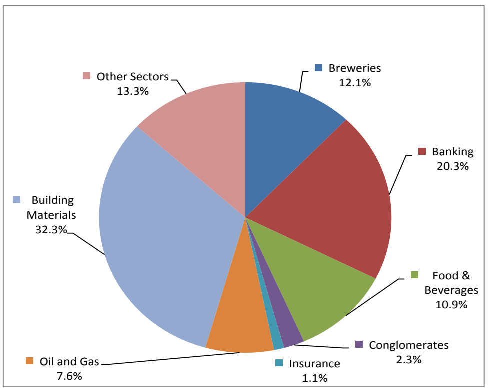
5.3.2 Market Turnover

Aggregate stock market turnover in the second half of 2014 increased by 5.55 per cent to 55.69 billion shares, valued at ₦758.24 billion, in 591,755 deals, compared with 52.76 billion shares valued at ₦579.69 billion, in 623,155 deals in the first half of 2014. Relative to the second half of 2013, market turnover however, decreased by 47.73 per cent from 106.54 billion shares valued at ₦1,043.31 billion, in 1,380,789 deals. This development can be attributed to the rapid outflow of Foreign Portfolio Investment (FPI) due to heightened sovereign risk by investors and the flight to quality, following the normalization of US monetary policy. Consequently, foreign portfolio investment outflows exceeded inflows by 22 per cent in 2014.

5.3.3 Sectoral Contribution to Equities Market Capitalization

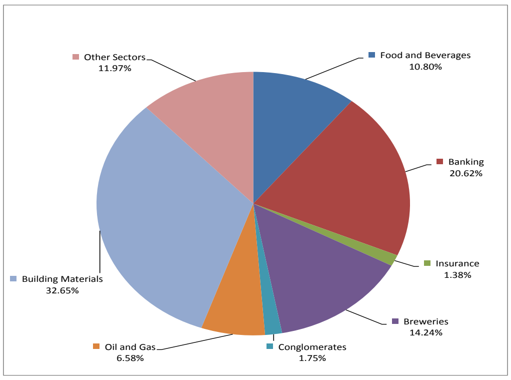
The building materials sub-sector had the highest valuation thus making the construction sector the most capitalized. Its share in overall market capitalization rose to 32.7 per cent at end-December 2014 from 32.3 per cent in the first half of 2014. Other leading sub-sectors were banking, breweries, and food & beverages, with respective market shares of 20.62, 14.24 and 10.80 per cent, at end-December 2014 (Figure 4.12).

Figure 5.11
NSE Market Capitalisation by Sector as at End-June 2014



Source: NSE

Figure 5.12
NSE Market Capitalisation by Sector as at End-December 2014



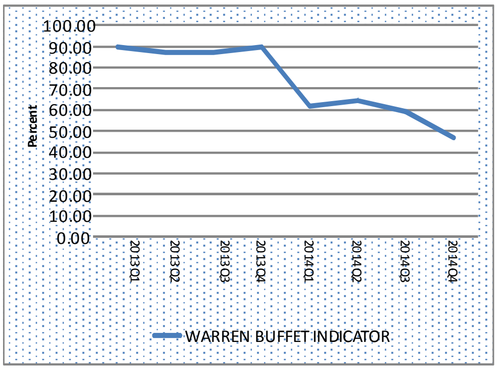
Source: NSE

5.3.4 Warren Buffett Valuation Metric and Nigeria's Equities Market

The Warren Buffett valuation approach of using the market value of publicly traded securities as a percentage of GDP was applied to evaluate the appropriateness of the price of Nigerian equities to guard against incidence of any bubble in the stock market during the review period. With the trend of 53.0 per cent in the first quarter and 47.0 per cent in the fourth quarter of 2014, the Nigerian stock market was undervalued as it was below the threshold of 75.0 to 115.0 per cent for appropriate valuation.

Despite the undervaluation of the market during the review period, investors adopted a cautious approach due to uncertainties surrounding the 2015 general elections, winding down of quantitative easing in the US, and falling oil prices leading to low accretion to reserves, all of which combined to increase sovereign risk.

Figure 5.13
Warren Buffet Valuation of Nigerian Equities Market



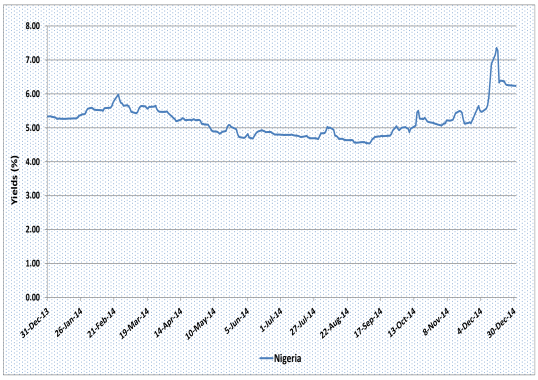
5.3.5 Bond Market

The Federal Government of Nigeria (FGN) bonds continued to dominate the fixed income securities market in Nigeria. Sub-national government and corporate bonds witnessed some activities, with the corporate bonds segment having the least share by market volume. During the review period, two new issues totaling ₦193.54 billion were made: 20-year FGN bond valued at ₦178.00 billion and 10-year corporate bond valued at ₦15.54 billion.

5.3.5.1 FGN Eurobond

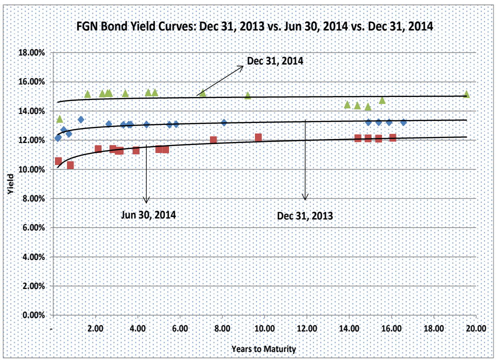
The yield on the 10-year dollar-denominated bond increased to 6.23 per cent at end-December 2014, from 4.80 and 5.33 per cent at end-June 2014 and end- December 2013, respectively (Figure 5.14). This development was attributed to investor preference for higher premium to compensate for perceived higher sovereign risk.

Figure 5.14
10-Year U.S. Dollar-denominated Bond Yield for Nigeria (December 31, 2013 – December 31, 2014)



Thus, the FGN bond yield curve at end-December 2014 trended upwards by 337 basis points, compared with the position at end-June 2014, and 192 basis points compared with the position at end-December 2013 (Figure 5.15). At this level, FGN bond yields were positive and well above the December 2013 – December 2014 rates of inflation, reflecting the sustained tight monetary policy stance of the Bank.

Figure 5.15
FGN Bonds Yield Curves: end-December 2013 vs. end-June. 2014 vs. end-December 2014



5.3.5.2 State/Local Government Bonds

Activity in the sub-national bonds market segment was low as no new bond was issued during the review period. The total value of outstanding state/local governments bonds at end-December 2014 was ₦524.67 billion compared with ₦528.87 billion at end-June 2014 and ₦558.50 billion at end-December 2013.

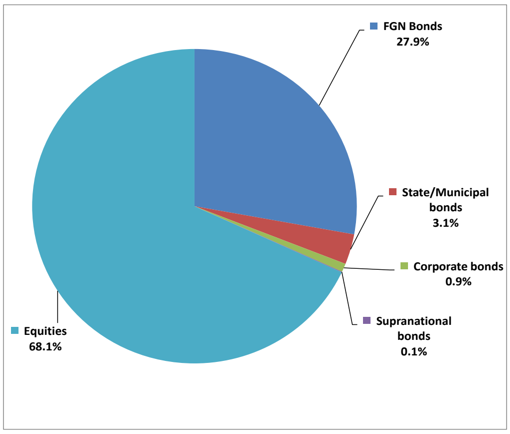
5.3.5.3 Corporate Bonds

At end-December 2014, the value of outstanding corporate bonds was ₦144.96 billion, compared with ₦169.90 billion at end-June 2014 and N139 billion at end-December 2013. One new 10-year bond valued at ₦15.54 billion was issued by Stanbic IBTC Plc., on September 30, 2014. The general slowdown of activities in the corporate segment of the bond market was due to investor preference for other asset classes in the review period in the face of perceived sovereign risk.

5.3.5.4 Overall Analysis of Fixed Income Securities

The value of FGN bonds increased by 8.21 per cent to ₦4.70 trillion at end-December 2014 from ₦4.35 trillion at end-June 2014 and by 18.46 per cent over the level at end-December 2013. FGN bonds accounted for 27.9 per cent of aggregate market capitalization as at end-December 2014. Also, the value of state/municipal bonds and corporate bonds closed at ₦524.67 billion and ₦144.96 billion, accounting for 3.1 and 0.9 per cent of the aggregate market capitalization, respectively. The value of supranational bonds remained at ₦12.00 billion, accounting for 0.1 per cent of aggregate market capitalization. The equity market accounted for 68.1 per cent of aggregate market capitalization as at end-December 2014, while the combined shares of FGN bonds, state/municipal bonds, corporate bonds and supranational bonds accounted for the remaining 31.9 per cent (Figure 5.16).

Figure 5.16
Structure of the Nigerian Capital Market (December, 2014)



5.4 Global Financial Market Developments

The global financial market was relatively stable in the review period, with performance differing across regions. Japan's expansion of its quantitative and qualitative monetary easing in the fourth quarter of 2014 also improved the liquidity conditions in the stock and fixed income markets.

Following the exit of the US from QE in the last quarter of 2014, there was increased demand for dollar-denominated assets, reflected in a sharp appreciation of the dollar and massive sell-offs in most emerging and developing economies. The euro area continued to be plagued by widespread fragmentation of financial markets along national borders, indicating weak credit conditions.

