CENTRAL BANK OF NIGERIA

MONETARY POLICY REVIEW

AUGUST 2018

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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

"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

CONTENTS

Page

Table of Contents

List of Tables

List of Figures

List of Boxes

STATEMENT BY THE GOVERNOR

Monetary policy in the first half of 2018 continued to be shaped by developments in the global and domestic economic and financial environment. At the global level, the key influences were: increased monetary policy divergence among the advanced economies; continued uncertainties surrounding the BREXIT negotiations and sustained monetary policy normalization in the US as the Fed hiked interest rate and gave forward guidance of more in the future. Others included the U.S withdrawal from the Iranian nuclear deal, the emerging trade tensions between the US and other major world economies as well as pockets of geo-political tensions. These, notwithstanding, the global economy continued on the path to recovery, stemming from the strengthening of domestic investment demand and relatively easier financing conditions in the advanced economies, as well as sustained recovery in oil and other commodity prices, amid limited spillovers of trade tensions to the financial markets. As a result, global output growth was projected to rise to 3.9 per cent in 2018 from 3.7 per cent in 2017.

In the domestic economy, the promising developments during the period were: improved fiscal receipts and accretion to external reserves as a result of sustained recovery in oil and other commodity prices, improved oil production, improvements in the 2017 capital budget implementation which was extended into the first half of 2018, sustained development finance interventions in the real sector by the Central Bank of Nigeria, and continued implementation of Economic Recovery and Growth Plan (ERGP). The outcome was reflected in improving but still fragile economic recovery in the first half of the year. Consequently, Gross Domestic Product (GDP) growth moderated to 1.95, and 1.50 per cent (year-on-year) in the first and second quarters of 2018 from 2.11 per cent in the fourth quarter of 2017.

On price developments, the Bank could report that notwithstanding the continuing liquidity surfeit in the banking system, inflationary pressure moderated in the review period as headline inflation declined progressively from 15.13 per cent in January to 11.23 per cent in June 2018. The development largely reflected the relative stability in the foreign exchange market, improvements in food supply, and stability in utility prices.

Monetary policy in the review period, was informed by key considerations which included; the slow output recovery; high but moderating inflation rate which remained above the Bank's target range; continuing liquidity surfeit in the banking system; weak macro-prudential indicators; growing sovereign debt and low fiscal buffers. These developments and the need to achieve the Bank's mandate of price and exchange rate stability provided the basis for the sustenance of the tight monetary policy stance in the first half of the year. Consequently, the Bank kept the Monetary Policy Rate (MPR) at 14.0 per cent and retained its standing facility corridor at +200/-500 basis points. The Cash Reserve Ratio (CRR) and Liquidity Ratio (LR) were also held constant throughout the review period at 22.5 and 30 per cent, respectively. The Bank also continued its reliance on Open Market Operations as main tool for liquidity management, complemented with regular foreign exchange interventions. Although the Nigerian capital market opened on a bullish note in the review period, the market witnessed a lull towards the end of the period, on account of a weak corporate environment and sustained capital reversals in response to on-going monetary policy normalization in the US. Consequently, the All Share Index (ASI) only recorded a marginal increase of 0.09 per cent from 38,243.19 at end-December 2017 to 38,278.55 at end-June 2018.

The broad outlook for the domestic economy in 2018 is promising. The economy is expected to continue on the path of recovery, anchored on higher oil prices and production, and prospects for improved agricultural performance, electricity supply and continuing reforms in the foreign exchange market. The price outlook indicates continuing moderation in the second half of the year towards the Bank's single digit inflation objective. The upside risks to inflation in the near-term would be the implementation of the expansionary 2018 budget and spending towards the 2019 general elections. In view of the near-term outlook, the Bank would continue to manage liquidity conditions in the domestic economy, to ensure that risks to inflation and growth are minimized.

GODWIN I. EMEFIELE
Governor, Central Bank of Nigeria
August 2018

CHAPTER ONE

1.0 OVERVIEW

The monetary policy environment in the first half of 2018 was clouded by developments in the global and domestic economies. On the global front, the key developments were: increased monetary policy divergence amongst the advanced economies; continued uncertainties surrounding the BREXIT negotiations; emerging trade war between the US and other major world economies; sustained monetary policy normalization in the US with implications for capital reversals from the emerging markets and developing economies; pull-out of the US from the Iranian nuclear deal; as well as pockets of geopolitical tensions. The moderating developments included the apparent return of peace to the Korean peninsula, following the meeting between the US and North Korean leaders, and the commencement of trade talks between China and the US to avert the looming trade war.

On the domestic scene, the major challenges to monetary policy were: the continuing liquidity surfeit in the banking system; fragile economic recovery; high but moderating inflationary pressure; as well as pressures in the foreign exchange market. Nevertheless, headline inflation declined progressively from 15.13 per cent in January to 11.23 per cent in June 2018. Food inflation was the major driver of overall moderation in consumer prices during the period, although, core inflation also contributed.

The domestic economy continued on the path of growth, which remained fragile. The development was due largely to increased fiscal receipts and accretion to reserves as a result of sustained recovery in oil and other commodity prices, improved oil production and continued implementation of the Economic Recovery and Growth Plan (ERGP). Others included: improvements in 2017 capital budget implementation which extended into the first half, continued development finance interventions in the real sector by the Central Bank of Nigeria (CBN), and stability in the foreign exchange market. As a result, data from the National Bureau of Statistics (NBS) showed that real GDP growth moderated to 1.95 per cent (year-on-year) in the first quarter of 2018, from 2.11 per cent in the preceding quarter. This was in contrast to the contraction of 0.91 per cent in the corresponding quarter of 2017. The oil sector remained the main driver of growth as it grew by 14.77 per cent compared with 11.20 per cent in the preceding quarter and a contraction of 15.60 per cent in the corresponding period of 2017. The sustained growth of the oil sector was traceable to the continued peace in the Niger Delta region, which had positive impact on oil production. Similarly, the non-oil sector grew by 0.76 per cent in the first quarter of 2018 compared with the growth of 0.45 and 0.72 per cent in the preceding and corresponding quarters of 2017, respectively. The growth in the non-oil sector reflected the performance of Industry (3.52%), Agriculture (3.0%) and Services (0.59%). However, the Construction and Trade sectors contracted by 1.54 and 2.57 per cent, respectively, in the first quarter of 2018. In the second quarter, real GDP growth further declined to 1.50 per cent (year-on-year) from 1.95 and 0.72 per cent in the preceding quarter and the corresponding period of 2017. The oil sector was the main driver of the decline as it contracted by 3.96 per cent from a growth of 14.77 per cent in the preceding quarter and 3.53 per cent in the corresponding period of 2017. The non-oil real GDP, however, grew in the second quarter of 2018 by 2.05 per cent up from 0.76 and 0.45 per cent in the preceding quarter and the corresponding period of 2017. The growth in non-oil real GDP largely reflected the performance of construction (7.66%), services (4.19%) and agriculture (1.19%), although trade contracted by 2.14 per cent in the second quarter of 2018.

During the first half of 2018, activities in the Investors and Exporters foreign exchange window intensified and provided stability in the foreign exchange market. However, new challenges emerged following the sustained normalization of monetary policy in some major advanced economies, thereby intensifying capital reversals from the emerging market economies, including Nigeria. The development led to renewed pressure in the foreign exchange market. Consequently, the Bank had to intensify its heterodox approach to foreign exchange policy, by implementing additional measures to stem these new sources of pressure in the market. These measures included: increased foreign exchange sales to BDCs from twice to thrice weekly as well as the conclusion and implementation of the bilateral currency swap between the Central Bank of Nigeria and the People's Bank of China. The currency swap was intended to facilitate the settlement of transactions between economic agents in both countries without recourse to a third currency (notably the US dollar), thereby reducing pressure on the exchange rate. The Bank also sustained the implementation of existing measures including: intensification of the policy on repatriation of export proceeds as well as return of unutilized foreign exchange sourced from CBN auctions; the restriction of access to 41 items; and the use of Bank Verification Number (BVN) in BDC transactions, to rein-in speculative practices and arbitrage opportunities in the market.

The Nigerian financial markets were moderately stable, although performance continued to reflect trends in the global and domestic economic and financial environments. In the pursuit of its price and monetary stability mandate, the Bank continued to deploy various monetary policy instruments in the first half of 2018. The following instruments were deployed: the Monetary Policy Rate (MPR), the

Cash Reserve Ratio (CRR), Liquidity Ratio (LR), Open Market Operations (OMO) and Discount Window Operations. In addition to these instruments, the Bank maintained its intervention in the foreign exchange market.

The Bank sustained its reliance on open market operations (OMO) as the main tool in managing banking system liquidity in the first half of 2018. Consequently, actual OMO sales in the review period increased to ₦9,743.76 billion compared with ₦7,472.21 billion and ₦3,874.27 billion recorded in the preceding and corresponding periods of 2017, respectively. This represented an increase of 151.50 per cent and 30.40 per cent, above the levels in the first and second halves of 2017, respectively. The high level of OMO sales was attributed to the incidence of Deposit Money Banks (DMBs) discounting OMO bills before maturity in the secondary market, thus expanding the monetary base and leading to a rise in the growth rate of money supply.

The monetary aggregates, largely, performed below their indicative targets in the review period. The development was as a result of the contraction in Net Domestic Assets (NDA) which was, however, unable to surpass the substantial growth in Net Foreign Assets (NFA) of the banking system. The contraction of NDA was traceable to the substantial contraction in credit to government, due to increased government receipts from crude oil sales, which reduced recourse to borrowing from the domestic financial markets. The huge growth in NFA, however, was due to the rise in global crude oil prices which improved accretion to external reserves.

The money market remained active, with market rates reflecting liquidity conditions in the banking system. The rates fluctuated widely outside the Standing Facilities corridor with no clear direction, indicating a high degree of uncertainty in the market. The uncertainties primarily were traceable to low fiscal activities as reflected in the delayed Federal Government budget for 2018, government's recent preference for borrowing from the international market, delays in Federation Account Allocation Committee (FAAC) disbursements and implementation of additional measures to manage demand pressure in the foreign exchange market. Rates at the uncollateralized segment of the market were higher compared with the collateralized OBB rates reflecting the heightened risks and uncertainties in the market.

In the first half of 2018, the Nigerian capital market opened on a bullish note reflecting improved growth sentiments as the economy was recovering from recession as well as increased activities at the Investors and Exporters window. However, towards the end of the period, the market witnessed some lull in activities, following sustained spate of capital reversals arising from the continued monetary policy normalization in some advanced economies, low fiscal activities following the delayed passage of the 2018 FGN budget and fragile economic recovery, all culminating in a weak corporate environment. Consequently, the All-Share Index (ASI) increased by 0.09 per cent to 38,278.55 as at end-June 2018 from 38,243.19 at end- December 2017. Similarly it also increased by 15.58 per cent compared with 33,117.48 at end-June 2017.

In the first half of 2018, activities in the bonds market were dominated by transactions in debt instruments of the Federal Government of Nigeria (FGN). There was also some activity in the Sub-national government and corporate bonds segments, with the latter recording the least share by market volume. At 5.90 per cent, the 10-year dollar-denominated bond yield for Nigeria increased by 143 basis points at end-June 2018, from 4.47 per cent at end-December 2017. When compared with end-June 2017 yield of 4.80 per cent, it increased by 33 basis points with, the developments traceable to the perception of rising sovereign risk by investors.

On the outlook for inflation available estimates suggest that consumer prices will continue their downward trajectory in the near –to-medium term. Headline inflation rate (year-on-year) decelerated to 11.23 per cent in June 2018, compared with 15.13 per cent recorded in January, 2018. Staff projections show that the year-on-year headline inflation would moderate to 10.94, 10.66, 10.41, 10.26 and 10.01 per cent in July, August, September, October and November 2018, respectively. Inflation is, however, forecast to inch up slightly to 10.36 per cent in December 2018. The upside risks to inflation would include the implementation of the 2018 budget and spending towards the 2019 general elections. Others are: poor power supply; increased cost of transportation; and persistent clashes between herdsmen and farmers; leading to disruptions in the food supply and distribution chain. As the Bank continues to manage liquidity conditions in the domestic economy, inflationary developments would continue to be monitored to ensure that the downside risks of inflation to growth are minimized.

The domestic economy is expected to continue on the path of recovery. Real GDP grew at 1.95 per cent (year-on-year) in Q1 2018, representing a stronger growth of 2.87 percentage points compared with -0.91 per cent in Q1 2017. However, the outcome represented a decline of 0.16 percentage point compared with 2.11 per cent recorded in Q4 2017. Similarly, real GDP grew by 1.50 per cent in Q2 2018 representing an expansion of 0.78 percentage point when compared with the growth of 0.72 per cent in the corresponding period of 2017. The outcome was, however, a decline when compared with the growth of 1.95 per cent in Q1 2018. The outlook for 2018 and beyond is positive, as the economy is projected to grow by 2.1 per cent in 2018 and 1.9 per cent in 2019 (IMF, 2018). Similarly, the World Bank projects a growth of 2.5 per cent in 2018 and 2.8 per cent in 2019. The outlook is anchored on higher crude oil prices and production, improved electricity supply, prospects of improved agricultural performance and continuing reforms in the foreign exchange market, among others. Nevertheless, the unemployment rate remained high at 18.8 per cent, requiring targeted fiscal spending to further strengthen output and create jobs. The downside risks to the outlook are: ongoing security challenges; loss of market share for Nigeria's crude oil export; increased political uncertainty due to electioneering activities, which may trigger capital outflows; and weak private sector credit growth. The conduct of monetary policy by the Bank will, therefore, continue to be anchored on the Medium-Term Framework, with the objective of minimizing the upside risks to inflation and downside risks to growth.

CHAPTER TWO

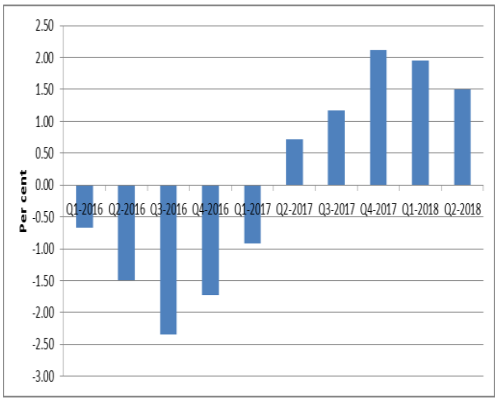
2.0 OUTPUT IN THE DOMESTIC ECONOMY

In the first half of 2018, the domestic economy continued on the path of growth, which however, remained fragile. The development was due largely to increased fiscal receipts and accretion to reserves as a result of sustained recovery in oil and other commodity prices, improved oil production and continued implementation of the Economic Recovery and Growth Plan (ERGP).

Available data from the National Bureau of Statistics (NBS) showed that real Gross Domestic Product (GDP) growth moderated to 1.95 per cent (year-on-year) in the first quarter of 2018, from 2.11 per cent in the preceding quarter. The growth was in contrast to the contraction of 0.91 per cent in the corresponding quarter of 2017. The oil sector remained the main driver of growth as it grew by 14.77 per cent, compared with 11.20 per cent in the preceding quarter and a contraction of 15.60 per cent in the corresponding period of 2017. The sustained growth of the oil sector was traceable to the continued peace in the Niger Delta region, which had positive impact on oil production. Similarly, the non-oil sector grew by 0.76 per cent in the first quarter of 2018 compared with the growth of 0.45 and 0.72 per cent in the preceding and corresponding quarters of 2017, respectively. The growth in the non-oil sector reflected the performance of Industry (3.52%), Agriculture (3.0%) and Services (0.59%). The Construction and Trade sectors, however, contracted by 1.54 and 2.57 per cent, respectively, in the first quarter of 2018.

In the second quarter of 2018, real GDP grew by 1.50 per cent (year-on-year) which was lower by 0.45 percentage point when compared with 1.95 per cent in the preceding quarter. It was, however, an increase of 0.78 percentage point compared with the growth of 0.72 per cent in the corresponding period of 2017. The oil sector was the main driver of the decline as it contracted by 3.96 per cent in Q2 2018 compared with the growth of 14.11 and 3.53 per cent in the preceding quarter and the corresponding period of 2017. The non-oil sector, however, grew by 2.05 per cent compared with the growth of 0.76 and 0.45 per cent in the preceding quarter and the corresponding period of 2017, respectively. Growth in the non-oil sector reflected the performance of construction (7.66%), services (4.19%) and agriculture (1.19%), although the trade sector contracted by 2.14 per cent in the second quarter of 2018.

Figure 2.1
Real GDP Growth (%) 2016 Q1 – 2018 Q2



Source: NBS

2.1 DOMESTIC ECONOMIC ACTIVITIES

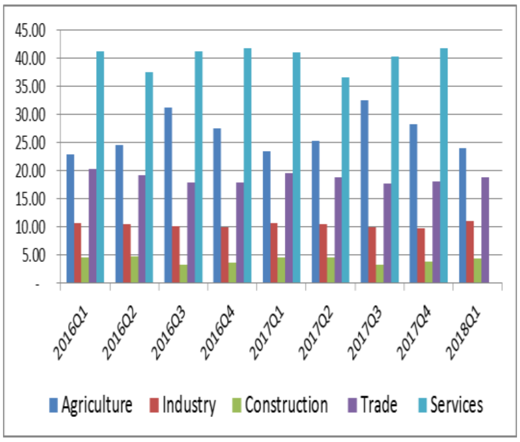
During the first half of 2018, real GDP growth was driven by activities in both the oil and non-oil sectors. In the first quarter of 2018, the oil sector was the main driver of growth, as it grew by 14.77 per cent. This represents an increase of 30.37 and 3.57 percentage points relative to -15.60 and 11.20 per cent in the corresponding and preceding quarters of 2017, respectively. Average daily crude oil production rose to 2.0 million barrels per day (mbpd) in the first quarter of 2018, which was 0.05 and 0.25 mbpd higher when compared with the average daily production of 1.95 and 1.75 mbpd in the preceding and the corresponding quarters of 2017, respectively.