5.4.1 Money Market and Central Banks Policy Rates

Liquidity conditions in the global financial market remained a source of concern as the US Federal Reserve Bank terminated its QE3 programme in October 2014. At about the same period, the continued weakening of the Euro area economy prompted the European Central Bank (ECB) to initiate plans for a round of quantitative easing commencing in February 2015. The programme would involve a monthly injection of 60 billion euro over an 18-month period and possibly beyond as determined by market conditions. These developments, coupled with continued monetary easing by Japan had implications for liquidity conditions in the global economy. Accordingly, policy rates in the advanced economies remained largely accommodating as they were kept unchanged during the review period.

In emerging and developing markets, financial conditions tightened in response to developments in advanced economies. The central banks of Ghana, Russia, Brazil, and Nigeria raised their policy rates between July and December 2014, owing to inflationary concerns, pressure on the foreign exchange market, and the effect of the normalization of US monetary policy.

Table 5.9

Policy Rates of Selected Countries July-December 2014

COUNTRY/ MONTH	JULY	AUGUST	SEPTEMBER	OCTOBER	NOVEMBER	DECEMBER
USA	0.25	0.25	0.25	0.25	0.25	0.25
UK	0.5	0.5	0.5	0.5	0.5	0.5
EU	0.15	0.15	0.15	0.05	0.05	0.05
JAPAN	0-0.10	0-0.11	0-0.10	0-0.10	0-0.10	0-0.10
S. AFRICA	5.5	5.5	5.5	5.5	5.75	5.75
KENYA	8.5	8.5	8.5	8.5	8.5	8.5
GHANA	19	19	19	19	21	21
RUSSIA	8.25	8.25	8.25	8.25	8.25	8.25
CHINA	6	6	6	6	5.6	5.6
INDIA	8	8	8	8	8	8
BRAZIL	11	11	11	11	11.25	11.25
NIGERIA	12	12	12	12	13	13

5.4.2 Capital Market

The major world stock indices performed poorly during the review period. In Europe, all major indices decreased by 2.6, 3.4, 0.3 and 5.4 per cent for the UK FTSE 100, France CAC 40, German DAX and Russian MICEX, respectively. In North America, the S&P 500 and Mexican Bolsa increased by 5.0 and 1.0 per cent between June and December 2014, respectively, although the Canadian S&P/TSX Composite decreased by 3.4 per cent.

The Asian market was, however, on the bullish trajectory, with all major indices rising during the period under review. The Japanese Nikkei, the Chinese Shanghai SE A and the Indian BSE Sensex rose sharply by 15.1, 58.0 and 8.2 per cent between June and December 2014.

In Africa, the Nigerian ASI, South African JSE All Share Index and Ghana GSE All Share Index declined by 18.4, 2.3 and 4.7 per cent, respectively, while Egypt EGX Case 30 and Kenya NSE 20 increased by 9.4 and 4.7 per cent. The relatively poor performance of African markets was due to pressure from capital reversals, caused by the normalisation of the US monetary policy. In addition, the capital markets of oil exporting countries were affected by the recent fall in oil prices.

Table 5.10
Selected International Stock Market Indices
as at December 31, 2014

Country	Index	End-Dec, 2013	End-Jun, 2014	End-Dec, 2014	% Change Jun 14 - Dec 14	% Change Dec 13 - Dec 14
AFRICA						
Nigeria	ASI	41,329.10	42,482.48	34,657.15	-18.4	-16.1
South Africa	JSE African AS	46,256.23	50,945.26	49,770.60	-2.3	7.6
Kenya	Nairobi NSE 20	4,926.97	4,885.04	5,112.65	4.7	3.8
Egypt	EGX CSE 30	6,782.84	8,162.20	8,926.58	9.4	31.6
Ghana	GSE All Share	2,145.20	2,373.38	2,261.02	-4.7	5.4
NORTH AMERICA						
US	S&P 500	1,848.36	1,960.23	2,058.90	5.0	11.4
Canada	S&P/TSX Composite	13,621.55	15,146.01	14,632.44	-3.4	7.4
Mexico	Mexico Bolsa (IPC)	42,727.09	42,737.17	43,145.66	1.0	1.0
SOUTH AMERICA						
Brazil	Bovespa Stock	51,507.16	53,168.22	50,007.41	-5.9	-2.9
Argentina	Merval	4,275.98	6,537.61	7,830.30	19.8	83.1
Colombia	COLCAP	1,606.33	1,705.99	1,512.98	-11.3	-5.8
EUROPE						
UK	FTSE 100	6,749.09	6,743.94	6,566.09	-2.6	-2.7
France	CAC 40	4,295.95	4,422.84	4,272.75	-3.4	-0.5
Germany	DAX	9,552.16	9,833.07	9,805.55	-0.3	2.7
Russia	MICEX	1,503.39	1,476.38	1,396.61	-5.4	-7.1
ASIA						
Japan	NIKKEI 225	16,291.13	15,162.10	17,450.77	15.1	7.1
China	Shanghai SE A	2,214.49	2,144.74	3,389.39	58.0	53.1
India	BSE Sensex	21,170.68	25,413.78	27,499.42	8.2	29.9

Source: Bloomberg

5.4.3 Commodities

Global commodity prices remained weak in the second half of 2014, as indicated by the S&P Goldman-Sachs Commodity index (GSCI), with accelerated decline in the last quarter of the year. The energy component of the index was down by 42 per cent as at end-December 2014, with crude oil accounting for the largest share of the decline.

The Food and Agriculture Organization (FAO) Food Price Index declined by 11.06 per cent from 208.9 in June to 185.8 in December 2014. The sub-indices of meat, sugar, dairy, cereal, and vegetable oil all declined during the review period.

The prices of industrial metals were also affected by weak economic conditions. Copper was down by 13.0 per cent in 2014, largely due to slowdown in the Chinese economy. Similarly, the price of silver fell by 19.0 per cent in the same period. This development was due to the cut back on construction and infrastructure spending, weakening the demand for base metal around the world.

In addition, a major reason for the softening of commodity prices was the recent appreciation of the U.S. dollar during the period. In many countries, a rising dollar makes dollar-denominated commodities more expensive in local-currency terms, thereby weakening global demand and prices.

However, prices of some commodities were bullish during the period. Coffee prices trended upwards, with the Coffee Index posting a 44 per cent rise in 2014, owing to a drought in the key growing regions of Brazil. Overall, the attractiveness of other asset classes and the appreciation of the U.S. dollar weakened investment in commodities.

5.4.4 Foreign Exchange market

Most currencies around the world depreciated against the US dollar in the review period, owing to continued investor appetite for dollar-denominated assets, the end of the US QE3 tapering, leading to capital flow reversals, and declining commodity prices. In the advanced economies, the Japanese yen, the euro, the British pound and the Canadian dollar depreciated by 15.40, 12.05, 9.38, and 7.76 per cent, respectively.

In the emerging and developing markets, the Russian ruble recorded the highest depreciation of 44.06 per cent in the review period. Other emerging market currencies depreciated with the Brazilian real, Indian rupee, South African rand and Chinese yuan losing 16.92, 4.52, 8.04 and 0.16 per cent, respectively. The Colombian Peso, Nigerian Naira, Argentine Peso and Kenyan Shilling depreciated by 21.00, 7.31, 4.01 and 3.31 per cent, respectively. On the other hand, the Ghanaian Cedi appreciated by 3.73 per cent, while on a year-to-date basis, it lost 26.1 per cent of its value. The Egyptian Pound remained stable in the review period.

Table 5.11
Exchange Rates of Selected Countries
(Value in currency units toUS$)

	Currency	31-Dec-13	30-Jun-14	31-Dec-14	Jun 30 - Dec 31, 2014 %App/Dep	YTD % App/Dep
AFRICA		a	c	d		
Nigeria	Naira	157.27	157.29	169.68	-7.30	-7.31
South Africa	Rand	10.52	10.64	11.57	-8.04	-9.08
Kenya	Shilling	86.30	87.60	90.60	-3.31	-4.75
Egypt	Pound	6.95	7.15	7.15	0.00	-2.80
Ghana	Cedi	2.38	3.34	3.22	3.73	-26.09
NORTH AMERICA						
Canada	Dollar	1.06	1.07	1.16	-7.76	-8.62
Mexico	Peso	13.10	12.97	14.75	-12.07	-11.19
SOUTH AMERICA						
Brazil	Real	2.36	2.21	2.66	-16.92	-11.28
Argentina	Peso	6.52	8.13	8.47	-4.01	-23.02
Colombia	Peso	1929.51	1877.44	2376.51	-21.00	-18.81
EUROPE						
UK	Pound	0.60	0.58	0.64	-9.38	-6.25
Euro Area	Euro	0.73	0.73	0.83	-12.05	-12.05
Russia	Ruble	32.87	33.98	60.74	-44.06	-45.88
ASIA						
Japan	Yen	105.26	101.33	119.78	-15.40	-12.12
China	Yuan	6.05	6.20	6.21	-0.16	-2.58
India	Rupee	61.80	60.19	63.04	-4.52	-1.97
Source: bloomberg						

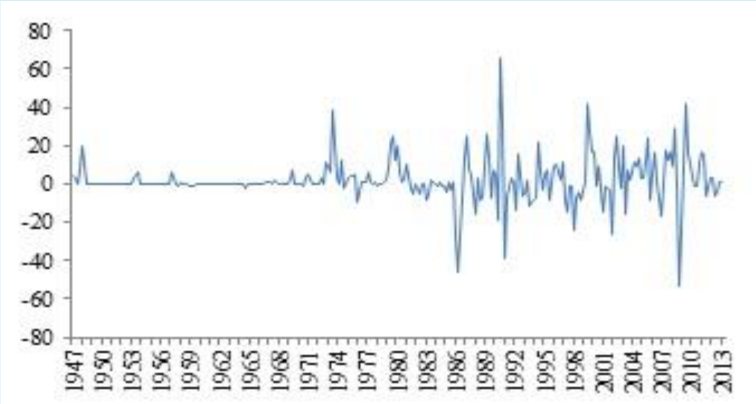
Source: CBN/ Bloomberg

Box 5.0: Oil Price Volatility

Crude oil is unarguably one of the most important driving forces of the global economy, and changes in its price have had significant effects on economic growth and welfare around the world. Historically, oil prices have displayed greater volatility than other commodity prices, with substantial financial and macroeconomic implications.