Growth of the non-oil sector moderated to 0.76 per cent in the first quarter of 2018 from 1.45 per cent in the preceding quarter of 2017. However, compared with 0.72 per cent in the corresponding period, it increased by 0.04 percentage point. Activities in the non-oil sector were driven by transportation (14.45%), financial institutions and insurance (13.30%), utilities (8.01%), fishing (4.25%), crop production (3.45%), manufacturing (3.39%), and Information & Communication (1.58%). These compare with the growth rates of 10.55, 0.67, 2.35, 5.49, 3.50, 1.36 and 2.73 per cent, respectively, in the corresponding quarter of 2017.

In the second quarter of 2018, the non-oil sector was the major driver of growth. It expanded by 2.05 per cent up from 0.76 per cent in the preceding quarter and 0.45 in the corresponding period in 2017. Activities in the non-oil sector were driven by transportation (21.76%), Information & Communication (11.81%), utilities (8.91%), forestry (3.96%), arts & entertainment (3.48%), solid minerals (2.86%), accommodation & food services (2.43%), administrative & support services (2.07%), and crop production (1.49%). This compares with their respective growth rates of -6.11, -1.15, 23.98, 3.89, -0.62, 2.28, -4.05, -1.72 and 3.21 per cent in the corresponding quarter of 2017.

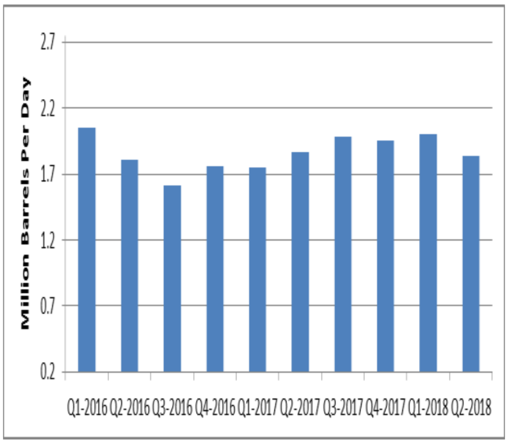
The decline in real GDP growth in Q2 2018 was largely due to the contraction in the oil sector by 3.95 per cent compared with the growth of 14.11 and 3.53 per cent in the preceding quarter and the corresponding period of 2017, respectively. Average daily crude oil production declined to 1.84 million barrels per day (mbpd) in the second quarter, which was 0.16 and 0.03 mbpd lower when compared with the daily average production of 2.0 and 1.87 mbpd in the preceding quarter and corresponding period of 2017, respectively.

Figure 2.2:
Non-oil Sector Performance 2016Q1-2018Q1



Source: NBS

Figure 2.3
Performance of the Oil Sector 2016Q1-2018Q2



Source: NBS

2.2 Sectoral Analysis

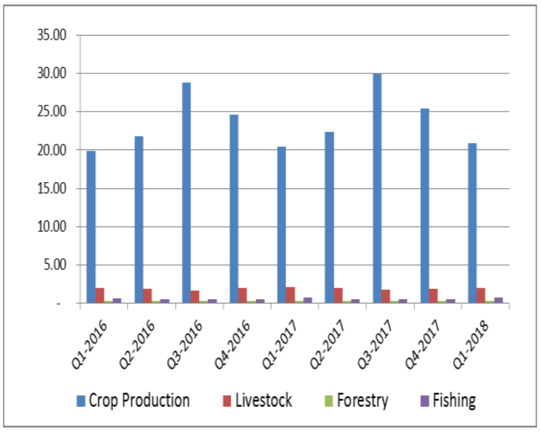
This section reviews the economy's sectoral performance, taking into account key institutional factors that contributed to output growth in the review period.

2.2.1 Agriculture

Real GDP growth in the agricultural sector in the first quarter of 2018 stood at 3.00 per cent, representing a decline of 1.23 and 0.39 percentage points when compared with 4.23 and 3.39 per cent in the preceding and corresponding quarters of 2017, respectively. The decline in the sector was driven by crop production which fell to 3.45 per cent from 4.58 and 3.50 per cent in the preceding and corresponding quarters, respectively. In addition, the livestock subsector contracted by 1.85 per cent compared with expansion of 0.19 and 1.72 per cent in the preceding and corresponding quarters of 2017, respectively. The decline in the agricultural sector was, however, moderated by the growth of 4.25 and 2.94 per cent in fishing and forestry, compared with 4.05 and 2.83 per cent, respectively, in the preceding quarter of 2017. The overall contribution of the sector to real GDP in the first quarter of 2018 stood at 21.65 per cent, which was lower than 26.13 per cent in the preceding quarter but slightly higher than 21.43 per cent in the corresponding quarter of 2017.

In the second quarter, real GDP agricultural output growth was 1.19 per cent, a decline of 1.91 and 1.92 percentage points when compared with 3.00 and 3.01 per cent in the preceding quarter and the corresponding period of 2017, respectively. The decline in the sector was driven by crop production which significantly fell to 1.49 per cent compared with 3.45 in the preceding quarter and 3.21 per cent in the corresponding period of 2017. In addition, livestock and fishing contracted by 1.95 and 1.35 per cent, respectively, compared with the contraction of 1.85 per cent for livestock and expansion of 4.25 per cent for fishing in the preceding quarter. The decline in the agricultural sector was, however, moderated by the growth of 3.96 per cent in forestry, compared with 2.94 and .3.89 per cent in the preceding quarter and the corresponding period in 2017, respectively. Overall, the contribution of the sector to real GDP in the second quarter of 2018 stood at 22.86 per cent per cent, which was higher than 21.65 per cent in the preceding quarter but slightly lower than 22.93 per cent in the corresponding quarter of 2017.

Figure 2.4
Agricultural Sector Contribution by Activity, 2016Q1-2018Q2



Source: NBS

2.2.1.2 Agricultural Policies and Institutional Support

The agricultural sector continued to benefit from a number of policies, reforms and institutional support in the first half of 2018, which are highlighted in this section.

The Agricultural Credit and Guarantee Scheme (ACGS)

In the first half of 2018, a total of 10,420 loans valued at ₦1.75 billion were guaranteed under the scheme compared with 20,268 loans valued at ₦2.82 billion in the second half of 2017, indicating decreases of 48.6 and 37.9 per cent, respectively, in the number and value of loans guaranteed. In the review period, 17,977 loans valued at ₦3.05 billion were repaid, compared with 22,475 loans valued at ₦3.01billion repaid in the second half of 2017. The performance reflected an increase of 1.33 per cent in the number but a decrease of 20.01 per cent in the value of loans repaid.

N200 Billion Commercial Agriculture Credit Scheme (CACS)

Under the scheme, the sum of ₦39.34 billion was disbursed to 8 banks for 16 projects in the first half of 2018 compared with ₦50.59 billion disbursed to 11 banks for 34 projects in the second half 2017. A total of ₦17.01 billion from 14 banks for 51 projects was repaid in the review period, compared with ₦28.825 billion from 18 banks for 191 projects repaid in the second half of 2017.

N220 Billion Micro, Small and Medium Enterprises Development Fund (MSMEDF)

In the first half of 2018, the sum of ₦4.77 billion was disbursed to 14,492 beneficiaries through the Participating Financial Institutions (PFIs) and State Governments compared with N1.59 billion disbursed in the corresponding period in 2017. Repayments during the period amounted to ₦3.48 billion compared with N15.52 billion repaid in the corresponding period of 2017.

Anchor Borrowers' Programme (ABP)

In the first half of 2018, the sum of ₦36.37 billion was disbursed to 155,732 farmers in 34 States for the cultivation of cassava, cotton, groundnut, maize, rice, soya beans, wheat and the production of fish and poultry. This represented an increase of 189.34 per cent when compared with N12.57 billion disbursed in the corresponding period of 2017.

Paddy Aggregation Scheme (PAS)

The Paddy Aggregation Scheme is a short term bridging facility introduced in 2017 to enable rice millers mop up paddy during the harvesting period. The sum of ₦4.25 billion was released to 3 banks for 3 projects in the first half of 2018, compared with ₦30.37 billion released to 4 banks for 8 projects in the second half of 2017. This brings the total disbursement under the scheme to ₦34.62 billion as at end-June, 2018. The sum of ₦13.37 billion was repaid in the first half of 2018.

National Food Security Programme (NFSP)

The programme provides financing for large-scale agricultural enterprises to support government's Strategic Grains Reserves by mopping up excess grains to promote investments in modern agriculture. The sum of ₦4.04 billion was disbursed to 2 banks for 3 projects in the first half of 2018, bringing cumulative disbursements since inception in 2017 to ₦43.99 billion for 11 projects. In the review period, the sum of ₦2.19 billion was repaid, raising the cumulative repayments under the scheme to ₦2.38 billion since inception.

Non-oil Export Stimulation Facility (NESF)

The NESF is aimed at improving access of exporters to finance for expansion and diversification of non-oil exports. The Facility commenced in 2018. In the first half of 2018, six (6) projects were financed with ₦19.04 billion, while repayments amounted to ₦5.04 billion.

Federal Government of Nigeria (FGN) Special Presidential Fertilizer Initiative (PFI)

The FGN Special Presidential Fertilizer Initiative was introduced to increase the production of fertilizer by local blending plants with a view to making the commodity more affordable to Nigerian farmers. In the review period, the sum of ₦20.0 billion was released, bringing the cumulative amount released since its inception in 2017, to ₦25.0 billion.

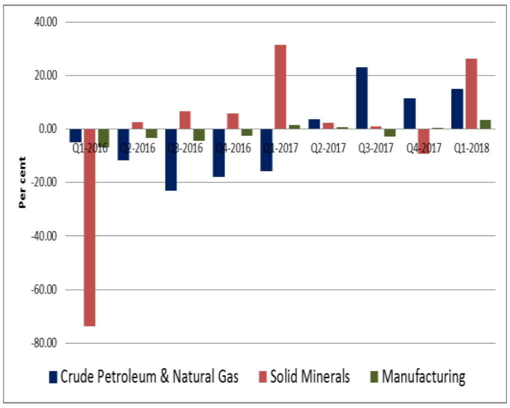
2.2.2 Industry

2.2.2.1 Industrial Production

In the first quarter of 2018, industrial sector output grew by 8.75 per cent, up from 4.72 and -7.24 per cent in the preceding and corresponding quarters of 2017. The main drivers of growth in the sector were: Solid minerals (26.29%), crude petroleum & natural gas (14.77%), and manufacturing (3.39%). These were higher than their respective growth rates of -9.18, 11.20 and 0.14 per cent in the preceding quarter of 2017. Also, they compare favourably with their respective rates of 31.47, -15.60 and 1.36 per cent in the corresponding quarter of 2017. Consequently, the share of Industry in overall GDP improved to 19.58 per cent in the first quarter of 2018 from 16.35 per cent in the preceding quarter.

In the second quarter of 2018, output of the industrial sector contracted by 1.56 per cent in contrast to the growth of 8.75 and 2.04 per cent in the preceding quarter and the corresponding period of 2017, respectively. The main driver of the contraction was crude petroleum (-3.95%), compared with growth of 14.77 and 3.53 per cent in the preceding quarter and the corresponding period of 2017, respectively. The contraction in the industrial sector was, however, moderated by respective growth of 2.86 and 0.68 per cent in the solid minerals and manufacturing sub-sectors, compared with 26.29 and 3.39 per cent in the preceding quarter of 2018 and 2.28 and 0.64 per cent in the corresponding period in 2017. Consequently, the share of the industrial sector in overall GDP declined to 17.99 per cent from 19.58 and 18.55 per cent in the preceding quarter and the corresponding period of 2017, respectively.

Figure 2.5
Industrial Sector's Contribution by Activity, 2016Q1-2018Q2



Source: NBS

2.2.2.2 Industrial Policy and Institutional Support

In the first half of 2018, a number of new and existing reforms and incentives were sustained to support the performance of the sector. These are highlighted in this section.

N300 Billion Power and Airline Intervention Fund (PAIF)

During the review period, ₦18.74 billion was disbursed to the following projects: Kano Power Project (₦3.01 billion), Ashaka Cement Limited Power Plant (₦6.75 billion), Azura Power Project (₦4.94 billion) and Paras Energy and Natural Resources Development Ltd. (₦4.05 billion). The sum of ₦12.35 billion was repaid in the first half of 2018, bringing the cumulative repayment since inception to ₦132.18 billion.

Nigerian Electricity Market Stabilization Facility (N213 billion)

In the first half of 2018, ₦38.53 billion was disbursed to one (1) distribution company (DisCo), seventeen (17) generating companies (GenCos), six (6) gas companies (GasCos) and five (5) service providers. Also, ₦4.99 billion was repaid in the review period, bringing the cumulative repayments to ₦20.56 billion.

Real Sector Support Facility (RSSF)

In the first half of 2018, ₦23.91 billion was released to five (5) projects. Also, ₦960.16 million was repaid in the review period, bringing cumulative repayments to ₦1.76 billion.

Textile Sector Intervention Facility

During the review period, ₦19.1 billion was disbursed to two (2) projects under the scheme. There were no repayments in the period, leaving the cumulative repayments since inception at ₦1.01 billion.

Nigeria Bulk Electricity Trading Payment Assurance Facility (NBET-PAF)

During the review period, ₦248.40 billion was disbursed to NBET Plc. Cumulatively, the amount disbursed under the programme stood at ₦358.09 at end-June, 2018.

Small and Medium Enterprises Restructuring and Refinancing Facility (SMERRF)

Disbursement under the scheme was discontinued following its replacement with the Real Sector Support Facility in December 2014. However, repayments during the review period amounted to ₦12.60 billion, bringing the cumulative repayments to ₦113.261 billion.

2.2.3 Construction and Trade

2.2.3 1 Construction

In the first quarter of 2018, the construction sector contracted by 1.54 per cent in contrast to the growth of 4.14 and 0.15 per cent in the preceding and corresponding quarters of 2017, respectively. The share of Construction in total GDP, however, improved to 4.04 per cent from 3.49 per cent in the fourth quarter of 2017.

In the second quarter of 2018, the construction sector grew significantly by 7.66 per cent up from -1.54 and 0.13 per cent in the preceding quarter and the corresponding period of 2017, respectively. Consequently, the share of construction in overall GDP in the second quarter of 2018 improved to 4.51 per cent from 4.04 in the first quarter.

2.2.3.2 Trade

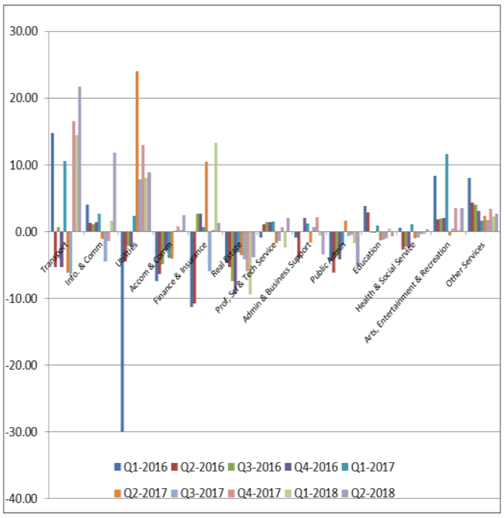
Trade sector real GDP contracted by 2.57 per cent in the first quarter of 2018 compared with the growth of 2.07 per cent in the preceding quarter and a contraction of 3.08 per cent in the corresponding period of 2017. The share of Trade in total GDP, however, rose from 16.72 per cent in the fourth quarter of 2017 to 17.06 per cent in the first quarter of 2018. In the second quarter, the trade sector contracted by 2.14 per cent, thus continuing the contractions of 2.57 and 1.62 per cent witnessed in the preceding quarter and the corresponding period of 2017, respectively. Consequently, the share of trade in total GDP declined from 17.06 in the first quarter to 16.45 per cent in the second of 2018.

2.2.4 Services Sector

The Service sector returned to growth following three successive quarters of contraction. The sector grew by 0.59 per cent in the first quarter of 2018, compared with a contraction of 0.44 per cent in the preceding quarter. The sector grew by 0.98 per cent in the corresponding quarter of 2017. Growth in the sector was driven by transport (14.45%), Finance & Insurance (13.30%), utilities (8.01%), other services (2.24%), Information & Communication (1.58%), Education (0.45%), and Arts, Entertainment & Recreation (0.30%). However, the sub-sectors that contracted during the period were: Real Estate (9.40%), Professional, Scientific & Technical Services (2.35%), Administrative & Support Services (0.52%), Public Admin (1.72%) and Health & Social Services (0.37%).

In the second quarter of 2018, growth in the services sector improved further to 4.19 per cent, compared with 0.59 and -0.15 per cent in the preceding quarter and the corresponding period of 2017, respectively. Growth in the sector was driven by Transport (21.76%), Information & Communication (11.81%), Utilities (8.91%), Arts, Entertainment & Recreation (3.48%), Accommodation and Food Services (2.43%), Professional, Scientific & Technical Services (2.07%), and Finance & Insurance (1.28%). Some sub-sectors, however, contracted including; Public Administration (5.21%), Real Estate (3.88%), Administrative & Support Services (3.41%), and Education (0.67). The share of the services sector in overall GDP increased from 37.67 per cent in the first quarter to 38.19 per cent in the second quarter of 2018.