The oil market was stable until the 1970s and 1980s when political instability in the Middle East disrupted production and supply with severe effect on global oil prices. Since then, oil price shocks due to exogenous forces have increased in size and frequency (Figure 1). Oil demand tends to increase slowly, largely driven by weather, industrialization and economic growth, while future supply prospects are becoming more uncertain, considering the persistent political tensions in oil-producing countries and the issues surrounding the discovery of new oil reserves. With such developments, oil prices could undergo further fluctuations in the medium term.

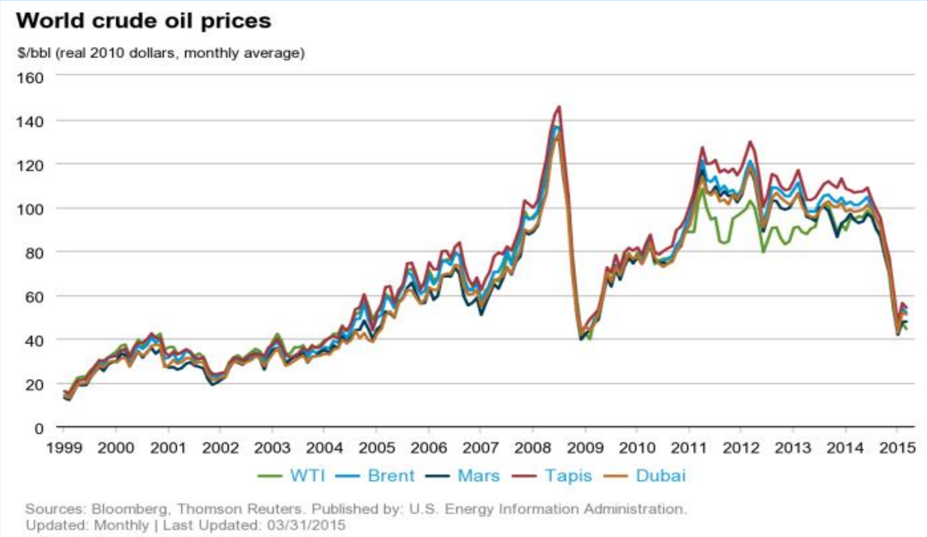
Figure 1: Percentage changes of the quarterly price of crude oil



Source: Thomson Reuters

Prices of most crude globally tend to move together and as shown in figure 2, the prices of all crude streams, including low and high sulfur grades, declined remarkably in 2014.

Figure 2: Trend in Major Crude Oil Prices



While a given oil price decrease may be perceived negatively by oil exporting countries and positively by importers, an increase in oil price volatility (i.e. consecutive positive and negative oil price shocks) increases perceived price uncertainty in the market. Such oil price volatility disrupts planning by governments and investors, cause firms to postpone investments, and may require costly reallocation of resources. Formulating and implementing national budgets become more difficult, as exporting countries face volatile revenues, and importing countries face uncertainty regarding import costs and fuel subsidies. This is usually a profound problem in an oil dependent country like Nigeria, which relies on oil exports as the main source of foreign earnings and public revenue.

Oil prices dropped sharply in the second half of 2014 with the price of Bonny Light (37^{0}API), Nigeria's reference crude, falling significantly from an average of US$108.59 p/b in June to US$56.06 p/b in December 2014. This drop was caused largely by increased supply from non-OPEC sources, particularly the US, where 0.9 million barrels per day (about 1 per cent of global supply) was produced using shale oil technology, OPEC's decision to maintain its production level and decreased oil demand reflecting weaker global economic growth. This development had adverse consequences of revenue shortfalls for oil exporting economies like Nigeria. The private sector is affected through the reduction in earnings of oil companies, constraining their ability to finance investments in exploration and new technology. In an economy where commercial banks are heavily exposed to the oil industry, fall in crude oil prices increases the risk of a build-up in non-performing loans with adverse implications for financial system stability. Measures used in the market to mitigate the effects of oil price volatility are based on hedging, using futures, options and swaps. A number of emerging and developing market economies responded swiftly to the perceived vulnerabilities and associated exchange rate risks from falling oil prices by raising policy rates to curtail possible outflow of capital.

CHAPTER 6

ECONOMIC OUTLOOK

CHAPTER 6

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6.1 Overview

Global economic growth stabilized at 3.3 per cent in 2014, driven largely by recoveries in the US and the UK as well as lower oil prices. The global output growth was projected to be positive in 2015, with the improved outlook expected mainly from high income countries, notably the US and the Euro Area, as a result of higher pass-through of the falling oil prices to consumers. The inflation outlook indicates a slight uptick in the United States, and is likely to remain subdued in other advanced economies as well as in emerging and developing economies, due largely to the decline in commodity prices.

The global economy grew by 3.75 per cent in the third quarter of 2014, up from 3.25 per cent in the second quarter. The IMF World Economic Outlook (WEO, January 2015) estimated global growth in 2014 at 3.3 per cent, same as in 2013. The Fund also projected global growth in 2015 and 2016 at 3.5 and 3.7 per cent, respectively, reflecting downward revisions of 0.3 percentage point relative to the October 2014 projections. The revisions were based on the IMF re-assessment of prospects in China, Russia, the Euro Area, and Japan, and weaker economic activities in selected major oil exporting countries due to the sharp drop in oil prices.

Global growth in 2014 was enhanced by recovery in the US and the UK, while the performance of other major economies, especially Japan, fell short of expectation, due to the protracted adjustment to weakening medium-term growth prospects. Growth was further boosted by lower oil prices from higher supply, due to increased shale oil production.

In the advanced economies, growth was projected at 1.8 per cent in 2014 up from 1.3 per cent in 2013. Growth in the United States was estimated at 2.4 per cent in 2014, up from 2.2 per cent in 2013 despite the contraction experienced in the first quarter of 2014. The Euro area economy was estimated to grow at 0.8 per cent in 2014 from a decline of 0.5 per cent in 2013. Activities in the Euro Area were boosted by lower oil prices, further monetary easing, a more neutral fiscal policy stance, as well as depreciation of the euro. These factors were, however, offset by weaker investment prospects and threat of deflation in the region.

In the Emerging Market and Developing Economies, growth was projected to slow to 4.4 per cent in 2014 from 4.7 per cent in 2013. The slowdown reflected weakness in China, weaker outlook in Russia, and downward revisions to growth in commodity exporting countries.

Growth in China declined to 7.4 per cent in 2014 from 7.8 per cent in 2013, while leading economic indicators point to a further slowdown. In Russia, the sharp decline in oil prices, the depreciation of the ruble as well as unrelenting geopolitical tensions weakened economic activity during the review period. The slowdown of the Russian economy to 0.6 per cent in 2014 from 1.3 per cent in 2013 affected the performance of other economies in the Commonwealth of Independent States (CIS).

In Sub-Saharan Africa (SSA), growth was estimated at 4.8 per cent in 2014 down from 5.2 per cent in 2013 with lower oil and commodity prices accounting for the weaker performance in the region. In South Africa, growth slowed to 1.4 per cent in 2014 from 2.2 per cent in 2013, due to the impact of labour unrest and energy challenges. However, growth continued to be strong in Nigeria, owing to the relatively robust non-oil sector, despite security challenges in the North-Eastern part of the country. The Nigerian economy grew by 6.22 per cent in 2014, up from 5.50 per cent in 2013.

6.2 Outlook for Global Output

Developments in the global economy had conflicting implications for growth forecast. The decline in oil prices underlined largely by supply factors, which is expected to reverse only gradually, could boost global growth in the medium term by lifting purchasing power and private demand in oil importing countries. The impact of fall in oil prices is forecast to be stronger in advanced oil importing economies, where the pass-through to end-user prices is expected to be significant relative to the emerging market and oil importing developing countries, where energy prices are usually subsidized by governments.

Global economic growth was forecast to rise to 3.5 per cent in 2015 and 3.7 per cent in 2016 from an annual rate of 3.3 per cent in 2014. The IMF projected annual growth of 2.4 per cent in 2015 for the advanced economies. Growth in the emerging markets and developing economies (EMDEs) was also projected at 4.3 per cent, while that of Sub-Saharan Africa was 4.9 per cent (Table 6.1). The improved growth outlook is expected mainly from high income countries, notably the US and the Euro Area, as a result of higher pass-through of the falling oil prices to consumers.

In the US, growth is expected to rise to 3.6 per cent in 2015 and moderate to 3.3 per cent in 2016. In the Euro Area, the projections for 2015 and 2016 are 1.2 and 1.4 per cent, respectively. Growth would continue to be bumpy in the region, with subdued outlook in the high-debt countries. The forecast for the United Kingdom is comparatively robust at 2.7 and 2.4 per cent in 2015 and 2016, respectively. Growth forecast for

Japan is 0.6 and 0.8 per cent in 2015 and 2016 respectively, in spite of the country's recession in the third quarter of 2014. The improved outlook is expected to be underpinned by the additional quantitative easing, delay in the second consumption tax increase, yen depreciation and a boost from falling oil prices.

In the EMDEs, growth is forecast at 4.3 and 4.7 per cent in 2015 and 2016, respectively. Growth in China is forecast to moderate to 6.8 per cent in 2015, as the government is focused on reducing vulnerabilities arising from rapid credit and investment growth. Slower growth in China is expected to have implications for much of emerging Asia. Brazil is forecast to grow by 0.3 per cent in 2015, owing to tighter financial conditions and continued weakness in business and consumer confidence.

In Sub-Saharan Africa, growth is projected at 4.9 and 5.2 per cent in 2015 and 2016, respectively, due largely to the expected recovery of oil prices and efforts to end the Ebola Virus Disease (EVD). Growth in South Africa is projected at 2.1 per cent in 2015.