Figure 2.6
Services Sub-Sector Contribution, 2016Q1-2018Q2



Source: NBS

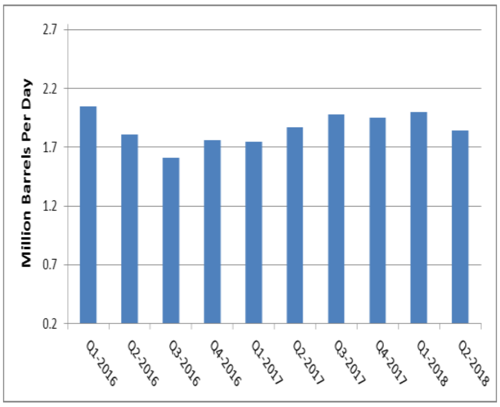
2.2.5 Oil Sector

During the review period, the oil sector sustained its improvement which began in mid-2017. This was driven by continued price recovery in the international crude oil market as well as increased production largely attributable to sustained peace in the

Niger Delta region. Consequently, average daily crude oil production rose to 2.0 million barrels per day (mbpd) in the first quarter of 2018, which was 0.05 mbpd and 0.25mbpd higher than the daily average production recorded in the preceding and corresponding quarters of 2017, respectively. In the second quarter of 2018, however, average daily crude oil production declined to 1.84 million barrels per day (mbpd), which was 0.16 and 0.03 mbpd lower when compared with the daily average production of 2.0 and 1.87 mbpd in the preceding quarter and the corresponding period of 2017, respectively.

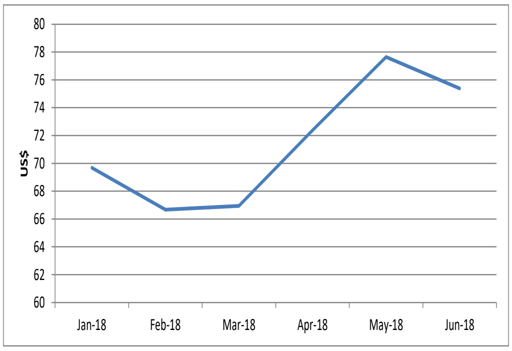
In the review period, crude oil price fluctuated upwards mainly due to the pulling out of the US from the Iranian nuclear deal and the continued implementation of the agreement by the Organization of the Petroleum Exporting Countries (OPEC) and Non-OPEC producers to freeze oil output. As a result, the price of Nigeria's reference crude, the Bonny Light 37⁰API which was at US$69.68 per barrel (PB) in January 2018, fell to US$66.94pb in March and peaked at US77.64pb in May. It, however, fell to US$75.38pb in June, 2018. Overall, the average price of Bonny Light of US$71.45pb in the first half of 2018 was US$20.45pb above the Federal Government of Nigeria's 2018 budget benchmark of US$51.0pb.

Figure 2.7
Quarter Oil Production (2016Q1-2018Q2)



Source: Bloomberg

Figure 2.8
Monthly Bonny Light Price, January – June 2018



Source: Bloomberg

Trade Tensions and Trade Wars

International trade refers the exchange of goods and services across national boundaries. It is the most traditional form of business activity across national borders and has played a major role in shaping world history and development. International trade allows producers and distributors to seek out markets, products and services available or produce in foreign countries. Be it products, services or components, industries and households acquire them because of cost advantage or in order to learn, in the case of firms, about advanced technical methods used in other production climes. The advantage lies in the transfer of technology to help reduce production cost, lower prices and in turn, induce more consumption, thus increasing income, profitability and employment. Trade also enables the acquisition of resources that are not available in the home country.

Growth and external trade are associated with increase in jobs as external markets enable firms to invest in plant capacity that is beyond the domestic demand. Several studies find strong positive correlations between export intensity and wages as well as imports and improved consumption and standard of living. Thus, trade as the traditional theory posits, generates mutual benefits of providing to consumers a variety of goods and services, advanced technical methods of production for firms, reduces cost of production and lower prices, increases profits and higher employment. Given all these benefits, why then do countries sometimes resort to imposing restrictions on trade, thus generating trade tensions which sometimes degenerate into trade wars?. Trade between and among nations is shaped by a number of factors which according to Seyoun (2009) include: the trade regime (import tariffs and quotas), exchange rate regime, efficiency enhancing government policy, presence of entrepreneurial class and secured access to transport and marketing services, among others. Principal among these factors is the trade regime, which when changed has the likelihood of eliciting retaliatory response from trading partners because of its instant and disruptive effects.

Country participation in international trade is guided by its respective trade policy. Trade policies exist to protect national or group interest in international trade. A nation's trade policy is often viewed as a component of its fiscal policy. In designing trade policy, account is taken of the bilateral and multilateral trade agreements that the country has entered into, and the policy is subject to revisions to accommodate developments in the domestic and international economy. Where a party assesses its position as disadvantageous in the trade relationship because current outcomes are not mutually or fairly beneficial to the parties, changes are bound to be introduced and most often in the trade regime. Politicians often rationalize tariffs and other trade interventions by claiming that they will help boost exports and reduce trade deficit. Their argument is that since net exports are a core component of GDP, any policy that reduces the trade deficit should, other things equal, serve to boost economic growth. This is, however, not always the case with an increase in tariffs. For a central bank that targets or have an eye on inflation, the inevitable rise in domestic prices sparked off by tariff increase would trigger the Bank to raise interest rates in order to contract money supply, sending aggregate demand downward. Thus, a key challenge is in how changes in the trade regime are introduced: would it be arbitrary, negotiated, gradual or instant? Where the actions are taken arbitrarily or non-negotiated, they are bound to generate tension and counter responses and, when not properly handled, could result in a trade war.

Trade Tensions and Wars

A trade war is usually an outcome of protectionism which occurs when one country raises tariffs on another country's imports thus prompting a retaliation from the second country by way of raising tariffs on the imports of the first country. It usually starts when country 1 adjudges the trade practices of country 2 as unfair and in order to correct the anomaly raise tariffs or introduce quotas. The counter response and the continuing tit-for-tat degenerates into a trade war. A trade war that begins in one sector can spread to other sector because countries produce and trade goods and services they have comparative advantage. Similarly in a globalized world, a trade war that begins between two countries can affect other countries that were not initially involved in the dispute.

A more connected world implies a higher incidence of trade disputes and a broadening of international economic tensions to include matters of national security and intellectual property (IP). Until recently, incidences of high tariffs were rare and transient following the framework of negotiation provided under the GATT and later WTO. This was because of numerous forces that push against substantial increase in tariff. These forces included: the welfare costs of protectionism, vertical integration of global supply-chain, threat of reciprocity and development of international trade institutions as umpires and custodians of commitments to trade agreements. Following the global financial crisis of 2008/2009, there have, been growing anti-globalization sentiments. Recent developments indicate that trade issues will continue to generate attention given trade's economic importance and the increasing concerns expressed against the unevenness of the benefits of globalization as well as the resultant shift in voter attitudes towards a more nationalistic or protectionist agenda., especially in the advanced economies.

The Recent US-China Trade Tension

Tensions between the United States and China regarding bilateral trade intensified in recent times. The United States announced in early March 2018 that it would impose tariffs on import of steel and aluminum products. The tariffs were not targeted exclusively at any particular country, but given China's volume of exports of steel and aluminum to the United States, it was obvious that the country will significantly be affected by the measures. In response, China announced its own tariffs on about $3 billion worth of American goods. On April 3, the United States announced that it would impose tariffs on the exports of about 1,300 Chinese goods, worth about $50 billion, in "response to China's unfair trade practices related to the forced transfer of U.S. technology and intellectual property." Following this, China again promptly responded with tariffs on 106 American products—mostly agricultural products, automobiles, aircraft and chemicals—whose export value to China total about $50 billion.

All these developments remain at the level of trade tension because the proposed tariffs from both sides have not yet gone into effect. The tariffs could completely be rescinded if negotiations by both sides reach agreement on ways to settle the trade tensions between them.

Economic consequences and Implications for Monetary policy

Higher tariffs hurt the economy most directly and quickly through higher prices of imported goods. Tariffs act much like a tax increase, weakening the purchasing power of consumers; if households need to spend more on imported goods, then they have less income to spend on other things. Exports also suffer as the tit-for-tat tariffs imposed by trading partners cause consumers and businesses to purchase what they need domestically or from competing nations that can now provide the goods more cheaply. Where the political authority has strong control over the economy, they can recommend to the citizens not to buy goods from the competing country. Higher tariffs always weigh on the profitability of multinationals and their stock prices. These occurs via weaker overseas sales. It also creates a risk-off environment in global financial markets. In the longer run, the reduction in trade affects productivity growth, as the benefits of comparative advantage are diminished.

The tit-for-tat in tariffs between or among countries breeds uncertainty, with fallout on business and investor confidence, which would surely be substantial as they contemplate the broader geo-political implications of the trade war. Businesses are less likely to make significant investment decisions. In other words, such situations hold down investment growth with deleterious effect on output growth, employment and citizens' welfare.

In today's world where the manufacture of many goods involves multiple cross-border movements of components from different economic climes with the final good only a product of assembly of these components, higher tariffs on final products may only lead to a shift in the global supply chain. This is because since the multinational companies have no idea on how long the tariffs will remain in place, and since there are many other places in the world not subject to higher tariffs, production may shift to where it is cheaper to make most of these goods. This, however, depends on how conducive is the business environment. Sentiment is very fickle; it is fine, until it is not. There is no telling when sentiment will swing significantly, but when it does, the economic pains intensify quickly.

Although Nigeria may not be directly involved in the trade dispute/war between the U.S. and the E.U, China and member countries of NAFTA, the enforcement of tariffs and counter tariffs by the parties may have spillover effects on other economies, especially those with strong trading ties with these countries. In addition, the U.S. being the leading economy in the world and the US dollar as the world's dominant trading currency, increase in tariff by the US would certainly lead to higher US domestic prices. For this reason, the Fed would raise rates sharply to head off inflationary pressures. The rise in interest rates would have two major effects. First is the reversal of capital flow as returns to capital will now be higher in the U.S, which is also considered a safer haven relative to the emerging markets and developing economies. Second is the increase in foreign currency liabilities arising from the re-pricing of foreign loans as interest rates rise.

In addition, while the effects of any tariffs on output and inflation may take time to materialize, the falls in equity prices in response to the US announcement to impose a tariff on steel and aluminum, and prevailing uncertainty on the scope of retaliatory measures, have already contributed to tighter financial conditions. And by fuelling uncertainty among market participants, fears of a "trade war" have added to the volatility already witnessed earlier this year in equity markets. None of this supports growth and employment. Therefore, given the dependence of commodity exporting economies on improvements in commodity prices which is directly related to global growth, any negative growth and employment effects of higher tariffs would mean lower demand for commodities, lower prices and resultant decline in foreign exchange earnings for such economies, increase in exchange rate pressure, currency depreciation and the pass-through to domestic inflation.

In conclusion, high tariffs may look politically expedient, especially when a country is confronted with a high fiscal or trade deficits. However, the tendency of such actions eliciting retaliatory measures from trading partners makes the policy of unilateral increase in tariffs no-win game in the long-run. Moderate and negotiated solutions remain the way out given the political economy of trade's distributional effects, supply-chain issues and the unanticipated spillover of retaliatory measures.

CHAPTER THREE

3.0 PRICE DEVELOPMENTS

During the review period, inflationary pressure receded, largely on account of the Bank's sustained tight monetary policy stance. All measures of inflation namely, headline, core and food, maintained a downward trajectory, although, headline inflation continued to trend above the upper limit of the Bank's target range of 6 - 9 per cent. Domestic price developments generally reflected the interplay of both supply and demand-side forces.
On the supply side, the pressure in the foreign exchange market abated, with favourable impact on the domestic price level in the review period. The naira strengthened in all segments of the market, reflecting the impact of recent reforms and interventions by the Bank, including the intensification of measures to encourage capital inflow and improve liquidity in the foreign exchange market.

Primarily, the significant improvement in accretion to external reserves on the back of the price recovery in the global crude oil market, helped to support the appreciation of the naira. In addition, the Bank sustained the implementation of existing measures, including the Investors' & Exporters' window, restriction of access to foreign exchange for some 41 items, the use of Bank Verification Number (BVN) in BDC transactions, and the sale of foreign exchange to BDCs by the Bank and International Money Transfer Operators (IMTOs). The Bank also intensified its existing policy on repatriation of export proceeds as well as the return to the Bank of unutilized foreign exchange sourced from CBN auctions.

On the demand-side, price developments were also influenced by activities in the money market, where rates fluctuated widely outside the Standing Facilities corridor with no clear direction, indicating a high degree of uncertainty in the market. The uncertainties primarily were as a result of low fiscal activities as reflected in the delayed Federal Government budget for 2018, government's recent preference for borrowing from the international market, delays in Federation Account Allocation Committee (FAAC) disbursements and implementation of additional measures to manage demand pressure in the foreign exchange market. The major sources of liquidity during the period included: continued implementation of the 2017 capital budget, Joint Venture Cash (JVC) call payments, CBN real sector interventions and maturing CBN bills and government securities. These developments made the Monetary Policy Committee (MPC) to sustain its monetary policy tightening stance during the period, in order to moderate inflationary pressures.

3.1 Trends in Inflation

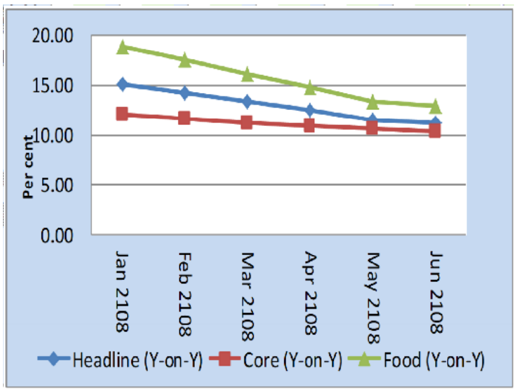
Headline, core and food inflation trended downwards in the period under review. These three measures of the consumer price index (CPI) stood at 248.4, 235.4 and 263.3 in January 2018 compared with 260.5, 246.1 and 278.3, respectively, in June 2018. Accordingly, food inflation (year-on-year) decreased by 5.94 percentage points from 18.92 per cent in January to 12.98 per cent in June 2018. Also, core inflation fell by 1.70 percentage points from 12.09 per cent in January to 10.39 per cent in June 2018. Consequently, headline inflation declined by 3.90 percentage points from 15.13 per cent in January to 11.23 per cent in June 2018 (Figure 3.1 and Table 3.1). The major driver of the overall moderation in consumer prices during the period was food inflation, even though the core measure also moderated (Table 3.4).

Table 3.1:
Inflation Rates, January – June 2018

	Headline Inflation			Core Inflation			Food Inflation		
	CPI	Y-on-Y	12MMA	CPI	Y-on-Y	12MMA	CPI	Y-on-Y	12MMA
Jan 2108	248.35	15.13	16.22	235.42	12.09	13.01	263.29	18.92	19.62
Feb 2108	250.32	14.33	15.93	237.20	11.71	12.67	265.52	17.59	19.52
Mar 2108	252.41	13.34	15.60	239.19	11.18	12.33	267.91	16.08	19.29
Apr 2108	254.52	12.48	15.20	241.26	10.92	12.02	270.35	14.80	18.89
May 2108	257.29	11.61	14.79	243.61	10.71	11.83	273.94	13.45	18.36
Jun 2108	260.47	11.23	14.37	246.12	10.39	11.65	278.25	12.98	17.75

Source: NBS

Figure 3.1:
Headline, Core and Food Inflation Rates (January – June 2018)



Source: NBS

3.1.1 Headline Inflation

The major components of headline inflation continued to decrease during the first half of the year, as a result of the downward trend in domestic prices. The key components that drove the decline were Food and Non-Alcoholic Beverages, which decreased from 9.99 per cent in January to 7.02 per cent in June, 2018. This was followed by housing, water, electricity, gas and other fuels, decreasing from 1.52 to 1.25 per cent during the period (Table 3.2 and Figure 3.4).

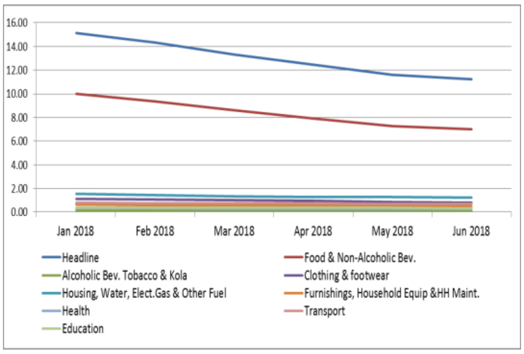
The moderation in inflation was still driven by the base effect which was gradually wearing-off, coupled with sustained stability in the foreign exchange market following intensified implementation of measures to manage the foreign exchange market including the Investors' and Exporters' window. Other contributory factors were the sustained tight monetary policy stance of the Bank and weak aggregate demand as reflected in low fiscal activity during the period.