Growth in the Middle East and North Africa (MENA) region is projected to trend upwards to 3.3 and 3.9 per cent in 2015 and 2016, respectively. This would be led by the oil-exporting economies in the region, where high public spending is expected to boost non-oil activities.

6.3 Downside Risks to Global Outlook

Future oil price uncertainties, along with the drivers of the current price downturns, are the major risks to the global economic outlook. The impact of falling oil prices on global demand could be greater than is currently envisaged, especially in the advanced economies. Oil prices could, however, go lower or rebound earlier than expected, if supply-side reaction to falling prices is stronger than projected.

In the global financial markets, risks could arise from monetary policy normalization in the U.S. This could offset global recovery to a large extent, while exposing emerging and developing market economies to major shocks from capital flow reversals. Already, the plunge in oil prices has been accompanied by reversals in capital flows in some oil exporting countries, as external and balance sheet vulnerabilities intensify, while oil importing countries gained buffers. This development will continue to pose threats to exchange rate management in oil exporting countries, further accentuating their monetary policy vulnerabilities.

In the Euro area, the risk of deflation remains elevated as prices continue to fall, and conventional monetary policy tools appear largely ineffective. Growth in emerging market economies continues to be fairly stable, although still exposed to risks arising from domestic and external weaknesses, which could worsen their financial conditions.

In sub-Saharan Africa, the plunge in oil prices could also have mixed implications. As oil exporting countries continue to struggle with dwindling reserves and exchange rate pressures, oil importing countries are expected to gain buffers.

To overcome the downside risks, the IMF recommends structural reforms in both the advanced and emerging economies. In the advanced economies, with output gap still substantial and inflation below official target, monetary policy should remain accommodative through other means to support growth. Emerging markets, on the other hand, should strive to increase macroeconomic policy space for inclusive growth.

A further consideration would be for the oil exporting countries, without substantial savings, to allow for significant exchange rate depreciation to cushion the impact of the oil price shock to their economies. Overall, the situation presents a unique opportunity for both oil importing and exporting countries to implement appropriate energy subsidies and tax reforms.

Table 6.1
Global Output and Inflation Outlook

	2013	2014	2015	2016
A. World Output				
World Output	**3.3**	**3.3**	**3.5**	**3.7**
Advanced Economies	**1.3**	**1.8**	**2.4**	**2.4**
USA	2.2	2.4	3.6	3.3
Euro Area	-0.5	0.8	1.2	1.4
Japan	1.6	0.1	0.6	0.8
UK	1.7	2.6	2.7	2.4
Canada	2.0	2.4	2.3	2.1
Other Advanced Economies	2.2	2.8	3.0	3.2
Emerging & Developing Economies	**4.7**	**4.4**	**4.3**	**4.7**
Commonwealth of Independent States	2.2	0.9	-1.4	0.8
Latin America and the Caribbean	2.8	1.2	1.3	2.3
Middle East and North Africa	2.2	2.8	3.3	3.9
Sub-Saharan Africa	5.2	4.8	4.9	5.2
B. Commodity Prices (US' Dollars)				
Oil	-0.9	-7.5	-41.1	12.6
Non-fuel	-1.2	-4.0	-9.3	-0.7
C. Consumer Prices				
Advanced Economies	1.4	1.4	1.0	1.5
Emerging & Developing Economies	5.9	5.4	5.7	5.4

Source: IMF WEO Update, January 2015

6.4 Outlook for Domestic Output Growth

Nigeria's real GDP declined by 0.3 percentage point to 5.94 per cent year-on-year in the fourth quarter of 2014, compared with 6.23 per cent in the third quarter. The impact of softer global oil prices as well as significant reduction in the nation's oil production contributed to the slower output growth during the last quarter.

GDP growth in 2015 has been projected downwards to 5.5 per cent from 6.2 per cent in 2014 on the back of lower oil price benchmark of US$65 p/b (later revised downwards to US$53 p/b) and oil production of 2.28 mbpd (FGN 2015 Budget), compared with US$77.50 p/b and 2.39 mbd respectively, in 2014. The downward growth forecast is conservative, when compared with the 7.3 per cent estimated by the IMF (WEO, October 2014) which has however, been reviewed downward to 4.8 per cent (WEO, January 2015). With the declining oil prices and production challenges in the oil sector, achieving the growth projection requires greater coordination of fiscal and monetary policies. Improvement in growth outlook is largely hinged on a sustained implementation of the on-going economic reforms and support from various macroeconomic policies. In particular, the implementation of the power sector reform as well as accompanying investments in the sector, are expected to improve power generation and supply and boost output growth.

The risks to the growth outlook are developments in the external environment, particularly the decline in oil prices with negative implications for fiscal sustainability, and security concerns in the North East as well as uncertainties surrounding the 2015 general elections.

6.5 Global Inflation Outlook

Global inflation remained largely subdued. The average global inflation rate is projected to stay close to 3.00 per cent, same as observed in the last two years. Trends at the regional levels may vary, ranging from deflation risks in the Euro area to high inflation in some developing countries.

In the United States, inflation is forecast to rise marginally to 1.8 per cent in 2015 from 1.7 per cent in 2014. The Euro area inflation is projected to increase gradually to 0.9 per cent in 2015 and 1.2 per cent in 2016 as recovery strengthens and output gaps decline. Notwithstanding, price pressures are expected to remain largely subdued due to a combination of persistent output gaps, weak credit conditions, and financial fragmentation in distressed economies. With the foregoing, Euro Area inflation rates would remain substantially below the ECB's price stability target of 2.0 per cent through to 2019. Inflation in Japan is projected to fall to 2.0 per cent in 2015 from 2.7 per cent in 2014, reflecting the waning effect of the consumption tax increase in 2014.

In the emerging and developing economies, inflation is projected to rise to 5.6 per cent in 2015 from 5.5 per cent in 2014. The marginal increase in inflation may be due to the effect of pass-through of recent exchange rate depreciation to domestic prices.

China's inflation rate is forecast to inch upwards to 2.5 per cent in 2015 from 2.3 per cent in 2014. On the other hand, consumer prices in India are forecast to decline to 7.5 per cent in 2015 from 7.8 per cent in 2014.

In Sub-Saharan Africa (SSA) inflation is forecast to rise to 7.0 per cent in 2015 up from 6.7 per cent in 2014. The forecast for South Africa is 5.8 per cent for 2015 down from 6.3 per cent in 2014, while that of Ghana is 16.8 per cent from 15.7 per cent over the same period.

6.6 Outlook for Domestic Inflation

Headline inflation (year-on-year) remained in single digit, declining to 8.0 per cent in December 2014 from 8.5 and 8.3 per cent in August and September, respectively, indicating the effectiveness of sustained tight monetary policy stance.

Staff estimates indicate that inflation is expected to rise gradually, and remain within single digits in the first half of 2015 (Table 6.2 and Figure 6.1). The moderate increase in inflation rate would be due to the liquidity impact of the 2015 election spending; depreciation of the naira and its pass-through to consumer prices; and continued disruption of supply and distribution chains by insurgency in some parts of the country. Other factors expected to raise food inflation rate include food scarcity due to the commencement of the planting season, and the expected increase in electricity tariff.

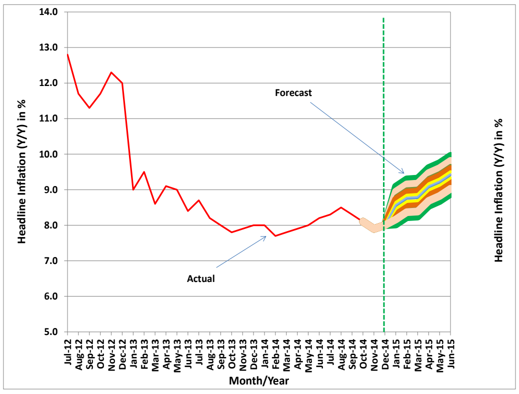
On the other hand, receding global inflation, especially in the advanced economies as well as reduction in the pump price of refined fuels is expected to cushion the impact of import costs on domestic prices. Also, the continued tight monetary policy stance of the Bank could minimize the downside risk posed by inflation to growth.

Table 6.2
Inflation Forecast (staff estimates)

YEAR-ON-YEAR INFLATION RATE

Status	Month	Headline inflation	Food inflation	Core inflation
Actual	Jul-14	8.3	9.9	7.1
	Aug-14	8.5	10.0	6.3
	Sep-14	8.3	9.7	6.3
	Oct-14	8.1	9.3	6.3
	Nov-14	7.9	9.1	6.3
	Dec-14	8.0	9.2	6.2
Forecast	Jan-15	8.6	9.6	7.2
	Feb-15	8.8	10.1	7.5
	Mar-15	8.8	9.9	7.9
	Apr-15	9.1	10.0	8.3
	May-15	9.2	10.3	8.4
	Jun-15	9.4	10.6	8.4
	Jul-15	9.5	10.6	9.2
	Aug-15	9.9	10.9	9.6
	Sep-15	10.2	11.3	9.6
	Oct-15	10.6	11.9	9.8
	Nov-15	11.0	12.3	10.0
	Dec-15	10.8	12.1	9.8

Figure 6.1
Inflation Fan chart



6.7 Outlook for Monetary Policy In 2015

The outcome of monetary policy largely depends on the domestic economic environment and the institutional framework. Achieving stable prices in 2015 would require the monetary authority to adopt a policy stance that promptly reacts to developments in economic and financial conditions. The Nigerian monetary policy environment has become challenging, following the recent fall in crude oil prices, capital flow reversals from the normalization of the US monetary policy, 2015 general election spending and security concerns. In particular, oil price shocks continue to exert pressure on the country's balance of payments (BoP), fiscal operations, accretion to external reserves and the general price level. Appropriate monetary and fiscal policies are, therefore, required to mitigate the effects of the macroeconomic shocks.

The immediate challenges to monetary policy implementation in 2015 would include exchange rate volatility, induced by demand pressure and speculative attack in the foreign exchange market; dwindling oil revenues, impacting on government finances and accretion to reserves; capital flow reversals; declining stock market performance; and sluggish growth in private sector credit.