Table 3.2
Major Components of Headline Inflation ((Y-on-Y), January - June 2018

	Headline	Food & Non-Alcoholic Bev.	Alcoholic Bev. Tobacco & Kola	Clothing & footwear	Housing, Water, Elect.Gas & Other Fuel	Furnishings, Household Equip &HH Maint.	Health	Transport	Education
Jan 2018	15.13	9.99	0.08	1.10	1.52	0.61	0.30	0.78	0.39
Feb 2018	14.33	9.34	0.08	1.07	1.44	0.60	0.30	0.77	0.38
Mar 2018	13.34	8.58	0.08	1.01	1.35	0.57	0.29	0.74	0.37
Apr 2018	12.48	7.93	0.08	0.94	1.30	0.54	0.28	0.72	0.36
May 2018	11.61	7.26	0.08	0.87	1.25	0.52	0.27	0.69	0.35
Jun 2018	11.23	7.02	0.08	0.82	1.25	0.49	0.26	0.67	0.34
Change btw Jan & Jun. 2018	-3.90	-2.97	0.00	-0.29	-0.28	-0.12	-0.04	-0.11	-0.05

Source: NBS

Figure 3.2
Major Components of Headline Inflation (Y-on-Y), January – June 2018



Source: NBS

On a month-on-month basis, headline inflation increased from 0.80 per cent in January to 1.24 per cent in June, 2018. The major components that drove the month-on-month headline inflation were the prices of food and non-alcoholic beverages, which rose from 0.48 per cent in January to 0.86 per cent in June; and Housing, Water, Elect. Gas & Other Fuel, from 0.10 per cent in January to 0.13 per cent in June, 2018 (Table 3.3 and Figure 3.5).

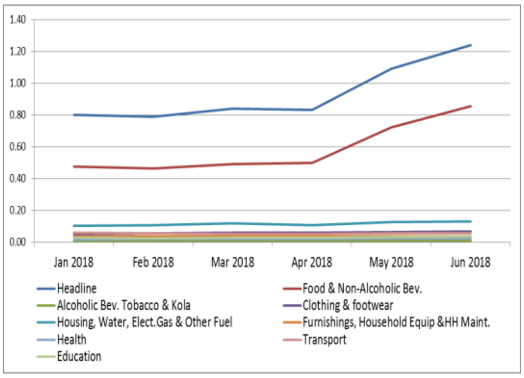
The phenomenon of moderating year-on-year headline inflation being experienced alongside rising month-on-month inflation rate suggests that the base effect driving the moderation was gradually wearing-off. Consequently, policies to address the likely threat of inflation resurgence need to start kicking in.

Table 3.3
Major Components of Headline Inflation (M-on-M), January - June 2018

	Headline	Food & Non-Alcoholic Bev.	Alcoholic Bev. Tobacco & Kola	Clothing & footwear	Housing, Water, Elect.Gas & Other Fuel	Furnishings, Household Equip &HH Maint.	Health	Transport	Education
Jan 2018	0.80	0.48	0.01	0.05	0.10	0.03	0.02	0.06	0.03
Feb 2018	0.79	0.46	0.01	0.06	0.11	0.03	0.02	0.05	0.03
Mar 2018	0.84	0.49	0.01	0.06	0.12	0.03	0.02	0.05	0.03
Apr 2018	0.83	0.50	0.01	0.06	0.11	0.03	0.02	0.05	0.03
May 2018	1.09	0.72	0.01	0.06	0.12	0.04	0.02	0.06	0.03
Jun 2018	1.24	0.86	0.01	0.07	0.13	0.04	0.02	0.06	0.03
Change btw Jan & Jun. 2018	0.44	0.38	0.00	0.01	0.03	0.00	0.01	0.00	0.01

Source: NBS

Figure 3.3
Major Components of Headline Inflation (M-on-M), January – June 2018



Source: NBS

3.1.2 Food Inflation

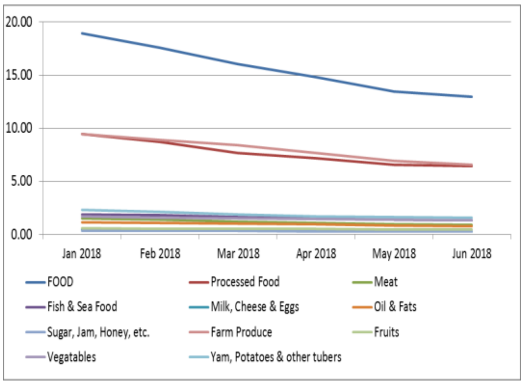
Food inflation (year-on-year) fell from 18.92 per cent in January to 12.98 per cent in June 2018, a decrease of 5.94 percentage points. The key components that drove the decrease were processed food and farm produce. The price of processed food fell by 3.06 percentage points from 9.46 to 6.40 per cent and that of farm produce by 2.89 percentage points from 9.46 per cent in January to 6.57 per cent in June 2018. The decrease in the price of processed food was accounted for by the fall in the prices of meat, fish & sea food, and oil & fat by 0.62, 0.56 and 0.38 percentage point, respectively. Also, the decrease in the price of farm produce was traceable to the fall in the prices of yam, potatoes & other tubers, vegetables and fruits by 0.76, 0.38 and 0.11 percentage point, respectively. The policy drivers of this moderation are traceable to the base effect, the favourable impact of CBN's interventions on food production and improved access to foreign exchange which help counteract the effect of farmer-herdsmen conflicts. Other complimentary factors were the improved accretion to foreign reserves, and sustained tight monetary policy stance of the Bank.

Table 3.4
Major Components of Food Inflation (Y-on-Y), January - June 2018

	FOOD	Processed Food	Meat	Fish & Sea Food	Milk, Cheese & Eggs	Oil & Fats	Sugar, Jam, Honey, etc.	Farm Produce	Fruits	Vegatables	Yam, Potatoes & other tubers
Jan 2018	18.92	9.46	1.51	1.88	0.43	1.14	0.35	9.46	0.55	1.66	2.31
Feb 2018	17.59	8.72	1.36	1.78	0.41	1.07	0.33	8.87	0.52	1.59	2.10
Mar 2018	16.08	7.67	1.20	1.64	0.37	1.00	0.30	8.41	0.50	1.50	1.89
Apr 2018	14.80	7.15	1.08	1.52	0.34	0.92	0.27	7.64	0.48	1.44	1.71
May 2018	13.45	6.55	0.96	1.39	0.29	0.82	0.25	6.90	0.43	1.35	1.59
Jun 2018	12.98	6.40	0.89	1.33	0.26	0.75	0.24	6.57	0.44	1.29	1.55
Change btw Jan & Jun. 2018	**-5.94**	**-3.06**	**-0.62**	**-0.56**	**-0.18**	**-0.38**	**-0.12**	**-2.89**	**-0.11**	**-0.38**	**-0.76**

Source: NBS

Figure 3.4
Major Components of Food Inflation (Y-on-Y), January – June 2018



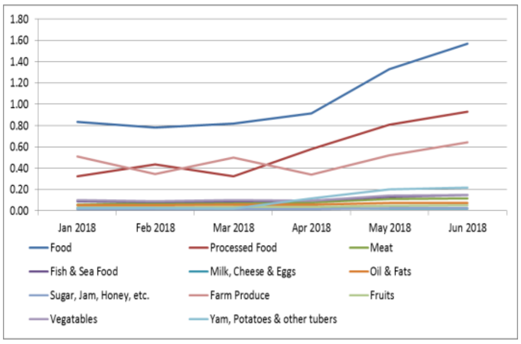
Contrary to the decreasing year-on-year trend, food inflation on a month-on-month basis rose by 0.74 percentage point from 0.83 per cent in January to 1.57 per cent in June 2018. The price of processed food rose by 0.61 percentage point from 0.32 per cent in January 2018 to 0.93 per cent in June 2018. Similarly, the price of farm produce rose by 0.13 percentage point from 0.51 to 0.64 per cent in the same period. Thus, the 0.74 percentage point increase in food inflation was largely due to the increase in the price of processed food. The key driver of the increase in the processed food category was fish and sea food which rose by 0.06 percentage point.

Table 3.5
Major Components of Food Inflation (M-on-M), January – June 2018

	FOOD	Processed Food	Meat	Fish & Sea Food	Milk, Cheese & Eggs	Oil & Fats	Sugar, Jam, Honey, etc.	Farm Produce	Fruits	Vegatables	Yam, Potatoes & other tubers
Jan 2018	0.83	0.32	0.06	0.09	0.02	0.05	0.01	0.51	0.03	0.10	0.02
Feb 2018	0.78	0.44	0.07	0.08	0.02	0.05	0.02	0.34	0.03	0.09	0.03
Mar 2018	0.82	0.32	0.08	0.09	0.02	0.06	0.02	0.50	0.04	0.10	0.02
Apr 2018	0.91	0.58	0.08	0.10	0.02	0.06	0.02	0.34	0.03	0.10	0.11
May 2018	1.33	0.81	0.11	0.13	0.02	0.07	0.02	0.52	0.05	0.14	0.20
Jun 2018	1.57	0.93	0.12	0.15	0.02	0.07	0.03	0.64	0.05	0.15	0.21
Change btw Jan & Jun. 2018	**0.74**	**0.61**	**0.06**	**0.06**	**0.00**	**0.02**	**0.01**	**0.13**	**0.02**	**0.05**	**0.19**

Source: NBS

Figure 3.5
Major Components of Food Inflation (M-on-M), January – June 2018



Source: NBS

3.1.3 Core Inflation

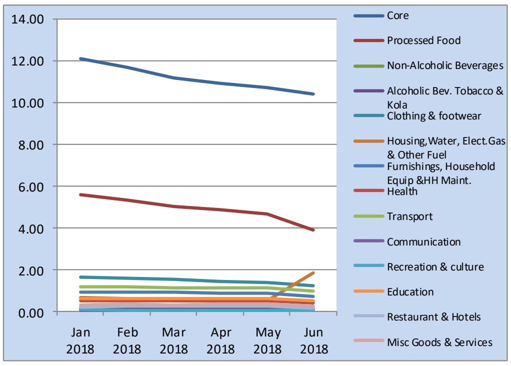
Core inflation (year-on-year) fell from 12.09 per cent in January 2018 to 10.39 per cent in June 2018, a decrease of 1.70 percentage points. The performance was driven by processed food (1.67 percentage points), Clothing & Footwear (0.42 percentage point), Transportation (0.18 percentage point), and Education (0.11 percentage point). All other components of core inflation increased in the reviewed period (Table 3.6 and Figure 3.8). The decline in Processed Food and Clothing & Footwear prices was due to the sustained stability in utility prices, the base effect as well as the impact of stability of the exchange rate on account of the Bank's foreign exchange management measures, particularly the establishment of the I&E window and improved funding of BDCs. In addition, the weakening of aggregate demand reflected in the accumulation of salary arrears and contractor debts in some states also contributed to lower prices.

Table 3.6
Major Components of Core Inflation (Y-on-Y) January – June. 2018

	Core	Processed Food	Non-Alcoholic Beverages	Alcoholic Bev. Tobacco & Kola	Clothing & footwear	Housing,Water, Elect.Gas & Other Fuel	Furnishings, Household Equip &HH Maint.	Health	Transport	Communication	Recreation & culture	Education	Restaurant & Hotels	Misc Goods & Services
Jan 2018	12.09	5.59	0.21	0.11	1.63	0.66	0.94	0.50	1.17	0.02	0.08	0.63	0.23	0.33
Feb 2018	11.71	5.34	0.20	0.11	1.60	0.59	0.93	0.50	1.16	0.03	0.07	0.62	0.23	0.33
Mar 2018	11.18	5.04	0.19	0.11	1.52	0.52	0.90	0.49	1.14	0.03	0.07	0.61	0.24	0.33
Apr 2018	10.92	4.85	0.18	0.11	1.45	0.52	0.88	0.50	1.13	0.03	0.06	0.62	0.25	0.33
May 2018	10.71	4.67	0.17	0.11	1.38	0.53	0.88	0.52	1.12	0.03	0.06	0.63	0.27	0.35
Jun 2018	10.39	3.92	0.15	0.11	1.21	1.82	0.74	0.41	0.99	0.03	0.06	0.52	0.17	0.25
Change btw Jan & Jun. 2018	**-1.70**	**-1.67**	**-0.06**	**0.00**	**-0.42**	**1.17**	**-0.20**	**-0.09**	**-0.18**	**0.01**	**-0.02**	**-0.11**	**-0.06**	**-0.08**

Source: NBS

Figure 3.6
Major Components of Core Inflation (Y-on-Y) January – June 2018



On a month-on-month basis, core inflation, however, increased by 0.35 percentage point from 0.68 per cent in January to 1.03 per cent in June 2018. Housing, Water, Elect. Gas & Other Fuel component remained the major driver of the rise in core inflation, increasing from -1.17 per cent in January to 0.17

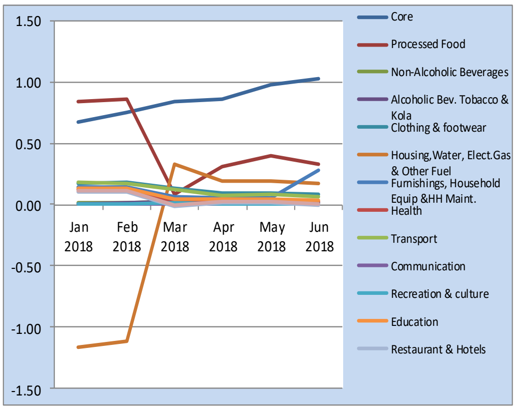
per cent in June 2018. This was followed by Furnishing and Household Equipment & maintenance (0.14 percentage point) (Table 3.7 and Figure 3.9).

Table 3.7
Major Components of Core Inflation (M-on-M) January – June. 2018

	Core	Processed Food	Non-Alcoholic Beverages	Alcoholic Bev. Tobacco & Kola	Clothing & footwear	Housing, Water, Elect.Gas & Other Fuel	Furnishings, Household Equip &HH Maint.	Health	Transport	Communication	Recreation & culture	Education	Restaurant & Hotels	Misc Goods & Services
Jan 2018	0.68	0.84	0.01	0.01	0.17	-1.17	0.15	0.12	0.18	0.00	0.00	0.14	0.11	0.11
Feb 2018	0.75	0.86	0.01	0.01	0.18	-1.12	0.15	0.12	0.18	0.00	0.00	0.13	0.11	0.11
Mar 2018	0.84	0.08	0.02	0.02	0.13	0.33	0.06	0.02	0.12	0.01	0.01	0.04	-0.01	0.00
Apr 2018	0.87	0.31	0.01	0.01	0.09	0.19	0.05	0.03	0.08	0.00	0.01	0.04	0.01	0.02
May 2018	0.98	0.40	0.01	0.01	0.09	0.20	0.05	0.04	0.08	0.00	0.01	0.05	0.01	0.02
Jun 2018	1.03	0.33	0.01	0.01	0.08	0.17	0.28	0.02	0.07	0.00	0.01	0.04	0.00	0.01
Change btw Jan & Jun. 2018	0.35	-0.51	0.00	0.00	-0.09	1.34	0.14	-0.10	-0.12	0.00	0.00	-0.10	-0.11	-0.11

Source: NBS

Figure 3.7
Major Components of Core Inflation (M-on-M) January – June 2018



3.1.4 Seasonally-Adjusted Inflation

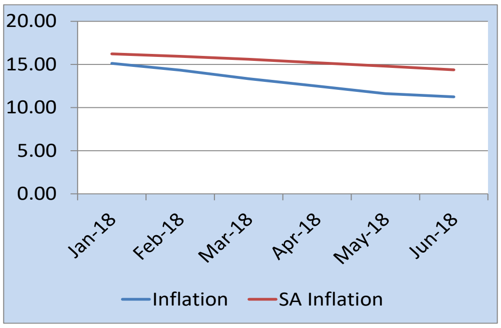
The actual and seasonally-adjusted measures of headline inflation both trended downwards in the review period, continuing the trend of decline witnessed towards the end of the second half of 2017 (Table 3.8 and Figure 3.10). Actual headline inflation continued to reflect the declining general price level in the economy, trending below the seasonally-adjusted measure throughout the first half of 2018. The overall downward trend in both measures could be attributed to the weakening of aggregate demand reflected in the accumulation of salary arrears and non-payment of contractor debt in some states. The incidence of weakening aggregate demand engendered a weak elasticity of inflation to seasonal factors such as the usual increase in expenditure associated with festive periods.

Table 3.8
Actual and Seasonally Adjusted Headline Inflation January – June 2018

Date	Inflation	SA Inflation
Jan-18	15.13	16.22
Feb-18	14.33	15.93
Mar-18	13.34	15.60
Apr-18	12.48	15.20
May-18	11.61	14.79
Jun-18	11.23	14.37

Source: NBS

Figure 3.8
Actual and Seasonally Adjusted Headline Inflation January – June 2018



Source: NBS

3.2 Key Factors that Influenced Domestic Prices

Inflation developments during the review period were primarily influenced by cost-push, demand-pull and moderating factors. The key highlights of these factors include: exchange rate stability, the sustained tight monetary policy stance of the Bank, continued intervention by the Bank in the agricultural sector, and relative stability in energy prices. Others included: the liquidity effects of the monetisation of improved export earnings, the payment of some outstanding obiligations by the Government; and herdsmen-farmer crisis in some parts of the country as well as production and distribution challenges associated with insurgency in the north east region of the country.

3.2.1 Demand-side Factors

The downward trajectory in headline inflation was driven amongst others by the tight monetary policy stance of the Bank, coupled with a number of reforms adopted in managing the foreign exchange market. These factors helped curb exchange rate depreciation and rein-in inflationary pressures. Also, stable energy prices contributed to reducing inflationary pressures. During the review period, agregate demand remained weak owing to oustanding contractor debt, workers' salaries and pension abligations, particularly at the sub-national levels of government. Overall, the net effect of these factors was the significant and steady reduction in inflationary pressures.

3.2.2. Supply-Side Factors

There were basically three groups of factors that led to the observed moderation in inflation during the period. These were factors related to: (i) improved supply of foreign exchange; (ii) improved productivity in the economy; and (iii) stability in administered or utilities prices. The factors related to the improved supply of foreign exchange included: the significant improvement in accretion to external reserves due to the recovery in crude oil prices; activities at the Investors' & Exporters' window; and sustained restriction of access to foreign exchange for 41 items, amongst others. The production related factors included: the continued intervention by the CBN in the real sector; the Federal Government of Nigeria (FGN) Special Presidential Fertilizer Initiative; and activities of the National Food Security Council. On administered prices, the factors included: improved availability of petroleum products and stable energy prices. All these supply side forces helped to moderate inflationary pressure during the first half of 2018.

3.2.3 Moderating Factors

The moderating factors were those that stoked inflationary pressures, thereby slowing the downward trend experienced during the review period. These included: continued herdsmen-farmer crisis, the waning base effect, and increased FAAC distribution following improvements in oil receipts.

CHAPTER FOUR

4.0 MONETARY POLICY AND LIQUIDITY MANAGEMENT

The monetary policy environment in the first half of 2018 was clouded by developments in the global and domestic economies. On the global front, the key developments were: increased monetary policy divergence amongst the advanced economies; continued uncertainties surrounding the BREXIT negotiations; emerging trade war between the US and other major world economies; sustained monetary policy normalization in the US with implications for capital reversals from the emerging markets and developing economies; pull-out of the US from the Iranian nuclear deal; as well as pockets of geopolitical tensions. The moderating developments include the apparent return of peace on the Korean peninsula following the meeting between the US and North Korean leaders, and the commencement of trade talks between China and the US to avert the looming trade war. On the domestic scene, the major challenges to monetary policy were: the continuing liquidity surfeit in the banking system; fragile economic recovery; high but moderating inflationary pressures; as well as pressures in the foreign exchange market. In the face of these challenges, the need to achieve price stability conducive to economic growth was the key consideration that shaped monetary policy decisions in the review period.

4.1 DECISIONS OF THE MONETARY POLICY COMMITTEE (MPC)

In the first half of 2018, decisions of the Monetary Policy Committee (MPC) were shaped by a variety of global and domestic economic and financial developments. Principal amongst these were: the continued adjustments in the global financial markets following monetary policy normalization in the US, growing trade tensions between major economies and continued geo-political tensions.

The key developments in the domestic economy were: slow output recovery; high but moderating inflation rate which remained above the Bank's target range; continuing liquidity surfeit in the banking system; weak macro-prudential indicators; growing sovereign debt and low fiscal buffers. These issues and the need to achieve the Bank's mandate of price and exchange rate stability provided the background for monetary policy decisions in the review period.

4.1.1 July 2017 MPC Meeting

The 3rd and 4th April, 2018 Monetary Policy Committee (MPC) meeting assessed developments in the global and domestic economic environments during the first quarter of 2018, as well as the risks to price stability, financial stability, and output growth in the short to medium term.

At the global scene, output growth was projected at 3.9 per cent for 2018 up from 3.7 per cent in 2017 on the heels of rebound in investments. The development was underpinned by improvements in investor confidence, strengthening commodity prices, rising aggregate demand and accommodative monetary policy in some advanced economies. The Committee, however, noted the downside risks to the global output growth to include: new U.S. trade policy; continuing normalization of monetary policy in some advanced economies; uncertainties associated with the BREXIT negotiations; and rising geo-political tensions in the Middle-East and the Korean Peninsula.

On the domestic front, the Committee observed that the economy was gradually returning to a path of sustainable growth as real Gross Domestic Product (GDP) grew by 1.92 per cent in the fourth quarter of 2017 up from 1.40 and 0.72 per cent in the third and second quarters, respectively. Overall, the economy grew by 0.83 per cent in 2017. The main drivers of real GDP growth were agriculture (1.08%), industry (0.56%) and trade (0.35%). Non-oil real GDP grew by 1.45 per cent in the fourth quarter of 2017 compared with a contraction of 0.76 per cent in the third quarter. The Committee also took cognizance of the continued positive growth outlook indicated by the twelfth and eleventh consecutive months of expansions of 56.7 and 57.2 index points in the Manufacturing and Non-manufacturing Purchasing Managers' indices, respectively, in March 2018.

In addition, the MPC examined available forecasts of key macroeconomic indicators which pointed to a positive outlook for the economy in 2018. The Committee, thus called for the quick passage and effective implementation of the 2018 budget and improvement of security situation in the country to help actualize the growth projections. It also called for sustained implementation of the Economic Recovery and Growth Plan (ERGP) in order to support the fragile recovery. The downside risks to the outlook, according to the MPC, included: the liquidity impact of spending towards the 2019 general elections; continuing herdsmen related violence; and rising yields in the advanced economies, which could trigger capital outflows and renew pressure on the exchange rate.

The MPC also noted the continued deceleration in inflation, with headline inflation (year-on-year) falling for the thirteenth consecutive month to 14.33 per cent in February 2018 from 18.72 per cent in January 2017. The Committee attributed the development to the relative stability in the foreign exchange market.

The Committee observed the improvements in the equities segment of the capital market being buoyed by increase in the level of reserves. As a result, the All-Share Index (ASI) rose by 8.5 per cent from 38,243.19 on December 29, 2017, to 41,504.51 on March 29, 2018. Market Capitalization (MC) also improved by 10.2 per cent from N13.61 trillion to N14.99 trillion during the same period, owing to growing investor confidence.

In its considerations, the MPC noted the fragile output recovery, moderation in price development and the relative stability of the banking system. The Committee noted that economic recovery, even though still weak, was strengthening, in view of the return to growth of the Services Sector. It called for a quick passage of the 2018 Appropriation Bill by the National Assembly, to keep fiscal policy on track and deliver the urgently needed reliefs in terms of employment and growth. The MPC was satisfied with the continued moderation in all measures of inflation as well as sustained stability in the naira exchange rate. The Committee applauded the relatively strong balance sheets and stable outlook of deposit money banks in spite of the concentration of non-performing loans in a few sectors, which it observed was satisfactorily being addressed by adequate mechanisms established by the Bank.

In reaching its decision, the MPC appraised potential policy options with a consideration for the balance of risks. The Committee also took note of the gains made so far as a result of its earlier decisions, including the stability of the foreign exchange market, the moderation in price developments as well as the restoration of output growth, and lauded the launch of the Food Security Council by the Federal Government to ensure food security.

The Committee was of the view that further tightening would strengthen the impact of monetary policy on inflation with complementary positive effects on capital flows and exchange rate stability. Nevertheless, it could potentially dampen the positive outlook for output growth and financial stability. On the other hand, the Committee was of the view that loosening may strengthen the outlook for growth by stimulating domestic aggregate demand through reduced cost of borrowing. This, the MPC noted, may lead to a rise in consumer price levels, generating exchange rate pressures in the process. It could also worsen the current account balance through increased importation of consumer goods and outflow of capital. On the argument to hold, the Committee was of the view that key macroeconomic variables have continued to evolve in a positive direction and should be allowed adequate time to fully manifest.

In consideration of the foregoing, the Committee decided unanimously to retain the Monetary Policy Rate (MPR) at 14.0 per cent; CRR at 22.5 per cent; Liquidity Ratio at 30.0 per cent; and the asymmetric corridor of +200 and -500 basis points around the MPR.

4.1.2 September 2017 MPC Meeting

At the 21st and 22nd May, 2018 MPC meeting, the Committee noted the sustained momentum of global economic activities, driven by: easing geo-political tensions on the Korean

Peninsula; reduced trade tensions between China and the United States; and easy financing conditions in the Euro Area, the UK and Japan. Accordingly, global output was projected to grow at 3.9 per cent in 2018, up from 3.8 per cent in 2017. The Committee noted that in spite of these optimistic developments, the downside risks to global growth remained: lingering geo-political tensions in the Middle-East; continued uncertainties around the BREXIT negotiations; withdrawal of the United States from the 2015 Iranian Nuclear Deal; and growing trend towards trade protectionism.

On the domestic scene, the Committee noted improvements in the economy, attributable to the steady decline in inflation, rebound in oil prices and increase in production level, as well as the continued stability in the foreign exchange market. Accordingly, data from the National Bureau of Statistics (NBS) showed that real Gross Domestic Product (GDP) for Q4 2017 was revised upwards from 1.92 to 2.11 per cent, while a growth of 1.95 per cent was recorded in the first quarter of 2018, up from a contraction of 0.91 per cent in the corresponding period of 2017. The Committee also noted the sustained positive outlook based on the Manufacturing, and Non-manufacturing Purchasing Managers' Indices (PMI), which rose for the thirteenth and twelfth consecutive months to 56.9 and 57.5 index points, respectively, in April 2018. While the Committee welcomed this development, it remained of the view that growth was still largely fragile and could benefit from further reforms and stimulus. In this regard, it urged the various levels of government to accelerate the settlement of contractor debt and salary arrears as well as facilitate the quick implementation of the 2018 Federal Government budget.

The MPC also noted that inflationary pressures continued to moderate, with headline inflation (year-on-year) declining for the fifteenth consecutive month to 12.48 per cent in April 2018 from 13.34 per cent in March 2018, driven by a decline in food prices and continued stability in the exchange rate.

On developments in the financial markets, the Committee observed with concern, the declining performance in the equities market, as the All-Share Index (ASI) decreased by 6.6 per cent from 43,330.54 on February 28, 2018 to 40,472.45 on May 18, 2018. Similarly, Market Capitalization (MC) fell by 5.7 per cent from N15.55 trillion on February 28, 2018 to N14.66 trillion on May 18, 2018. The decline was due largely to profit taking activities by investors, as well as capital flow reversals in response to monetary policy normalization in the United States. The MPC thus, noted the need to maintain remunerative domestic rates to stem the trend towards huge capital outflows.

In its considerations, the Committee expressed satisfaction on the positive outlook in the domestic economy as real GDP grew for the fourth consecutive quarter by the first quarter of 2018. The Committee also welcomed the continued deceleration in headline inflation as well as stability in the foreign exchange market and therefore, called on the Bank to sustain the momentum in order to further subdue inflation and ensure continued growth. The MPC, however, noted the potential effects of the expansionary 2018 budget, the buildup in election-related spending towards the 2019 general elections and the liquidity impact of rising FAAC distributions following the increase in crude oil prices. The Committee took note of the improved performance of deposit money banks and observed that the relatively high level of non-performing loans in the industry was moderating and urged the Federal Government to promptly settle outstanding contractor arrears to help improve aggregate demand.

The MPC critically assessed the impact of developments in the international and domestic environments on key macroeconomic variables such as output growth, inflation, the exchange rate and accretion to external reserves and evaluated the policy options. In its evaluation, the Committee considered the forecast of high liquidity injection in the second half of 2018 and its likely upward pressure on prices. Tightening, it argued would ensure the mop-up of excess liquidity, noting that inflation still remained in double digits and above the ceiling of the Bank's inflation corridor in spite of its continued moderation. Raising the policy rate, however, may depress investment and consumer spending and impact the fragile recovery adversely. Loosening, the Committee considered, would help stimulate aggregate demand through lower cost of credit. Nevertheless, it deliberated on the effectiveness of the choice at a time when high liquidity injections had been forecast in the second half of the year as likely to exacerbate inflationary pressures, increase capital outflow and pressure on the exchange rate. It further noted that loosening would worsen the current account balance through increased importation of cheaper foreign goods, margin lending, lowering of risk evaluation in accessing loans which may result in increased NPLs with potential negative consequences on the stability of the banking industry. In the Committee's opinion, the prevailing downside risk to growth and upside risk to inflation appeared relatively balanced as growth continued to strengthen even though moderately, while the pace of price development continued to taper. Maintaining the current policy stance, it argued, would sustain gradual improvements in both indices.

In summary, the predominant argument for a hold at this time was to await the passage and implementation of the 2018 budget and to monitor its impact on price development and output growth. In consideration of the foregoing, the

Committee decided by a vote of 8 members to retain the Monetary Policy Rate (MPR) at 14.0 per cent alongside all other policy parameters. One (1) member, however, voted to increase the MPR by 50 basis points. Thus, the MPC voted to retain the: MPR at 14.0 per cent; CRR at 22.5 per cent; Liquidity Ratio at 30.0 per cent; and the asymmetric corridor of +200 and -500 basis points around the MPR.

4.2 Instruments of Liquidity Management

In pursuance of its price and macroeconomic stability mandate, the Bank continued to deploy various monetary policy instruments in the first half of 2018. The following instruments were deployed: the Monetary Policy Rate (MPR), the Cash Reserve Ratio (CRR), Liquidity Ratio (LR), Open Market Operations (OMO) and Discount Window Operations. In addition to the use of these instruments, the Bank maintained active intervention in the foreign exchange market.

4.2.1 Monetary Policy Rate (MPR)

The MPR remained the key instrument for monetary policy management during the review period, remaining unchanged at 14.0 per cent throughout the period as conditions in the economy did not necessitate an adjustment. The asymmetric corridor around the MPR was also left unchanged at +200 and -500 basis points. The retention of MPR and the asymmetric corridor, showed the Bank's commitment to a tight policy stance.

4.2.2 Open Market Operations (OMO)

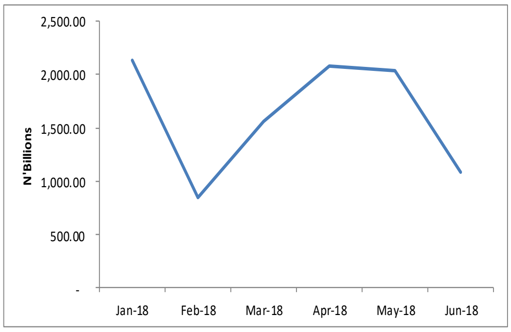
Liquidity management in the first half of 2018 was conducted primarily through Open Market Operations (OMO). OMO sales increased to ₦9,743.76 billion in the review period from ₦7,472.21 billion and ₦3,874.27 billion, representing an increase of 30.40 per cent and 151.50 per cent above the levels in the preceding and corresponding periods of 2017, respectively (Table 4.1). The high level of operations was attributed to the incidence of Deposit Money Banks (DMBs) discounting OMO bills before maturity in the secondary market, thus expanding the monetary base and leading to a rise in the growth rate of money supply.

Table 4.1
OMO Bills Auction (January 2017 – June 2018)
(N'billion)

Date	2017	2018	% Change
Jan	700.52	2,132.61	204.43
Feb	619.14	845.28	36.52
Mar	391.16	1,561.38	299.17
Apr	316.09	2,084.46	559.45
May	580.08	2,033.42	250.54
Jun	1,267.28	1,086.61	-14.26
1st Half	**3,874.27**	**9,743.76**	**151.50%**
Jul	1,517.53		
Aug	1,104.57		
Sep	741.85		
Oct	1,179.20		
Nov	1,461.13		
Dec	1,467.93		
2nd Half	**7,472.21**		**30.40%**

Source: Financial Market Department, CBN

Figure 4.1
OMO Bills Auction (January – June 2018)



Source: CBN

4.2.3 Reserve Requirements

The Cash Reserve Ratio (CRR) was used to complement the MPR and OMO as instruments of liquidity management in the first half of 2018. The Monetary Policy Committee (MPC) maintained the CRR at 22.5 per cent during the review period, the same level as it was at end-December 2017, as liquidity in the banking system remained relatively high. The liquidity ratio also remained unchanged at 30.0 per cent during the review period.

4.2.4 Standing Facilities

The Standing Facilities windows were active during the review period to enable Deposit Money Banks (DMBs) and the Discount House (DH) meet their daily liquidity requirements. The Bank maintained the standing facilities corridor of +200/-500 basis points around the MPR.

The request for Standing Lending Facility (SLF), decreased significantly by 72.62 per cent from ₦25,664.35 billion in the second half of 2017 to ₦7,027.46 billion in the first half of 2018. The volume also declined by 74.41 per cent when compared with ₦27,466.58 billion in the corresponding period of 2017 (Table 4.2).

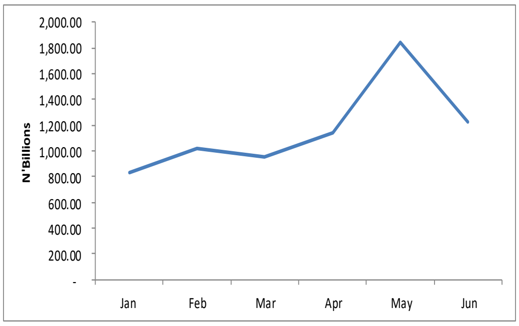
In contrast, total deposits at the Standing Deposit Facility (SDF) window increased significantly by 149.93 per cent to ₦10,684.38 billion in the first half of 2018 from ₦4,275.00 billion in the second half of 2017. This represented an increase of 93.88 per cent relative to N5,510.75 billion recorded in the corresponding period of 2017 (Table 4.3). Transactions at the two windows resulted in a net deposit of ₦3,656.92 billion in the first half of 2018. The increased level of deposits was due to sustained monetary policy tightening stance which helped to rein-in excess liquidity from the money market.