The prevailing excess liquidity in the banking system despite high interest rates in the economy, continue to constrain the potency of monetary policy. The result is that the flow of credit to the real sector is undermined. Therefore, monetary policy should adopt measures to lower lending rates and encourage financial intermediation. Accordingly, the Bank continues to provide wholesale funding to the economy through development finance institutions such as the Bank of Agriculture (BoA) and the Bank of Industry (BoI). These, however, need to be weighed against measures to moderate the recent uptick in headline inflation, exchange rate volatility and external reserves depletion.

Given the challenges clouding the monetary policy outlook in 2015, the success of policy measures would require a greater coordination between the monetary and fiscal authorities to minimize the risks of economic downturn in the short-to-medium term.

Appendices

Central Bank of Nigeria Communiqué No. 96 of the Monetary Policy Committee Meeting, July 21-22, 2014

The Monetary Policy Committee (MPC) met on July 21 and 22, 2014 against the backdrop of continuing QE3 tapering by the U.S Federal Reserve which has resulted in the slowing of inflows to emerging markets and frontier economies; and the attendant uncertainties in the outlook for monetary policy and financial stability in the post-tapering period. The meeting was attended by 10 members. A new member, Prof. Dahiru Hassan Balami, whose appointment had recently been confirmed by the Senate, was also in attendance. The Committee deliberated on key external and domestic economic developments and considered the Banking Stability Report since the MPC meeting of May 2014 as well as the outlook for the rest of the year.

The global monetary policy environment appears to be further complicated by risks posed by continued currency crisis and fragility in Europe, geo-political tensions in the Middle East and a number of emerging and developing economies. Domestically, the policy challenges remain. These include the uptick in inflation, anticipated increased spending towards the general elections and the possible effects of US tapering on the domestic market.

International Economic Developments

The Committee noted that the rebound in global economic activity strengthened in the first half of 2014; although at levels lower than previously projected. The tapered growth arose mainly from the emerging and developing economies owing to the rising real interest rates and geo-political crisis. On the whole, the effects of the global financial crisis have continued to wane even as the issues of rising income inequality, unemployment and poverty appear to be gaining prominence; engaging the attention of the monetary authorities. These latest projections indicate that the euro area is gradually coming out of recession, as growth projection for 2014 is positive for all member countries albeit with significant variation. Growth is expected to be stronger in the core EU countries while high debt and financial fragmentation continue to weigh on aggregate domestic demand in the peripheral countries. For the entire euro zone, there is a risk of low inflation or outright deflation which could result in higher real interest rates that may constrain output expansion.

In the emerging and developing economies, growth is projected at 5.0 per cent in 2014 from 4.7 per cent in 2013, buoyed by stronger external demand from the advanced countries. The key downside risks in the developing and emerging economies include: political uncertainty, exchange rate realignment in response to changing fundamentals, further monetary tightening to address emerging currency crisis, and tighter external financing conditions arising from the rapid normalization of the US monetary policy. Inflation is projected to remain subdued in 2014 and 2015, partly reflecting the significant output gaps in the developed economies, weaker domestic demand in developing and emerging economies, and sliding commodity prices, especially fuels and food. In the advanced economies, inflation is currently below target and its return to the long run trend could take a while due to the slow pace of economic recovery. Likely depreciation in currencies, domestic demand pressure, and capacity constraints could pose upside risks to inflation in the emerging market economies.

The Committee noted that the stance of monetary policy could diverge across regions over the medium term on account of variations in risks and other challenges confronting various economies. The US is expected to commence tightening by the second half of 2015 as inflation hits the long run target and unemployment rate falls to the threshold level. The euro area and Japan are expected to continue with supportive monetary policy due to low inflation including threat of deflation in some countries, weak recovery, weakness in bank balance sheets, and strong demand for their bonds as a result of low sovereign risk.

Majority of the central banks remained cautious with regard to the stance of monetary policy. While most advanced economies are likely to maintain an accommodative stance for monetary policy for the rest of the year to firm up aggregate demand and employment, the major impetus for monetary policy adjustments in the emerging markets and developing economies could come from the effects of the US Fed's tapering of QE3 on their currencies and the financial markets.

Domestic Economic and Financial Developments Output

The National Bureau of Statistics (NBS) reported revised growth numbers from 2010 to 2013 and the first quarter of 2014, as part of the GDP rebasing exercise. Accordingly, the estimated growth rate for 2013 now stands at 5.49 per cent, compared with 5.31 and 4.21 per cent recorded in 2011 and 2012, respectively. Similarly, the revised estimate of 6.77 per cent for the fourth quarter of 2013 was an improvement over the 5.17 and 3.64 per cent in the previous quarter and the corresponding period of 2012, respectively. In the first quarter of 2014, real GDP growth was 6.21 per cent, which was higher than the corresponding quarter of 2013. In line with the trend, the non-oil sector was the main driver of growth in the first quarter of 2014, recording 8.21 per cent growth. The key growth drivers in the non-oil sector in the first quarter of 2014 remained industry, agriculture, trade, and services which contributed 1.77, 1.26, 1.26 and 3.15 per cent, respectively. The oil sector continued to record improvements in performance with its growth rate improving from -9.36 and -11.40 per cent, respectively, in the fourth and first quarters of 2013, to -6.60 per cent in the first quarter of 2014.

The Committee welcomed the impressive growth performance but noted that the country has the potential to do better with appropriate supportive macroeconomic policies. The Committee, therefore, stressed the imperatives for monetary policy to sustain efforts aimed at supporting non-inflationary growth in key sectors of the economy. The Committee also emphasized the need for government to sustain and deepen tax revenue and enhance efforts aimed at fast-tracking the structural transformation of the economy with a view to making it resilient to adverse shocks as well as creating the necessary platforms for reducing unemployment, income inequality, and poverty in the country.

Prices

Developments in the aggregate price level suggest an underlying inflationary pressure since January 2014. The year-on-year headline inflation steadily inched up marginally from 7.9 per cent in April to 8.0 per cent in May 2014 and further to 8.2 per cent in June. The up-tick in June was, however, largely attributed to the rise in food inflation which rose from 9.7 per cent in May 2014 to 9.8 per cent in June while core inflation, on the other hand, rose from 7.7 per cent in May 2014 to 8.1 per cent in June. The Committee noted that all measures of inflation have witnessed progressive upward trend since February 2014 and agreed that this trend should be monitored closely to achieve a reversal.

Monetary, Credit and Financial Markets' Developments

Broad money (M2) rose by 1.66 per cent in June 2014 over the level at end-December 2013, indicating an annualized growth rate of 3.31 per cent. The annualized growth rate was considerably lower than the growth benchmark of 15.52 per cent for fiscal 2014. For the same period, net domestic credit increased by 0.88 per cent compared with the growth rate of 15.39 per cent over the corresponding period of 2013. When annualized, net domestic credit rose by 1.77 per cent, compared with the growth benchmark of 28.5 per cent for fiscal 2014. The expansion in aggregate domestic credit was mainly due to the increase in claims on the private sector which increased by 2.75 per cent in June 2014, which was however, moderated by the contraction in net credit to Government.

Meanwhile, money market rates remained within the MPR corridor during the review period. The monthly weighted average OBB rate was 10.38 per cent in May 2014 but it increased by 14 basis points to 10.52 per cent in June. The uncollaterized overnight rate was 10.50 per cent in June 2014, compared with 10.63 per cent in May 2014. Overall, both the OBB and overnight call rates were trading closer to the lower bound of the MPR corridor on account of liquidity surfeit in the banking system. Activities in the capital market were bullish during the period with the All-Share Index (ASI) increasing by 2.8 per cent from 41,329.19 at end-December 2013 to 42,482.48 at end-June 2014. Market capitalization also moved in the same direction.

External Sector Developments

All the segments of the foreign exchange market witnessed a considerable degree of stability during the period. The exchange rate at the retail-Dutch Auction System Segment (rDAS) of the market was flat at N157.29/US$ in the review period. At the interbank market, the selling rate opened at N162.20/US$ and closed at N162.95, representing a depreciation of N0.75 or 0.46 per cent. Conversely, at the BDC segment, the exchange rate opened at N167.00/US$ and closed at N168.00/US$, representing a depreciation of N1.00 or 0.6 per cent. Gross official reserves rose to US$40.20 billion by 18 July from US$37.31 billion at end-June 2014. The increase in reserves was mainly due to increased accretion and moderation in the rate of depletion.

The Committee's Consideration

The Committee was satisfied with the relative stability in the macroeconomy as reflected in the impressive growth rates, stable consumer prices and exchange rate as well as increased external reserves. It was however concerned about the weak translation of stability to microeconomic gains in employment and access to finance especially by small and medium scale businesses. It, therefore, emphasized the need for the MPC decisions to take into account the long run impact on employment level, wealth creation and growth of businesses.

The Committee noted the potential of the power sector to stimulate output growth through enhanced investment and the spill-over effect in employment generation if the challenges confronting the sector are effectively and appropriately addressed. Specifically, it noted that gas-to-power has remained a binding constraint in reaping the benefits of the recently-concluded power sector reforms; urging for the collective efforts of government, private investors and the banks to resolve. Other pressure points include the underlying pressure from food/core inflation and the risks that could emanate from the likely increase in aggregate spending in the run up to the 2015 general elections. The Committee was also concerned about the implications of the on-going QE3 tapering for inflows and external reserves. The Committee recognized the necessity of sustaining a stable naira exchange even as it has to deal with the delicate balancing of the need for a low interest rate regime. The Committee noted that portfolio flows were not employment generating but were essential in the absence of adequate fiscal buffers.

The Committee welcomed the moderation in the rate of depletion in external reserves in recent months, noting that reserves accretion needed to improve much faster to provide a strong and more resilient buffer to fiscal operations. The Committee, however, noted that a gradual reduction in the country's import bills through domestic production of some of the major food imports should be a key element in the overall reserves accretion strategy. It welcomed the decision of the Bank to collaborate with other stakeholders in this regard.