Table 4.2
CBN Standing Lending Facility (January 2017 – June 2018) (N'billion)

Date	2017	2018	% Change
Jan	3,380.57	833.09	-75.36
Feb	4,478.50	1,020.15	-77.22
Mar	5,052.56	952.23	-81.15
Apr	5,746.68	1,145.52	-80.07
May	4,596.99	1,847.69	-59.81
Jun	4,211.28	1,228.78	-70.82
1st Half	**27,466.58**	**7,027.46**	**-74.41%**
Jul	3,855.13		
Aug	5,585.51		
Sep	4,377.89		
Oct	5,605.30		
Nov	3,909.09		
Dec	2,331.43		
2nd Half	**25,664.35**		**-72.62%**
Total	**53,130.93**		**371.07**

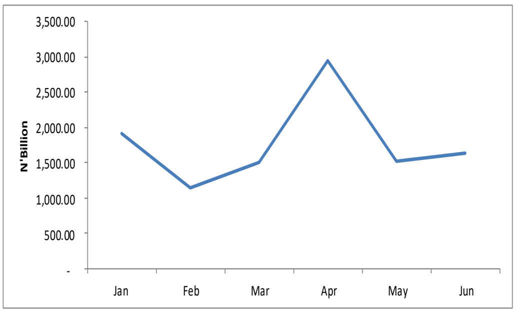
Source: CBN

Figure 4.2
Standing Lending Facility (January 2017 – June 2018)



Source: CBN

Figure 4.3
Standing Deposit Facility (January 2017 – June 2018)



Source: CBN

Table 4.3
CBN Standing Deposit Facility (January 2017 – June 2018) (N'billion)

Date	2017	2018	% Change
Jan	1,855.98	1,919.78	3.44
Feb	804.07	1,144.10	42.29
Mar	889.35	1,508.75	69.65
Apr	593.79	2,952.20	397.18
May	665.28	1,527.04	129.53
Jun	702.28	1,632.51	132.46
1st Half	**5,510.75**	**10,684.38**	**93.88%**
Jul	825.1		
Aug	315.24		
Sep	411.43		
Oct	405.21		
Nov	691.97		
Dec	1,626.05		
2nd Half	**4,275.00**		**149.93%**
Total	**9,785.75**		

Source: CBN

4.2.5 Foreign Exchange Intervention

During the first half of 2018, activities in the Investors and Exporters foreign exchange window intensified and provided stability in the foreign exchange market. However, new challenges emerged following the sustained normalization of monetary policy in some major advanced economies, thereby intensifying capital reversals from emerging market economies, including Nigeria. The development renewed pressure in the foreign exchange market. Consequently, the Bank had to intensify its heterodox approach to foreign exchange policy, by implementing additional measures to stem these new sources of pressure in the market. These measures included: increased foreign exchange sales to BDCs from twice to thrice weekly as well as the conclusion and implementation of the bilateral currency swap between the Central Bank of Nigeria and the People's Bank of China. The currency swap was intended to facilitate the settlement of transactions between economic agents in both countries without recourse to a third currency (notably the US dollar), thereby reducing pressure on the exchange rate.

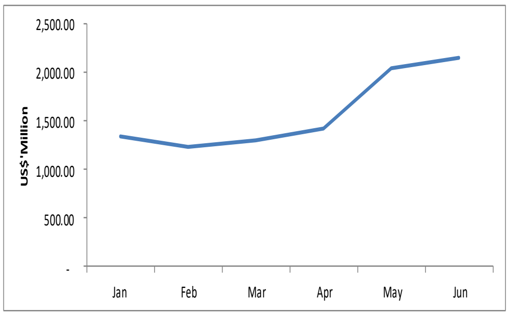
The Bank also sustained the implementation of the existing measures including: intensification of the policy on repatriation of export proceeds as well as return of unutilized foreign exchange sourced from CBN auctions; the restriction of foreign exchange access of some 41 items; the use of Bank Verification Number (BVN) in BDC transactions; resumption of sale of foreign exchange by the Bank and International Money Transfer Operators (IMTOs) to BDCs; as well as special foreign exchange auctions to targeted sectors and foreign exchange sales for small scale importers. As a result, the total supply of foreign exchange increased by 23.21 per cent to US$9,499.92 million in the first half of 2018, from US$7,710.49 million in the second half of 2017. It also increased by 17.21 per cent when compared with US$8,104.95 million in the corresponding period of 2017 (Table 4.4). The increased supply of foreign exchange was largely due to improved accretion to foreign reserves from higher oil prices as well as modest capital inflow from the sustained tight monetary policy stance of the Bank.

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

Date	2017	2018	% Change
	Total FX Supply (including Forward Sales)	Total FX Supply (including Forward Sales)	
Jan	768.76	1,343.12	74.71
Feb	876.48	1,237.26	41.16
Mar	1,309.44	1,300.93	-0.65
Apr	1,919.30	1,422.35	-25.89
May	2,109.93	2,039.51	-3.34
Jun	1,121.04	2,156.75	92.39
1st Half	**8,104.95**	**9,499.92**	**17.21%**
Jul	1,207.00		
Aug	1,449.49		
Sep	1,220.33		
Oct	1,315.99		
Nov	1,210.99		
Dec	1,306.69		
2nd Half	**7,710.49**		

Source: CBN

Figure 4.4
Foreign Exchange Supply by the CBN (January – June 2018)



Source: CBN

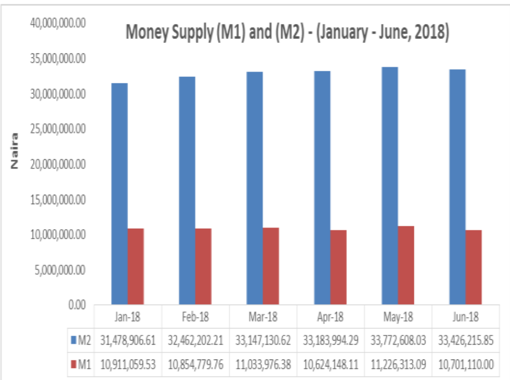
4.3. Developments in the Monetary Aggregates

In the first half of 2018, most of the monetary aggregates performed below their indicative targets. The development was as a result of the contraction in Net Domestic Asset (NDA) which was, however, unable to overwhelm the substantial growth in Net Foreign Assets (NFA) of the banking system. The contraction of NDA was traceable to the substantial contraction in credit to government, due to increased government receipts from crude oil sales, which reduced recourse to borrowing from the domestic financial market. The huge growth in NFA, however, was due to the sustained rise in global crude oil prices, which improved accretion to external reserves.

4.3.1 Broad Money (M2)

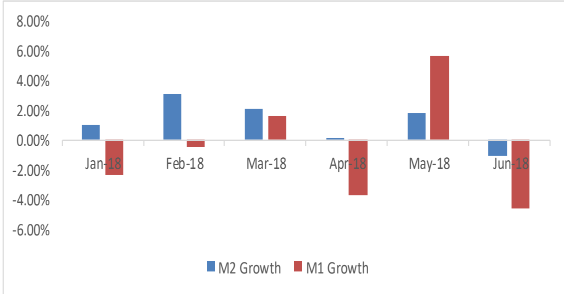
Broad Money (M2) grew by 2.79 per cent to ₦24,814.00 billion at end-June 2018, from ₦24,140.63 billion at end-December 2017. Compared with the end-June 2017 level of ₦21,980.58 billion, M2 increased by 12.89 per cent. The year-on-year growth in M2 of 12.89 per cent was above the 2018 indicative growth target of 10.48 per cent.

Figure 4.5
Money Supply (M1) and (M2) (January – June, 2018)



Source: CBN

Figure 4.6
Growth in Money Supply (M1) and (M2) (January - June, 2018)



Source: CBN

4.3.2 Narrow Money (M1)

Narrow Money (M1) contracted by 4.25 per cent to ₦10,701.11 billion at end-June 2018 from ₦11,175.11 billion at end-December 2017. However, compared with end-June 2017 figure of N10,190.19 billion, M1 grew by 5.01 per cent which was, however, below the indicative growth target of 8.04 per cent indicating that M1 under-performed during the review period (Figures 4.4 and 4.5).

4.3.3 Net Foreign Assets (NFA)

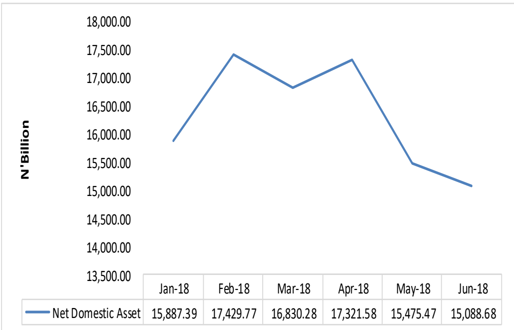
Net Foreign Assets (NFA) increased by 18.15 per cent to ₦ 18,337.53 billion at end-June 2018 from ₦15,520.76 billion at end-December 2017. Compared with the end - June 2017 figure of ₦8,468.08 billion, NFA grew by 116.55 per cent which was well above the indicative growth target of 18.15 per cent. The substantial growth in NFA was due to the continued rise in global crude oil prices, which improved accretion to external reserves. Average crude oil prices (Bonny Ligth) rose to

US$71.45 in the first half of 2018 from US$54.09 in the second half of 2017.

4.3.4 Net Domestic Assets (NDA)

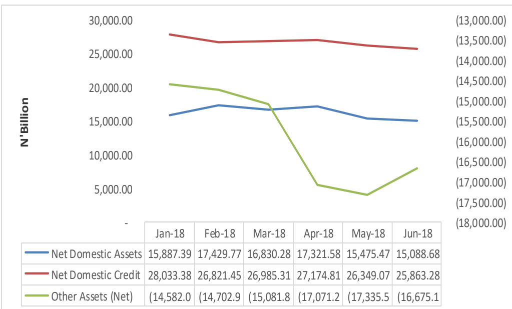
Net Domestic Assets (NDA) contracted by 3.51 per cent to ₦15,088.68 billion at end-June 2018 from ₦15,636.80 at end-December 2017. Compared with the end-June 2017 figure of ₦19,851.20 billion, NDA also contracted by 31.56 per cent, which was significantly below the indicative growth target of 1.97 per cent, largely on account of huge contraction in credit to the government.

Figure 4.7
Net Domestic Asset (NDA) (January - June 2018)



Source: CBN

Figure 4.8
NDA, NDC and Other Assets (net) (January – June, 2018)



Source: CBN

4.3.5 Credit to the Government (C_g)

Credit to Government (Cg) in the first half of 2018 contracted by 9.74 per cent to ₦3,286.34 billion at end-June 2018 from ₦3,640.93 billion at end-December 2017. When compared with the end-June 2017 figure of ₦5,250.49 billion, it also contracted by 37.41 per cent, in contrast to the indicative growth benchmark of 54.25 per cent. The development was attributed to increased government receipts from crude oil sales which reduced Government's recourse to borrowing from the domestic financial market.

4.3.6 Credit to the Private Sector (C_p)

Credit to the private sector (Cp) declined marginally by 0.04 per cent to ₦22,281.87 billion at end-June 2018 from ₦22,290.66 billion at end-December 2017. Compared with the end-June 2017 figure of ₦21,985.95 billion, Cp, however, grew by 1.35 per cent, which was still below the 2018 indicative growth target of 5.75 per cent. The decline in credit to the private sector in the review period can be attributed to the continued risk aversion by banks in lending to the real sector.

Figure 4.9
Domestic Credit to Private Sector (January – June, 2018)

Source: CBN

4.3.7 Reserve Money (RM)

Reserve Money (RM) contracted marginally by 1.91 per cent to ₦6,360.47 billion at end-June 2018 compared with ₦6,484.30 billion at end-December 2017. It, however, increased by 16.06 per cent when compared with its end-June 2017 level of ₦5,480.21 billion, but was below the 2018 indicative growth benchmark of 21.50 per cent.

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

Variables	Actual June 2017	Actual December 2017	Actual June 2018	Benchmark 2018	Deviation (N'b)	Change in H1 2018 over H1, 2017
M2 (N'b)	21,980.58	24,140.63	24,814.00	27,791.26	-2,977.26	2,833.42
M2 (%)	5.9	9.83%	2.79%	10.48%	-0.11	12.89%
M1 (N'b)	10,190.19	11,175.57	10,701.11	11,951.18	-1,250.07	510.92
M1 (%)	24.14	9.67%	-4.25%	8.04%	-0.10	5.01%
RM (N'b)	5,480.21	6,484.30	6,360.47	6,710.96	-350.49	880.26
RM (%)	-1.99	18.32%	-1.91%	21.50%	-0.05	16.06%
NDC (N'b)	27,236.43	25,931.58	25,568.21	28,340.64	-2,772.43	-1,668.22
NDC (%)	12.13	-4.79%	-1.40%	12.45%	-0.10	-6.12%
Cg (N'b)	5,250.49	3,640.93	3,286.34	3,123.22	163.12	-1,964.15
Cg (%)	151.56	-30.66%	-9.74%	54.25%	0.05	-37.41%
Cp (N'b)	21,985.95	22,290.66	22,281.87	25,217.41	-2,935.54	295.92
Cp (%)	3.29	1.39%	-0.04%	5.75%	-0.12	1.35%
NFA (N'b)	8,468.08	15,520.76	18,337.53	15,604.16	2,733.37	9,869.45
NFA (%)	-18.12	83.29%	18.15%	18.15%	0.18	116.55%

Source: CBN

Electoral Cycles and Monetary Policy in Nigeria

Democracy has become the dominant form of government around the world. Indeed the wave of democratization became so forceful during the turn of the 20th century, when the proportion of democratic states grew from 27.0 to 61.0 per cent. Democratic governance in modern states is underpinned by periodic elections, the process by which representatives are selected to conduct the affairs of government on behalf of the citizenry.

An empirical regularity had been severally established between the growth rate of M1 and the periods leading up to and during major election cycles in both advanced and developing democracies. Prior literature had linked electoral cycles to monetary policy through two main hypotheses. The first, which has become popularly known as the political business cycles hypothesis is consistent with the thinking that the monetary authorities, who are to some degree subservient to the government, are somewhat compelled to deliberately manipulate instruments in the monetary policy toolkit to expand money supply, thus reducing interest rates in periods leading up to elections. The aim is to signal good performance by the political authorities, with the motive being to curry the favour of electorates and secure the re-election of the incumbent or the ruling political ideology.

The alternative explanation for monetary growth during electoral cycles lies in the government deliberately "cultivating" the electorate during election years in order to influence voting behavior and sentiments. This deliberate show of concern for the electorate is manifested in several ways including increased budgetary spending in election years, election-related spending, and systematic vote buying - the processes through which election outcomes are swayed in a given direction by means of gifts or cash inducements. Vote buying requires high level of liquidity which may entail converting illiquid assets into cash, thus substituting broad money for cash or bank deposits. Also because vote buying is an illicit activity, the financing most often comes from the underground economy. Funds from such shadow economy eventually find their way into formal bank deposits, thereby increasing the money stock.

Prior empirical tests of the money-election cycle theory have produced rather weak and inconclusive evidence, particularly for democracies with weak institutions in developing countries. Thus the alternative of increased budgetary provisions and vote buying perspective seems to come handy in explaining the money-election nexus. Preliminary observations on the evolution of narrow money stock (M1) during Nigeria's election years of 1999, 2003, 2007, 2011, and 2015 indicate a pattern of increase in MI during the election periods. The data showed a clear increase in money stock (M1) as from the months of February and March, when political and electoral activities were at their peak in the respective election years; with money stock peaking in periods around and immediately after inauguration in May. Subsequently, money stock returned to trend. These observations were, however, not empirically tested.

These issues are particularly relevant as the preparation towards Nigeria's upcoming elections in early 2019 portend liquidity management challenges. The common believe is that due to the late passage of the 2018 budget, the year would experience liquidity flows arising from the implementation of the 2018 and 2017 FGN budgets, as well as other spending associated with increased political and electoral activities. With the country's fledgling democracy since 1999, the increasing monetization of the electoral process raises the concern of stakeholders particularly the Central Bank which rely on achieving targets for the growth rates of monetary aggregates to support its price stability mandate.

CHAPTER FIVE

5.0 DEVELOPMENTS IN THE FINANCIAL MARKETS

In the review period, the Nigerian financial markets were moderately stable, although performance continued to reflect developments in the global and domestic economic and financial environments. The key forces on the global front were: rising trade tensions between the US and its major trading partners; the withdrawal of the US from the Iranian nuclear deal; and the continued uncertainties around the BREXIT negotiations. Other factors included: sustained monetary policy divergence in the advanced economies; and heightened geo-political tensions in the Middle East and Korean Peninsula. On balance, the effect of these factors were considerably muted by the commencement of peace talks on the Korean Peninsula and sustained recovery in oil and other commodity prices, leading to a rebound in investment and manufacturing output. Accordingly, global economic recovery strengthened, with more central banks in advanced economies gearing up to join the US and the UK in normalizing monetary policy. The US Fed raised its rate twice in 2018, with markets largely anticipating one more before year end. The Bank of England (BOE) indicated that a gradual hike in the policy rate would be required in order to address inflation concerns and manage investment outflow from uncertainties surrounding BREXIT. The European Central Bank (ECB) provided guidance that it would review its asset purchase programme in 2018. Nonetheless, the monetary environment during the review period remained broadly accommodative relative to historical trends.

At the domestic scene, the money market remained active in the review period, with market rates reflecting liquidity conditions in the banking system. The rates fluctuated widely outside the Standing Facilities window, indicating a high degree of uncertainty in the market. The stability in the foreign exchange market was threatened by intensified capital reversals, following sustained normalization of US monetary policy. In response, the Bank sustained implementation of existing and new measures including: increased foreign exchange sales to BDCs as well as the conclusion and implementation of the bilateral currency swap between the Central Bank of Nigeria and the People's Bank of China, which helped rein-in speculative practices and arbitrage opportunities in the market. The Nigerian stock market witnessed a lull in activity as the All-Share Index (ASI) remained almost flat at 0.09 per cent year-to-June 2018, on the back of fragile economic recovery, weak corporate environment and low fiscal activities which fuelled adverse investor sentiments.

5.1 The Money Market

During the review period, the money market remained active, with market rates reflecting liquidity conditions in the banking system. The rates fluctuated widely outside the Standing Facilities corridor with no clear direction, indicating a high degree of uncertainty in the market. The uncertainties primarily were traceable to low fiscal activities as reflected in the delayed Federal Government budget for 2018, government's recent preference for borrowing from the international market, delays in Federation Account Allocation Committee (FAAC) disbursements and implementation of additional measures to manage demand pressure in the foreign exchange market. Accordingly, the Bank increased its OMO auctions and interventions in the foreign exchange market in response to the observed volatility in the market. The major sources of liquidity during the period included: continued implementation of the 2017 capital budget, Joint Venture Cash (JVC) call payments, CBN real sector interventions, and maturing CBN bills and government securities. Rates at the uncollateralized segment of the market (interbank call rates) were higher compared with the collateralized OBB rates reflecting the heightened risks and uncertainties in the market.

These developments made the Monetary Policy Committee (MPC) to sustain its monetary policy tightening stance during the period by maintaining the Monetary Policy Rate (MPR) at 14.0 per cent and the asymmetric corridor of +200/-500 basis points as well as the Cash Reserve Ratio (CRR) and Liquidity Ratio (LR) of 22.5 and 30.0 per cent, respectively.

5.1.1 Short-term Interest Rate Developments

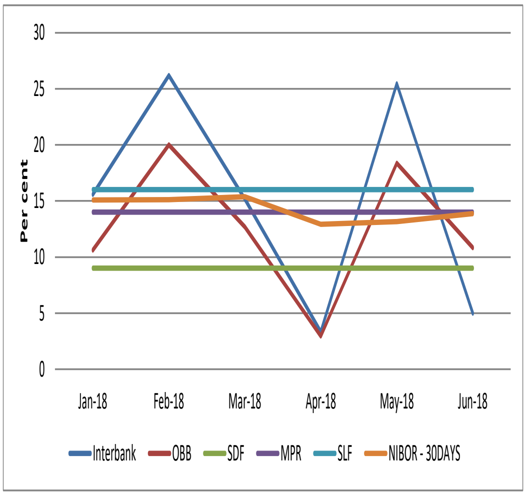
Market interest rates largely reflected liquidity levels in the banking system. Liquidity in the money market was mainly influenced by statutory FAAC disbursements, OMO and NTB transactions, maturing government securities and CBN bills, Joint Venture (JVC) cash call payments and continued implementation of the 2017 FGN budget. CBN's foreign exchange interventions to moderate FOREX demand pressures also affected liquidity in the money market. During the review period, both segments of the money market remained active and experienced periods of high volatility. The interbank call rate ranged between 3.34 per cent and 26.19 per cent, averaging 15.12 per cent in the entire period, while the OBB rate had a narrower range of between 2.96 per cent and 19.99 per cent, averaging lower at 12.58 per cent in the period. The average interbank call rate was generally higher than the OBB rates mirroring heightened risks in the market.

Table 5.1
Weighted Average Monthly Money Market Interest Rates (January – June 2017)

MONTHS	Interbank	OBB	SDF	MPR	SLF	NIBOR - 30DAYS
Jan-18	15.58	10.62	9.00	14.00	16.00	15.09
Feb-18	26.19	19.99	9.00	14.00	16.00	15.10
Mar-18	15.16	12.69	9.00	14.00	16.00	15.38
Apr-18	3.34	2.96	9.00	14.00	16.00	12.91
May-18	25.43	18.37	9.00	14.00	16.00	13.15
Jun-18	5.00	10.84	9.00	14.00	16.00	13.88
Average	15.12	12.58	9.00	14.00	16.00	14.25

Source: (Statistics, CBN)

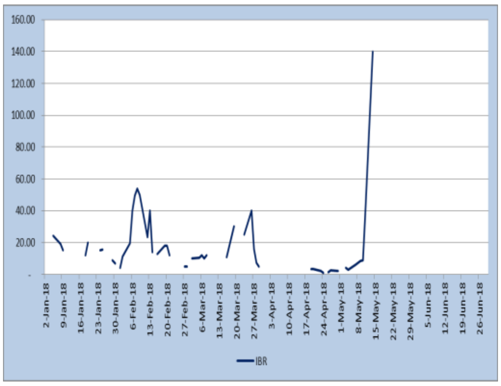
Figure 5.1
Weighted Average Monthly Money Market Interest Rates (Jan.–Jun. 2018)



(i) The Interbank Call Rate

During the review period, the interbank call segment experienced a lull in activities, as evidenced by several non-trading days. The high frequency of non-trading days in the uncollateralized segment was due to heightened risk aversion amongst deposit money banks (DMBs). Consequently, interbank call rates increased from 15.19 per cent in January to 26.19 per cent in February, before declining significantly to 3.34 per cent in April, 2018. The rate further spiked to 25.43 per cent in May before closing lower at 5.00 per cent in June, 2018. The flat rate of 5.00 per cent recorded in June was based on only one transaction for the entire month. The peak in the review period affirms the sustained tight monetary policy stance of the Bank, which led to occasional liquidity crunch in the money market. The interbank call rate ranged between 3.34 per cent and 26.19 per cent, averaging 15.12 per cent in the review period, compared with 19.78 per cent in the preceding half year. Analysis of the daily rates showed that the call rate ranged from 1.00 to 140.00 per cent between January and June 2018. The rate spike of 140.00 per cent recorded in May, 2018 was due to the withdrawal of liquidity from the banking system through OMO auctions, Naira deposit made by commercial banks for the purchase of foreign currency and revenue remittances by Nigerian National Petroleum Corporation (NNPC), Nigeria Customs Service (NCS) and Federal Inland Revenue Service (FIRS) and other government agencies during the period of FAAC distributions. The rate however, declined to 5.00 per cent in June following improved liquidity conditions.

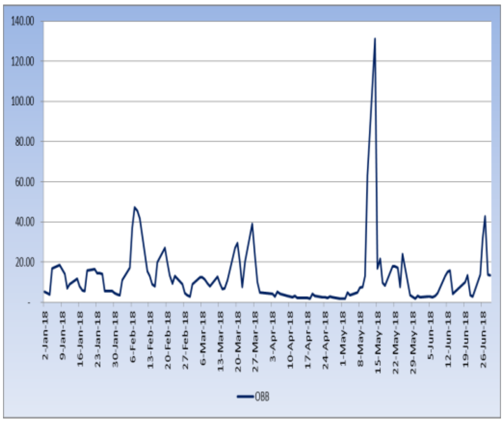
Figure 5.2
Daily Interbank Call Rate (January – June 2018)



(ii) The Open Buy Back Rate

During the review period, non-trading days were not observed in the OBB segment, which remained active in comparison with activities at the interbank call segment. The improved activities at the OBB segment were largely traceable to the security of transactions of the segment. The OBB rate rose from 10.62 per cent in January to 19.99 per cent in February, before declining significantly to 2.96 per cent in April, 2018. The rate, however, spiked to 18.37 per cent in May before closing lower at 10.84 per cent in June, 2018. As in the interbank call segment, the spikes in the OBB rate in February and May were largely as a result of low levels of liquidity in the banking system, arising from the sale of NTBs and CBN Bills. The OBB rate had a narrower range of between 2.96 per cent and 19.99 per cent, averaging lower at 12.58 per cent in the period compared with 22.57 per cent in the preceding half year. Analysis of the daily rates showed that the OBB rate ranged from 1.85 to 131.04 per cent between January and June 2018. The rate spike of 131.04 per cent recorded in May, 2018 was as a result of withdrawal of liquidity from the banking system through OMO auctions, Naira deposit made by commercial banks for the purchase of foreign currency and revenue remittances by NNPC, NCS and FIRS and other government agencies during the period of FAAC distributions. The rate however, closed at 13.30 per cent in June following improved liquidity conditions.

Figure 5.3
Daily Open Buy Back Rate (January-June 2018)



(iii) The Nigeria Interbank Offered Rate (NIBOR)

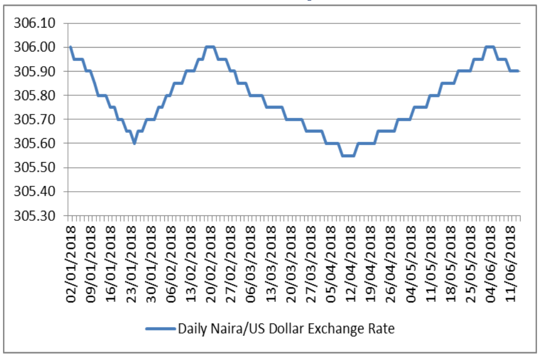
The reference rate in the Nigerian money market, the NIBOR, was relatively stable across all tenors in the review period. The rate generally fluctuated downwards as opposed to movements in the interbank call and OBB rates that did not show a clear direction. The weighted average 30-day NIBOR, rose from 15.09 per cent in January to 15.38 per cent in March 2015. It, however, moderated to 13.15 per cent in May, and subsequently closed at 13.88 per cent in June 2018.

The average NIBOR rate for the review period was 14.25 per cent, down from 27.83 per cent in the preceding half year, indicating that liquidity conditions were easing (Table 5.1).

5.2 Foreign Exchange Market

During the first half of 2018, the key challenge to foreign exchange stability was the sustained normalization of monetary policy in the US, which led to intensified capital reversal from emerging market economies, including Nigeria. The development was in spite of increased activities at the Investors and Exporters window, targeted at providing stability to the market. Consequently, the Bank sustained the implementation of existing measures including: the continuation of the policy on repatriation of export proceeds as well as return of unutilized foreign exchange sourced from CBN auctions; the restriction of access to foreign exchange for some 41 items; the use of Bank Verification Number (BVN) in BDC transactions; resumption of sale of foreign exchange by the Bank and International Money Transfer Operators (IMTOs) to BDCs; as well as special foreign exchange auctions to targeted sectors and foreign exchange sales for small scale importers. In addition to these policies, the Bank introduced new measures which included: increased foreign exchange sales to BDCs from twice to thrice weekly, as well as the conclusion and implementation of the bilateral currency swap between the Central Bank of Nigeria and the People's Bank of China. These measures were able to rein-in speculative practices and arbitrage opportunities in the market.

Figure 5.4
Daily Naira/US Dollar Exchange Rate (January - June 2017)



5.2.1 Average Exchange Rates

The foreign exchange rate appreciated by 0.03 per cent to an average of ₦305.79/US$ in the first half of 2018 from ₦305.88/US$ in the second half of 2017. During the same period, the BDC rate also appreciated by 0.48 per cent, from an average of ₦363.99/US$ to ₦362.25/US$ (Table 5.2).

Table 5.2
Average Monthly Spot Exchange Rates (July 2017 – June 2018) (₦/US$)

Month / Year	Interbank Rate	BDC Rate
2017: Jul	305.86	365.38
Aug	305.67	365.57
Sep	305.89	365.55
Oct	305.62	362.21
Nov	305.9	362.41
Dec	306.31	362.83
Average	**305.88**	**363.99**
2018: Jan	305.78	363.2
Feb	305.9	362.48
Mar	305.74	362.07
Apr	305.61	362.25
May	305.83	362.86
Jun	305.87	360.66
Average	**305.79**	**362.25**

Source: CBN

5.2.2 End-Period (Month) Exchange Rates

The naira appreciated at the interbank and the BDC segments of the foreign exchange market at the end of the first half of 2018. At the interbank foreign exchange market, the naira appreciated by 0.02 per cent to ₦305.78/US$ at end-June, 2018 from ₦305.85/US$ at end-December 2017. At the BDC segment, it, also, appreciated by 0.30 per cent to N362.00/US$ at end-June, 2018 from N363.08/US$ at end-December, 2017. The development indicated a trend towards convergence of the rates in the market in response to the Bank's policy measures (Figure 5.5 and Table 5.3).

Table 5.3
End-Month Exchange Rates (July 2017 – June 2018) (N/US$)

Month / Year	Interbank Rate	BDC 'B' Rate
2017: Jul	305.70	362.00
Aug	305.85	364.00
Sep	305.75	364.50
Oct	305.80	362.00
Nov	306.00	363.00
Dec	306.00	363.00
Average	**305.85**	**363.08**
2018: Jan	305.70	363.00
Feb	305.90	362.00
Mar	305.65	362.00
Apr	305.70	362.00
May	305.95	362.50
Jun	305.75	360.50
Average	**305.78**	**362.00**

Source: CBN

5.2.3 Nominal and Real Effective Exchange Rates

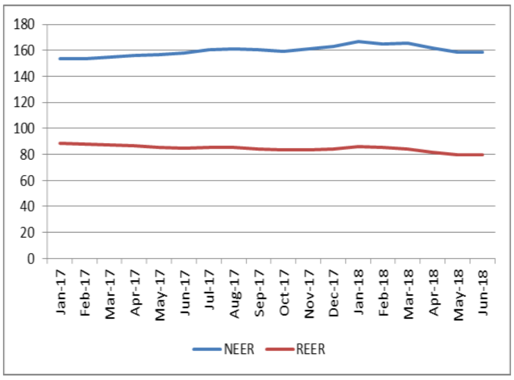
The Nominal Effective Exchange Rate (NEER) depreciated by 1.27 per cent to an average of 162.87 in the first half of 2018 from an average of 160.83 in the second half of 2017. It also depreciated significantly by 4.87 per cent when compared with 155.31 in the corresponding period of 2017. In contrast, the Real Effective Exchange Rate (REER) appreciated by 2.02 per cent from an average of 84.44 in the second half of 2017 to an average of 82.77 in the first half of 2018. When compared with 86.80 in the corresponding period of 2017, the average REER appreciated by 4.87 per cent (Table 5.4). Thus, the naira appreciated in real terms relative to the currencies of Nigeria's major trading partners in the review period, indicating the effectiveness of efforts by the Bank to manage inflation which sustained its downward trend in the review period (Table 5.4 and figure 5.6).

Table 5.4
Nominal and Real Effective Exchange Rates Indices (Jan 2017 – Jun 2018)

DATE	NEER	REER
2017: Jan	153.29	88.75
Feb	153.33	87.71
Mar	154.54	87.03
Apr	155.84	86.62
May	156.95	85.71
Jun	157.92	84.95
2017:H1 Average	**155.31**	**86.8**
2017: Jul	160.61	85.56
Aug	161.37	85.42
Sep	160.32	84.33
Oct	159.05	83.23
Nov	160.9	83.73
Dec	162.74	84.39
2017:H2 Average	**160.83**	**84.44**
2018: Jan	167.13	86.12
Feb	165.02	85.31
Mar	165.35	84.12
Apr	162.03	81.93
May	158.85	79.56
Jun	158.86	79.56
2018:H1 Average	**162.87**	**82.77**

Source: CBN

Figure: 5.5
Nominal and Real Effective Exchange Rates Indices (January 2017 – June 2018)



Source: CBN

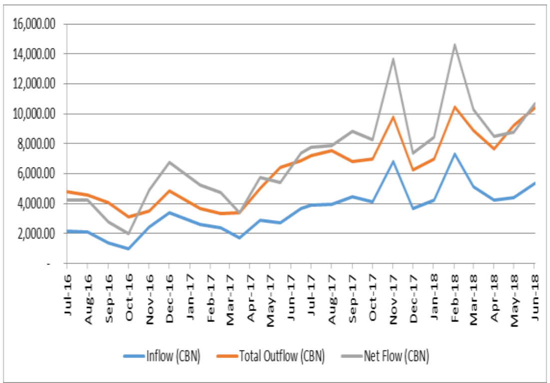
5.2.4 Foreign Exchange Flows through the CBN

Foreign exchange inflows through the CBN increased by 13.23 per cent to US$30,414.98 million in the first half of 2018, from US$26,861.61 million in the preceding period. It also increased by 90.89 per cent compared with US$15,933.36 million in the corresponding period of 2017. Foreign exchange outflows also rose by 29.44 per cent to US$22,942.33 million in the first half from US$17,724.26 million in the preceding period. On a year-on-year basis, foreign exchange outflows represented an increase of 79.86 per cent compared with US$12,755.62 million in the corresponding period of 2017. The development resulted in a lower net inflow of US$7,472.65 million in the first half of 2018 compared with US$9,137.35 million in the preceding half year. The inflow was, however, higher when compared with US$3,177.74 million in the corresponding half of 2017 (Table 5.5 and Figure 5.7). The modest inflows were traceable to higher oil receipts and the effectiveness of the Bank's measures in managing capital outflows.