The Committee further expressed concern about the liquidity level and the trending uptick in inflation which may not be unconnected with the poor harvest in some agricultural producing areas, particularly in the north eastern and central states of the country. It however, noted that other reform measures could dampen food prices in the short to medium term and restore inflation to a sustainable long-run path. Overall, the Committee noted that the policy direction of inflation, exchange rate and interest rate must be seen not only in the context of price and financial stability but also in enhancing the quality of life of Nigerians and promoting employment generation.

The Committee's Decisions

In view of these developments, the Committee decided by a unanimous vote to retain the current stance of monetary policy with one member voting for an asymmetric corridor around the MPR. Consequently, the MPC voted to:

(i) Retain the MPR at 12 per cent with a corridor of +/- 200 basis points around the midpoint;

(ii) Retain the Liquidity Ratio at 30 per cent;

(iii) Retain the public sector Cash Reserve Requirement at 75.0 per cent; and

(iv) Retain the private sector Cash Reserve Requirement at 15.0 per cent.

Thank you.

Godwin I. Emefiele

Governor, Central Bank of Nigeria

22nd July 2014

CENTRAL BANK OF NIGERIA COMMUNIQUÉ No. 97 OF THE MONETARY POLICY COMMITTEE MEETING, SEPTEMBER 18-19, 2014

The Monetary Policy Committee (MPC) met on September 18 and 19, 2014 with all the 12 members in attendance. The Chairman welcomed the new member, representing the Board of the Central Bank of Nigeria, Mr. Stanley I. Lawson to membership of the Committee. The meeting held against the backdrop of the increasingly limited choices for monetary policy, particularly, in the emerging market and developing economies; tapered recovery in the euro area coupled with the social and political tensions in the domestic and global environment, some of which have had fundamental impact on domestic macroeconomic management. The Committee reviewed key developments in the global and domestic economy up to mid-September 2014, and the outlook for the near-term.

International Economic Developments

The Committee noted the slow global growth prospects as the IMF, in July, marked down its projection by 0.3 per cent to 3.4 per cent, reflecting weak economic recovery, particularly in the Euro Area, and a less than optimistic outlook for several emerging market economies. Global growth which moderated more than expected in the first quarter of 2014 regained momentum in the second quarter although recovery remained largely uneven. The United States provided strong tailwinds for growth recovery but fiscal constraints continued to limit robust possibilities. Similarly, economic activity in the United Kingdom maintained a strong momentum in the second quarter, supported by improved household confidence and an impressively recovering housing market. Growth in China also recovered following the fiscal policy stimulus and a surge in credit. In contrast, growth moderated in Japan after the VAT hike in April, but the quantitative easing programme of the Bank of Japan continues to support recovery. Growth in the Euro area is expected to strengthen to 1.1 per cent in 2014 and 1.5 per cent in 2015, but would remain uneven across the region, reflecting continued financial fragmentation, impaired private and public sector balance sheets, and high unemployment in some EU economies. In the emerging markets and developing economies, growth is projected at 4.6 per cent in 2014, which is 0.2 percentage point lower than the earlier projection. The sources of growth include strong external demand from the advanced economies; however, tight financial condition is expected to dampen growth in domestic aggregate demand. Global inflation has remained relatively stable while spare capacity remains large, suggesting no significant inflationary pressures in the short-to-medium-term. The stance of monetary policy has remained unchanged across most advanced and emerging economies in view of the unclear outlook for monetary conditions and financial stability especially in the post-QE tapering era.

The expectations of increase in policy interest rate remain in focus in the US and the UK, even though the Fed reaffirmed that it would maintain the current highly accommodative monetary policy stance. The European Central Bank (ECB) and Peoples Bank of China (PBoC) have also announced new monetary stimulus programmes which will moderate the impact of the end of QE3 on frontier markets.

Domestic Economic and Financial Developments Output

The Committee noted the continued resilience of the economy as real GDP grew by 6.54 per cent in Q2, 2014 compared with 5.40 per cent in the corresponding quarter of 2013. The observed growth rate also surpassed the 6.21 per cent recorded in the Q1 of 2014. The non-oil sector remained the main driver of growth recording 6.71 per cent in Q2, 2014; although lower than the 8.21 and 8.88 per cent recorded in Q1, 2014 and the corresponding quarter of 2013, respectively. The decline in growth of non-oil GDP was traced to the decline in agricultural output, construction, trade and services relative to the levels recorded in Q1, 2014. The slowdown in agricultural output was attributed to the insurgency activities in the North Eastern axis and some parts of the North Central States which led to displacement of farming communities, thereby limiting agricultural activities and, hence, output from that region.

Growth in the services and industry sectors remained relatively stable compared with the corresponding period in 2013. The Committee commended all levels of government and the general population for the coordinated, prompt and effective response to the Ebola Virus Disease (EVD) in Lagos and Port Harcourt; two cities that are commercial hubs and leading growth axes for the service and industry sectors of the economy.

The oil sector grew by 5.14 per cent in Q2 2014, a marked reversal from the decline recorded in the preceding four quarters. The Committee welcomed the intensification of efforts by government at addressing vandalism of oil facilities and theft of crude oil in the Niger Delta region as well as efforts towards addressing gas supply shortages to the power plants. The Committee reiterated its commitment to continue to support the efforts, in addition to facilitating other measures aimed at promoting inclusive noninflationary growth.

Prices

Headline inflation rose to 8.5 per cent in August from 8.3 in July 2014. The mild but sustained underlying inflationary pressures were attributable mainly to food production and distribution challenges posed by the insurgency activities. From 9.4 per cent in April 2014, food inflation, measured on a year-on-year basis, rose to 10.0 per cent in August while core inflation moderated consecutively in the last two months since June 2014. In August 2014, the year-on-year core inflation was 6.3 per cent, down from 8.1 and 7.1 per cent in June and July, respectively. The Committee was concerned that the insurgency was forcing a switching from domestic to imported food to meet domestic shortfall with huge impact on external reserves and underscored the need to expedite action to restore normalcy to the troubled region to sustain the tempo of growth. The Committee further reaffirmed its commitment to sustain efforts at ensuring price stability.

Monetary, Credit and Financial Markets' Developments

Broad money supply (M2) grew by 2.94 per cent in August 2014 over the level at end-December 2013 compared with 4.83 per cent in July. The annualized growth of 4.41 per cent in August 2014 was below the growth benchmark of 14.52 per cent for the year. Net domestic credit, however, increased by 5.31 per cent in August relative to the end-December 2013 level. When annualized, net domestic credit rose by 7.96 per cent, compared with the growth benchmark of 28.5 per cent for fiscal 2014. The rather slow expansion in money supply in August reflected the 10.17 per cent contraction in net foreign assets of the banking system (NFA).

Money market interest rates, however, remained within the MPR corridor as the overnight and collaterized OBB rates moderated from 11.30 and 11.49 per cent in August to 11. 08 and 10.62 per cent on 11 September 2014, respectively. The MPC noted that both rates traded around the lower band of the MPR corridor on account of the liquidity surfeit in the banking system.

Activities in the capital market were bearish during the period with the All-Share Index (ASI) decreasing by 4.3 per cent from 42,482.48 on June 30, 2014 to 40,672.94 on September 12, 2014. Market Capitalization (MC) also decreased by 4.3 per cent from N14.03 trillion on June 30, 2014 to N13.43 trillion on September 12, 2014. Market indicators declined owing to the profit taking activities of investors.

External Sector Developments

The average naira exchange rate remained considerably stable in all segments of the foreign exchange market. The exchange rate at the retail-Dutch Auction System Segment (rDAS) was stable at N157.29/US$, but depreciated at the inter-bank and substantially at the BDC segments between July and August 29, 2014. At the interbank segment, the naira depreciated slightly by N0.32 or 0.20 per cent to $/N162.40 from $/N162.08. Similarly, at the BDC segment, the exchange rate depreciated by N2.00 or 1.2 per cent from US$/N167.00 to U$/N169.00. The premium between the rDAS and interbank rates was 3.25 per cent while that between the rDAS and BDC rates stood at 7.45 per cent in the review period. Gross official reserves rose from US$39.1 billion at end-July to US$40.7 billion on 17th September, 2014. The current level of external reserves provides approximately 7 months of imports cover.

The Committee's Considerations

The MPC expressed satisfaction with the relative stability in the economy while also noting the risks that lie ahead. The key risks include: the possibility of capital reversals as the Fed's Quantitative Easing in the US finally ends in October, amidst dwindling oil output and declining oil prices, domestic security challenges and upward trending headline inflation. The Committee further expressed concern about high banking system liquidity and its potential effects on inflation and the exchange rate. The policy challenges, the Committee noted, would include sustaining the stability of the naira exchange rate, managing the vulnerability to capital flow reversal, building fiscal buffers to insure against global shocks, managing inflation and exchange rate expectations and safeguarding the financial system stability as well as a buildup in election related spending.

The Committee welcomed the efforts by government to address some of the constraints and risks to economic activity like the insurgency in the North-East and the Ebola Virus Disease epidemic. It noted that as progress is made in these areas and in respect of other constraints like power and improving SME financing, the outlook for growth appears bright and prospects for upward price pressure would be moderated. The Committee further noted that the restrictive stance of monetary policy provided important defenses against structural liquidity in the banking system and also reaffirmed the willingness to play a key role in managing expectations around exchange rate and inflation vulnerabilities.

Consequently, adequate consideration would need to be accorded the goal of reining-in banking system liquidity to safeguard the objective of price stability. The Committee was, however, concerned that banks were holding large excess reserves averaging over N300 billion even when there were ample opportunities for productive and profitable lending to the real sector of the economy. The concern was further strengthened by the reality of injecting an additional N866 billion into the system through the redemption of maturing AMCON bonds in October. Given the apathy to lending, banks may be inclined more to placing these new funds in the SDF or use it to increase pressure on the exchange rate. The Committee advised the Bank to explore ways of encouraging banks to lend such excess reserves to the real sector.

In light of the foregoing and consideration of other key risk factors, the Committee was of the view that the direction for policy in the short- to medium term would be either to retain the current tight stance of monetary policy or further tighten monetary policy.

The Committee's Decisions

In view of these developments, the Committee was split between retaining the current stance of monetary policy and further tightening. Consequently, 6 members voted to retain the current stance of monetary policy. Five members voted to increase private sector CRR while one member voted to increase public sector CRR. In addition, one member voted for an asymmetric corridor around the MPR. Consequently, the MPC decided by a majority vote to:

(i) Retain the MPR at 12 per cent with a corridor of +/- 200 basis points around the midpoint;

(ii) Retain the public sector Cash Reserve Requirement at 75.0 per cent; and

(iii) Retain the private sector Cash Reserve Requirement at 15.0 per cent.

Thank you.

Godwin I. Emefiele

Governor, Central Bank of Nigeria

19th September 2014

Central Bank of Nigeria Communiqué No. 98 of the Monetary Policy Committee Meeting of Monday 24th and Tuesday 25th November, 2014

The Monetary Policy Committee (MPC) met on November 24th and 25th 2014 against the backdrop of moderate but uneven growth in the global economy and build up of vulnerabilities in the domestic economy. In attendance were all 11 members, following the expiration of the tenure of Dr. Kingsley C. Moghalu as a Deputy Governor of the Bank on 5th November 2014. The Committee reviewed key developments in the global and domestic economies during the first ten months of 2014 and assessed the short-to-medium term risks to price and financial stability as well as the outlook for the rest of the year up to the first half of 2015.

International Economic Developments

The global economic space continued to be dominated by strong downside risks to growth, including the softening commodity prices, rising geo-political tensions, and heightening threats to financial markets in the emerging and frontier economies in the aftermath of the termination of Quantitative Easing by the US Federal Reserve at the end of October 2014. Developments in the international oil market have intensified the risks and vulnerabilities faced by oil exporting countries in the wake of a new episode of falling oil prices. The uncertainty is complicated by the absence of clear signals on how far and how long this episode would last. While the revenue impact of falling oil prices was severest on the oil exporting countries, it was largely positive on the oil importing countries led by the United States, which has also emerged as a major oil exporter.

With considerable divergence across regions, global growth picked up in the second half of 2014 at a lower than predicted pace. In view of the perceived vulnerabilities and associated risks, the International Monetary Fund (IMF) has recently downgraded its global growth forecast for 2015 to 3.3 per cent from an earlier projection of 3.7 per cent. The expected tepid performance in 2015 reflects the impact of the strong headwinds arising from the negative spillover effects of the unwinding of the US monetary stimulus, deteriorating geo-political tensions in many regions, uncertainty about the direction of the US-led economic sanctions on Russia; a development which in combination with the shale oil revolution has created a glut in the oil market at below long run price trends, unsustainable fiscal stance and absence of fiscal buffers in a number of countries and declining aggregate demand in others. These risks were, however, moderated by the expansionary monetary stimulus of the European Central Bank and the Bank of Japan which has led to increased consumption, particularly in the wake of falling oil prices.

Growth in the advanced economies is projected at 1.8 per cent in 2014 compared with 1.2 and 1.4 per cent in 2012 and 2013, respectively. The US is estimated to grow at 2.2 per cent in 2014, driven by strong private consumption, export growth, and contraction in imports. A stronger dollar, softening global growth, and sharp financial market correction could, however, undermine confidence and favorable terms of trade. In addition, the growth could be met by rising wage demands, obviating the Federal Reserve's early normalization of monetary policy with negative impact on global interest rates.

In the United Kingdom, at 3.2 per cent in 2014, output has remained above its long run average compared with 0.3 and 1.7 per cent in 2012 and 2013, respectively. The Euro area performance, however, seem to be at variance with the trend in other key advanced economies. Fundamental fiscal headwinds, high unemployment, and weak bank lending extended into Q3 of 2014, reflecting largely the failure of its comprehensive assessment program designed to reduce financial fragmentation. The Committee observed that the monetary stimulus of the ECB has neither stimulated aggregate demand nor restored growth to a sustainable long run path as the prospects of a deepening recession looms large. A key for the ECB is that decoupling the euro zone from the US monetary conditions would create its own shocks but the impact would be even more severe when the Federal Reserve commences monetary policy normalization. An uptick in global demand, a weakening euro and the ECB's monetary stimulus could create a benign environment for growth. The depth of the slowdown, however, suggests that the ECB may need to implement full quantitative easing to return the Euro area to its long run growth path.

The emerging markets and frontier economies remain constrained by limited macroeconomic space to implement demand-enhancing monetary stimuli. A retrenchment of portfolio flows has already begun following the end of Quantitative Easing by the Federal Reserve, thus scaling up exchange rate pressures. Thus, growth has been revised downwards to 4.4 per cent in 2014 with China facing its lowest growth of 7.4 per cent since 1990 due to the cooling of its property market. The divergence in the monetary policy stance of the US, China, and Japan has further heightened risk in most emerging economies, elevating financial market fragility and currency risk in the balance sheet of banks and corporate bodies.

In Sub-Saharan Africa, growth was revised downwards to 5.1 per cent in 2014 from the earlier projection of 5.4 per cent to reflect the ongoing sluggish global growth and declining commodity prices. In addition, political crisis, infrastructural challenges, and of late the Ebola outbreak in Guinea, Liberia and Sierra Leone have moderated earlier robust growth outlook. The key risks remain declining aggregate demand, falling commodity prices, delayed recovery and potential intensification of the euro zone financial stress, sharp adjustment in the bonds and equities markets in the US, and muted growth in China.

Domestic Economic and Financial Developments Output

Available data from the National Bureau of Statistics (NBS) has indicated that the domestic economy remains strong and resilient in the face of strong global headwinds. Nevertheless, key vulnerabilities are emerging. Real Gross Domestic Product (GDP) was estimated at 6.23 per cent for the third quarter of 2014. Although lower than the 6.54 per cent in the preceding quarter, it was higher than the 5.2 per cent achieved in the corresponding period of 2013. The non-oil sector remained the major driver of growth recording 7.5 per cent in contrast to the oil sector, which contracted by 3.6 per cent. Overall, output is projected to grow at about 7.0 per cent in 2014, compared with the 4.2 and 5.5 per cent, recorded in 2012 and 2013, respectively. The Committee noted that the robust expansion in domestic output in the third quarter of 2014 against the tepid growth in the global economy was anchored by the improved performance in services, agriculture, trade, and industry.

The Committee welcomed the impressive output growth performance but cautioned that the continuing insurgency in the North East of Nigeria in combination with other risks could adversely affect the growth outlook. The Committee noted with concern the continued decline in the contribution of the oil sector to growth and urged the political authorities for the speedy passage of the Petroleum Industry Bill to halt the trend. The Committee commended government's efforts to sustain the tempo of the power sector reforms, especially the amortization of the legacy debt owed to major stakeholders in the power value chain and enjoined the political authorities to fast track the implementation of other complementary measures that would improve power generation and distribution.

Employment

The November 2014 national unemployment survey by the National Bureau of Statistics (NBS) revealed that a total of 349,343 new jobs were created in Q3 of 2014 compared with 259,353 jobs in the preceding quarter. The Central Bank of Nigeria's development initiative under the N200 billion Commercial Agriculture Credit Scheme (CACS) has created 166,790 jobs since inception in September 2009. The Committee noted with satisfaction that the reforms in the power sector and other complementary policies if followed through; would promote investment and create the needed jobs for inclusive growth and development.

Prices

Inflationary pressure moderated across the three measures of inflation during the review period. Consequently, headline inflation (year-on-year) declined further to 8.5, 8.3 and 8.1 per cent in August, September and October, respectively. Core and food inflation decelerated from 6.28 and 9.68 to 6.25 and 9.34 per cent in September and October, respectively.

The deceleration in food inflation was traced to the decrease in the prices of both processed foods (from 4.4 to 4.3 per cent) and farm produce (from 5.3 to 5.0 per cent). The Committee noted with satisfaction that all the measures of inflation were within single digit. The Committee, however, recognized the upside risks to inflation in the near-term to include increased spending in the build up to the 2015 general elections, depreciated exchange rate arising from the falling oil prices accompanied by external reserves depletion, and food supply shocks arising from the increased insurgency activities in the major agricultural belts of the country. The Committee was satisfied, as indicated by Staff forecasts that headline inflation would remain well anchored at single digit within the band at year-end if the necessary macroeconomic policy actions were taken.

Monetary, Credit and Financial Markets' Developments

Broad money supply (M2) grew by 4.17 per cent in October 2014 over the level at end-December, 2013, which annualized to 5.01 per cent. The annualized growth rate reflects an improvement over the decline of 6.16 per cent achieved in the corresponding period of 2013 but lower than the growth benchmark of 15.02 per cent for 2014. Net domestic credit grew by 9.09 per cent in October relative to the end-December 2013 level. On annualized basis, net domestic credit rose by 10.91 per cent compared with the benchmark level of 28.5 per cent for 2014. The sluggish growth in broad money was largely due to Net Foreign Assets, which contracted by 18.74 per cent in October 2014. The tapered growth in money supply also helped in moderating inflationary pressures.

Interest rates in all segments of the money market showed further moderation between September and October 2014, reflecting persisting liquidity surfeit in the banking system. Average interbank call rate moderated from 10.96 to 10.81 per cent while the collaterised Open Buy Back (OBB) rate moderated from 10.76 to 10.48 per cent during the period. Both rates hovered around the lower band of the MPR during the period. The Committee, however, noted that the structure of rates at the retail end of the credit market did not significantly reflect banking system liquidity conditions as both the prime and maximum lending rates remained largely elevated. The maximum lending rate declined marginally from 25.77 to 25.75 per cent between September and October while the prime lending rate on the other hand increased from 16.44 to 16.48 per cent. The high interest rates notwithstanding, credit to private sector rose by 7.75 per cent during the period. To improve the efficiency of monetary policy, the Committee, urged the Bank to ensure that credit levels reflected liquidity conditions in the banking system.

The bearish conditions in the capital market continued as the equities market indicators trended downwards in the review period. The All-Share Index (ASI) declined by 17.9 per cent from 41,329.19 to 33,962.18 between December 31, 2013 and November 21, 2014.

Also, Market Capitalization (MC) decreased by 15.0 per cent from ₦13.23 trillion to ₦11.24 trillion during the same period. The decline in equities market performance was largely due to increased capital outflows, as some foreign investors sold off, amidst concerns over currency depreciation in the face of the steady declines in external reserves and international crude oil prices.

External Sector Developments

Developments in the external sector since September 2014, manifested in a buildup of pressures in the foreign exchange market. While the Bank sustained its efforts to maintain the stability of the naira exchange rate at the rDAS window, a considerable degree of weakening was recorded at both the interbank and Bureau de Change (BDCs) segments.

The exchange rate at the rDAS window during the review period opened at ₦157.31/US$ and closed at ₦157.32/US$, reflecting a marginal depreciation of ₦0.01. To maintain and stabilize the exchange rate at that level, gross official reserves declined from US$40.7 billion on 17th September, 2014 to $36.75 billion at end-October 2014. From year to date, substantial currency depreciation has occurred in comparator oil exporting countries but the naira has depreciated by only 1.74 per cent.

At the interbank segment, the naira depreciated by ₦1.75 or 1.06 per cent to $/₦165.55 from $/₦163.80. In the same vein, the exchange rate depreciated by ₦1.00 or 1.19 per cent from US$/₦169.00 to $/₦170.00 at the BDC segment. The depreciation at both the interbank and the BDC segments largely reflected recent demand pressures arising from the falling oil prices and dwindling external reserves. As part of the demand management measures, the Bank in two recent circulars excluded certain import items from the rDAS window. Despite the tight measures, the high demand for foreign exchange has continued unabated. This demand does not seem to have any bearing on the genuine foreign exchange needs of the country, which the Bank stands ready and has the capacity to meet. The current level of external reserves provides approximately 7 months of imports cover.

Committee's Consideration

The Committee noted with satisfaction the deceleration in all the three measures of inflation since September 2014; a development which has provided headroom for policy flexibility and maneuver. The robust output expansion amidst strong headwinds arising from a weakening of the international oil market gives credence to the efficacy of our macroeconomic policy. The Committee also noted that unlike in previous episodes, the current downturn in oil prices is not transitory but appears to be permanent; being a product of technological advancement. Currently, the US which use to be Nigeria's former major oil export destination now meets on average 80 per cent of its domestic oil demand from local shale oil retorting technology production and exports over 8 million barrels of crude oil daily.

The Committee found credence in the permanency theory of current oil price dynamics in the fact that the political restiveness in the Middle East and North Africa (MENA) region has not created uncertainty in oil supplies as both Libya and Iraq (Southern) have open and strong supply lines in the market. A nuclear deal with Iran could further complicate the situation, opening up the supply space for new oil supplies from Iran. Available data shows that a number of 6-month oil futures are currently signed at below US$70/barrel while improvements in technology have driven down the break-even cost of shale oil production to an average range of US$52-US$70 per barrel. In the light of this development, the Committee is of the view that the oil price benchmark of US$73/barrel proposed in the 2015 Federal Government budget may be overly optimistic, requiring considerable caution on the budget's revenue projections. A weak public finance may impinge adversely on growth prospects as it shows up in reduction in critical public and private consumption and investment spending.

Without prejudice to this position, the Committee is of the view that the softening crude oil prices could provide necessary leverage for the fiscal authority to reduce budgetary outlays on fuel subsidy and channel such savings to growth enhancing sectors of the economy. The Committee took note of the supportive fiscal stance in this regard and public commitment to take advantage of the low oil price to reduce fuel subsidy spending and liberalize prices as in many emerging economies. Furthermore, the Committee expressed satisfaction with the recent demand management measures announced by the fiscal authorities to contain pressure in both the goods and money markets and provide some respite in the near term.

Notwithstanding, efforts should be geared towards addressing the binding supply side constraints such as the insecurity, infrastructural, and institutional challenges. The Committee also noted the gradual improvement in labor market conditions which resulted in the additional employment of 349,343 in the third quarter of 2014. The dominance of the informal sector in the new jobs profile, suggests the preponderance of underemployment over the unemployment phenomenon, requiring intensification of reforms to unlock the growth potential of the formal sector.

Given the not too impressive fiscal revenue outlook, the Committee challenged the sub-national governments to seize this unique opportunity to reduce reliance on allocations from the Federation Account in funding their operations. To this end, the Committee commended the efforts of some states which recorded unprecedented growth in Internally Generated Revenues (IGRs) in 2013. Consequently, the Committee enjoined other states of the Federation to emulate these states by strengthening their IGR mechanisms with a view to minimizing reliance on FAAC allocations with attendant disruptions to their budget implementation arising from dwindling oil revenues.

A major issue considered by the Committee, however, was the declining level of external reserves, which arose from demand and supply constraints. On the supply side, the falling oil price has considerably reduced the accretion to external reserves thus constraining the ability of the Bank to continually defend the naira and sustain the stability of the naira exchange rate. The supply side is further weakened by the commencement of normalization of monetary policy by the US Federal Reserve following the termination of the third quantitative easing on 29th October, 2014; a development which has accentuated capital outflows. These developments are against the backdrop of considerable loss of fiscal space following from our inability to build sufficient reserves during the boom days.

On the demand side, the pressures in the foreign exchange market were aided mostly by the excess liquidity conditions in the banking system and speculative activities. It has become increasingly worrisome that improvement in liquidity conditions in the banking system, designed to enhance the resilience and stability of the banking system, has not translated to increased credit expansion to the real sector to engender inclusive growth and boost employment. Rather, it has led to an upward pressure in the foreign exchange market and Standing Deposit Facility window of the Bank while banks continually exercise a cautious approach to lending.

Against this background, the Committee is of the view that the current challenge requires bold policy moves on both the demand and supply sides of the foreign exchange market. Consequently, bold policy and administrative measures in the management of the nation's stock of foreign exchange reserves have become inevitable in order to align the market towards its long-run equilibrium path.

On this note, the Committee wishes to reiterate that the Bank remains committed to a stable exchange rate within the limits of available resources and would continue to maintain sufficiently strong level of external reserves to meet its short term obligations and other regular balance of payments commitments. Without prejudice to this commitment, our foreign exchange management framework would have zero tolerance for infractions and would penalize economic agents whose primary objective is to speculate in the Nigerian market.

The Committee is fully aware of the short run implications of a tight monetary policy stance on lending and growth. However, available data indicates that banking system liquidity has been lavishly deployed in pursuit of speculative foreign exchange trading at the short-end of the market. While the Committee remains fully committed to the goal of promoting inclusive growth through lower interest rates in the medium- to long-term, banks as agents of financial intermediation have a critical role to play in the nation's development process. A banking system with an overly high profit motive negates the core tenets of banking and purpose of a banking license. Under the circumstance, monetary policy must be bold and emphatic on the goals macroeconomic management seeks to achieve and encourage the flow of credit along those lines.

The current situation demands that the Bank confronts the issue of declining external reserves head-on in order to strengthen the value of the domestic currency. Consequently, stabilizing prices and maintaining exchange rate stability and charting a sustainable path for medium to long-term growth are the immediate top priorities. The Committee remains committed to these in order to sustain the credibility of our policies and anchor the expectations of our core stakeholders.

In the Committee's opinion, a more flexible naira in the face of nonexistent fiscal buffers was the most viable policy option at a time of heightened demand pressure for foreign exchange and falling oil prices. The Committee was, therefore, of the view that if it failed in taking the right policy actions now, the market would force the Bank to take more drastic actions in the future with far less foreign exchange reserves. Also, given the level of excess liquidity in the banking system, it becomes imperative for the Bank to address the sources of the foreign exchange demand pressure.

In the light of the above considerations, the Committee was of the opinion that the economy stood to gain by:

a) Further tightening of monetary policy stance to anchor inflation expectations; and
b) Allowing some flexibility in the exchange rate to stem speculative activities and depletion of reserves.

Consequently, the Committee decided as follows:

Decision

Having considered all the issues above the Committee decided as follows:
a) Nine members voted to increase the MPR to 13 per cent while two members voted to retain the MPR at 12 per cent
b) Ten members voted for a symmetric corridor of +/- 200 basis points around the MPR, while one member voted for an asymmetric corridor of +200 and -500 basis points around the MPR
c) All the 11 members voted to increase CRR on Private Sector deposits from 15 to 20 per cent with immediate effect
d) All the 11 members voted to retain CRR on Public Sector deposits at 75 per cent
e) All the 11 members voted to move the midpoint of the official window of the foreign exchange market from ₦155/US$ to ₦168/US$
f) All the 11 members voted to widen the band around the midpoint of the exchange rate from +/-3 per cent to +/-5 per cent.
g) All the 11 members voted to retain the net open foreign exchange trading position at 1 per cent.

Consequently, the MPC decided as follows:
i. Increase the MPR by 100 basis points from 12.00 to 13.00 per cent;
ii. Increase the CRR on private sector deposits by 500 basis points from 15.00 to 20.00 per cent with immediate effect;
iii. Move the midpoint of the official window of the foreign exchange market from ₦155/US$ to ₦168/US$;
iv. Widen the band around the midpoint by 200 basis points from +/-3 per cent to +/-5 per cent;
v. Retain public sector CRR at its current level of 75.00 per cent;
vi. Maintain a symmetric corridor of +/-200 basis points around the MPR; and

vii. Retain the net open foreign exchange trading position at 1.00 per cent.

I thank you all for Listening

Godwin I. Emefiele, CON
Governor, Central Bank of Nigeria
25th November, 2014