Table 5.5
Monthly Foreign Exchange Flows through the CBN
(July 2015 – June 2017)

Dates	Inflow (CBN)	Total Outflow (CBN)	Net Flow (CBN)
Jan-17	2,605.50	1,055.84	1,549.66
Feb-17	2,374.48	978.56	1,395.92
Mar-18	1,693.40	1,672.59	20.81
Apr-18	2,874.86	2,164.40	710.46
May-18	2,712.38	3,676.12	-963.74
Jun-18	3,672.74	3,208.11	464.63
2017 H1 Total	**15,933.36**	**12,755.62**	**3,177.74**
Jul-17	3,867.04	3,358.32	508.72
Aug-17	3,943.45	3,594.32	349.13
Sep-17	4,425.53	2,390.41	2,035.12
Oct-17	4,132.80	2,839.15	1,293.65
Nov-17	6,811.96	2,957.60	3,854.36
Dec-17	3,680.83	2,584.46	1,096.37
2017 H2 Total	**26,861.61**	**17,724.26**	**9,137.35**
Jan-18	4,212.56	2,734.38	1,478.18
Feb-18	7,303.15	3,163.29	4,139.86
Mar-18	5,076.48	3,754.12	1,322.36
Apr-18	4,238.05	3,437.72	800.33
May-18	4,373.01	4,821.91	-448.90
Jun-18	5,211.73	5,030.91	180.82
2018 H1 Total	**30,414.98**	**22,942.33**	**7,472.65**

Figure 5.6
Monthly Foreign Exchange Flows through the CBN
(Jul 2016 – Jun 2018)



5.2.5 Foreign Exchange Flow through the Economy

In the review period, gross foreign exchange inflow to the economy increased by 18.16 per cent to US$66,931.28 million, from US$56,646.51 million in the second half of 2017. It significantly increased by 100.64 per cent when compared with US$33,358.96 million in the corresponding period of 2017. Similarly, gross foreign exchange outflow increased by 26.24 per cent to US$24,928.57 million in the first half of 2018, from US$19,746.94 million in the second half of 2017. When compared with US$13,859.55 million in the corresponding period of 2017, it surged by 79.87 per cent.

Table 5.6
Monthly Foreign Exchange Flows through the Economy
(Jan. 2017 – June 2018) (Million)

PERIOD	Inflow (CBN)	Inflow (Autonomous)	Total Inflows	Outflows (CBN)	Outflows (Autonomous)	Total Outflow	Net Flow	Net Flow (CBN)	Net Flow (Autonomous)
Jan-17	2,605.50	1,880.08	4,485.58	1,055.84	179.12	1,234.96	3,250.62	1,549.66	1,700.96
Feb-17	2,374.48	2,769.45	5,143.93	978.56	224.32	1,202.88	3,941.05	1,395.92	2,545.13
Mar-18	1,693.40	2,997.32	4,690.72	1,672.59	255.20	1,927.79	2,762.93	20.81	2,742.12
Apr-18	2,874.86	3,312.95	6,187.81	2,164.40	129.90	2,294.30	3,893.51	710.46	3,183.05
May-18	2,712.38	3,474.35	6,186.73	3,676.12	162.59	3,838.71	2,348.02	-963.74	3,311.76
Jun-18	3,672.74	2,991.45	6,664.19	3,208.11	152.80	3,360.91	3,303.28	464.63	2,838.65
2017 H1 Total	**15,933.36**	**17,425.60**	**33,358.96**	**12,755.62**	**1,103.93**	**13,859.55**	**19,499.41**	**3,177.74**	**16,321.67**
Jul-17	3,867.04	4,622.05	8,489.09	3,358.32	250.35	3,608.67	4,880.42	508.72	4,371.70
Aug-17	3,943.45	4,802.68	8,746.13	3,594.32	196.61	3,790.93	4,955.20	349.13	4,606.07
Sep-17	4,425.53	5,423.72	9,849.25	2,390.41	379.23	2,769.64	7,079.61	2,035.12	5,044.49
Oct-17	4,132.80	5,016.26	9,149.06	2,839.15	229.12	3,068.27	6,080.79	1,293.65	4,787.14
Nov-17	6,811.96	4,833.41	11,645.37	2,957.60	546.82	3,504.42	8,140.95	3,854.36	4,286.59
Dec-17	3,680.83	5,086.79	8,767.62	2,584.46	420.55	3,005.01	5,762.60	1,096.37	4,666.23
2017 H2 Total	**26,861.61**	**29,784.90**	**56,646.51**	**17,724.26**	**2,022.68**	**19,746.94**	**36,899.57**	**9,137.35**	**27,762.22**
Jan-18	4,212.56	6,288.40	10,500.96	2,734.38	297.61	3,031.99	7,468.97	1,478.18	5,990.79
Feb-18	7,303.15	3,561.35	10,864.50	3,163.29	447.64	3,610.93	7,253.58	4,139.86	3,113.72
Mar-18	5,076.48	6,147.23	11,223.71	3,754.12	331.74	4,085.86	7,137.85	1,322.36	5,815.49
Apr-18	4,238.05	8,721.00	12,959.05	3,437.72	222.55	3,660.27	9,298.78	800.33	8,498.45
May-18	4,373.01	5,865.39	10,238.40	4,821.91	321.53	5,143.44	5,094.96	-448.90	5,543.86
Jun-18	5,211.73	5,932.93	11,144.66	5,030.91	365.18	5,396.09	5,748.58	180.82	5,567.76
2018 H1 Total	**30,414.98**	**36,516.30**	**66,931.28**	**22,942.33**	**1,986.24**	**24,928.57**	**42,002.71**	**7,472.65**	**34,530.06**

Figure 5.7
Monthly Foreign Exchange Flows through the Economy(Jul 2016 – Jun 2018) (US$ Million)

5.3 Capital Market

In the first half of 2018, the Nigerian capital market opened on a bullish note reflecting improved growth sentiments as the economy was recovering from recession, and also partly due to increased activities at the Investors and Exporters window. Towards the end of the period, however, the market witnessed some lull in activities, following sustained spate of capital reversals arising from the continued monetary policy normalization in some advanced economies, low fiscal activities following the delayed 2018 FGN budget and fragile economic recovery, all culminating in a weak corporate environment. Many corporate entities were unable to declare dividends, while some had to capitalize their earnings due to weak profitability. Nonetheless, the Nigerian capital market remained substantially under-valued and still presents promising investment opportunities for both local and foreign investors.

5.3.1 Equities Market

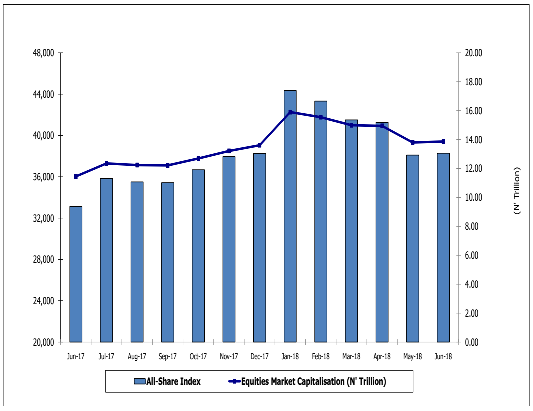
The All-Share Index (ASI) increased by 0.09 per cent to 38,278.55 at end-June 2018 from 38,243.19 at end- December 2017. It also increased by 15.58 per cent compared with 33,117.48 at end-June 2017. In the same vein, Market Capitalization (MC) increased by 1.91 per cent to ₦13.87 trillion at end-June 2018, from ₦13.61 trillion at end-December 2017. The MC when compared with ₦11.45 trillion at end-June 2017, increased by 21.14 per cent. Although, ASI experienced a year-on-year increase of 15.58 per cent, the lull in the market during the review period was traceable to the decline in some key sectors including Banking, Breweries, Building Materials and Oil & Gas which decreased to 14.66, 11.35, 29.85 and 2.28 per cent from their respective shares of 19.10, 13.52, 32.36 and 5.14 per cent in the preceding half year.

Table 5.7
NSE All-Share Index (ASI) and Market Capitalization (MC) (June 2017 – June 2018)

Date	ASI	MC(Equities) N'Trillion)
Jun-17	33,117.48	11.45
Jul-17	35,847.75	12.35
Aug-18	35,504.62	12.24
Sep-18	35,429.31	12.21
Oct-18	36,680.29	12.69
Nov-18	37,944.60	13.21
Dec-18	38,243.19	13.61
Jan-18	44,343.65	15.9
Feb-18	43,330.54	15.55
Mar-18	41,504.51	14.99
Apr-18	41,268.01	14.95
May-18	38,104.54	13.8
Jun-18	38,278.55	13.87

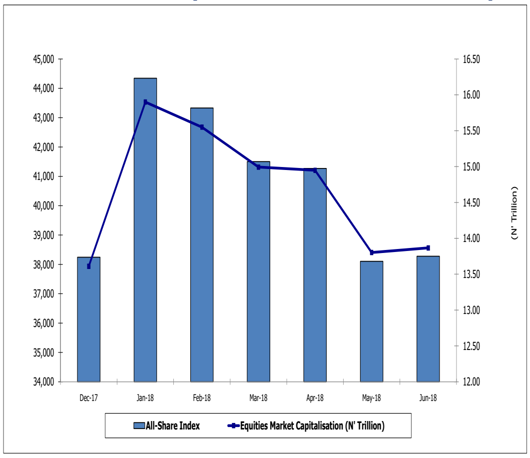
Source: NSE

Figure 5.8
NSE ASI and MC (June 2017– June 2018)



Source: NSE

Figure 5.9
NSE ASI and MC (December 2017 – June 2018)

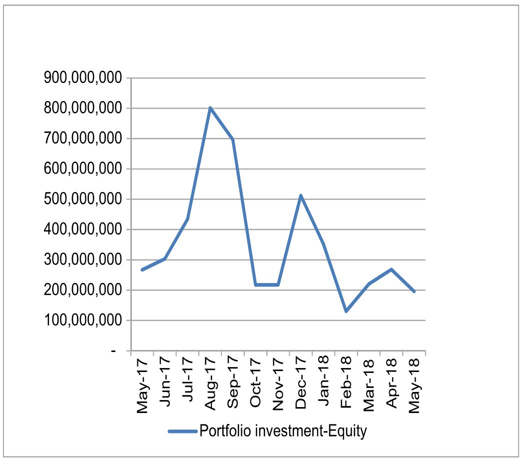


Source: NSE

5.3.2 Market Turnover

Aggregate stock market turnover in the first half of 2018 increased by 13.52 per cent to 67.42 billion shares, valued at N805.52 billion in 649,551 deals compared with 59.39 billion shares, valued at N803.82 billion in 491,300 deals in the second half of 2017. On a year-on-year basis, market turnover also increased by 52.67 per cent from 44.16 billion shares, valued at N467.67 billion in 448,950 deals. Foreign portfolio investment outflow exceeded inflow by N68.94 billion in the first half of 2018, largely attributable to sustained monetary policy normalization in some advanced economies coupled with political uncertainties which affected investor confidence in the Nigerian economy.

Figure 5.10
Portfolio Inflows (May 2017 – May 2018)

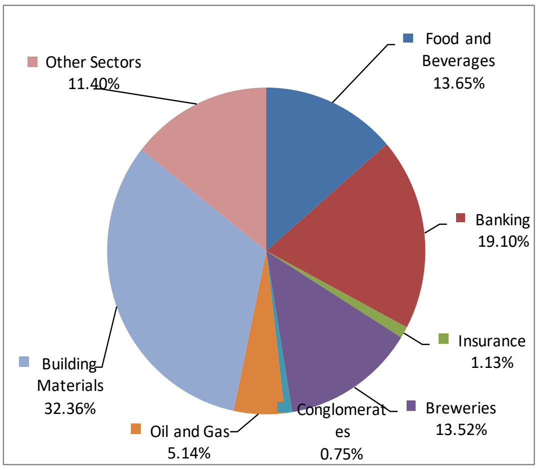


Source: NSE

5.3.3 Sectoral Contribution to Equity Market Capitalization

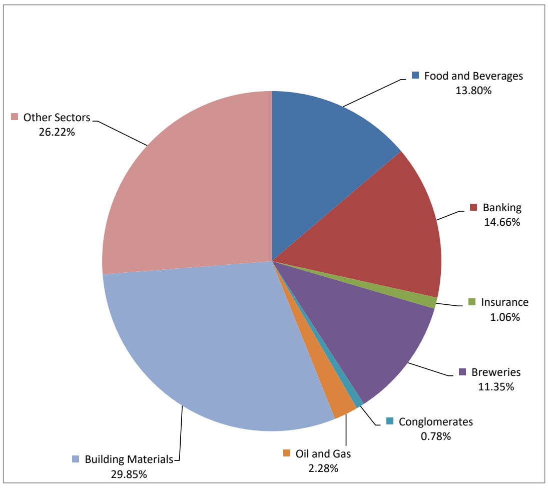
Despite the lull in market activity, the construction sector still dominated overall market capitalization, driven primarily by activities in the building materials sub-sector. The contribution of the building materials sub-sector declined to 29.85 per cent at end-June 2018 from 32.36 per cent at end-December 2017. Other major sub-sectors were banking, food & beverages and breweries, with market shares of 14.66, 13.80 and 11.35 per cent, respectively, at end-June 2018 (Figure 5.12).

Figure 5.11
NSE Market Capitalisation by Sector as at End-December 2017



Source: NSE

Figure 5.12
NSE Market Capitalisation by Sector as at End-June 2018

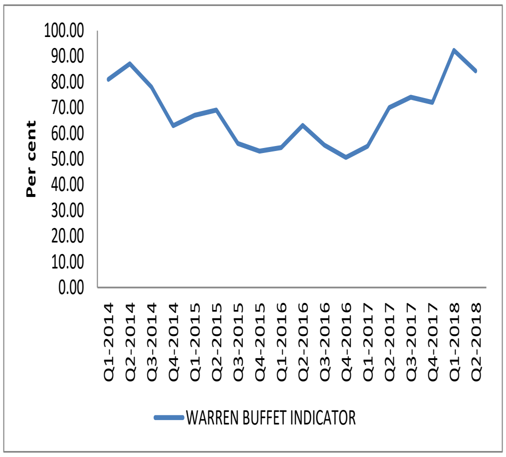


Source: NSE

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

The Warren Buffett valuation metric which measures the market value of securities as a ratio of GDP showed that the Nigerian equities market was fairly-valued in the review period. At 92.29 and 84.29 per cent in the first and second quarters of 2018, the metric was within the threshold of 75.0 - 115.0 per cent. The development was attributable to a number of factors, including improving economic conditions, reflected in the modest output recovery of 1.95 per cent in the first quarter of 2018, increased investor activity in the capital market during the early part of the review period, as well as sustained yields on domestic assets. In addition, the continuous downward trend in inflation and relatively stable foreign exchange market, supported improved stock market valuation. The improved stock market valuations along with encouraging macroeconomic outcomes are expected to continue to attract foreign investment into the economy.

Figure 5.13
Warren Buffett Valuation of Nigerian Equities Market



Source: NSE

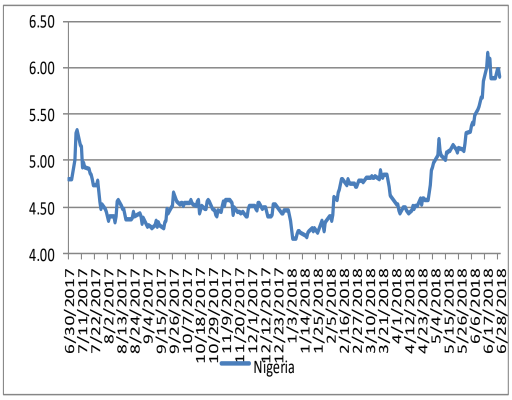
5.3.5 Bond Market

In the first half of 2018, the bond market was dominated by transactions in debt instruments of the Federal Government of Nigeria (FGN). The Sub-national government and corporate bonds segments also witnessed some activity, with the latter recording the least share by market volume.

5.3.5.1 FGN Eurobond

At 5.90 per cent, the 10-year dollar-denominated bond yield for Nigeria increased by 143 basis points at end-June 2018, from 4.47 per cent at end-December 2017. When compared with end-June 2017 yield of 4.80 per cent, it increased by 33 basis points (Figure 5.14). The development was attributable to perception of rising sovereign risk by investors.

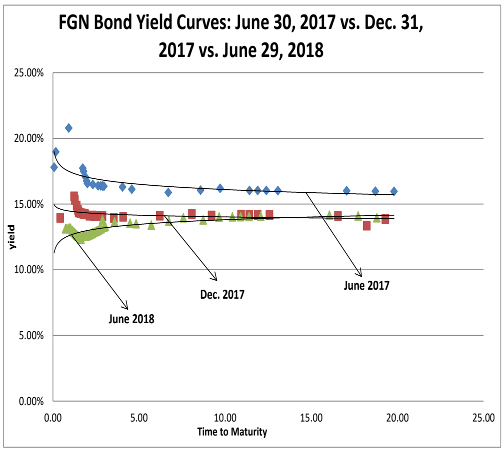
Figure 5.14
10-Year U.S. Dollar-denominated Bond Yield for Nigeria (June 30, 2017 – June 29, 2018)



Source: NSE

At 13.19 per cent, the yield on FGN Bonds for June 2018 decreased by an average of 355 basis points and 107 basis points when compared with 16.74 and 14.26 percent on June 30, 2017 and December 31, 2017, respectively. The yield curve for June 2018 had a concave shape, suggesting an optimistic macroeconomic outlook. This can be attributed to the sustained recovery in oil and other commodity prices, improved oil production, as well as stability in the foreign exchange market (Figure 5.15).

Figure 5.15
FGN Bonds Yield Curves: end-June. 2017 vs. end-Dec. 2017 vs. end-June. 2018



Source: NSE

5.3.5.2 State/Local Government Bonds

In the review period, activity at the sub-national bonds market improved moderately. Total value of outstanding state/local government bonds, increased by 2.97 per cent to ₦565.82 billion at end-June 2018, from ₦562.81 billion at end-Dec 2017. When compared with ₦563.58 billion at end-June 2017, it also increased by 0.14 per cent.

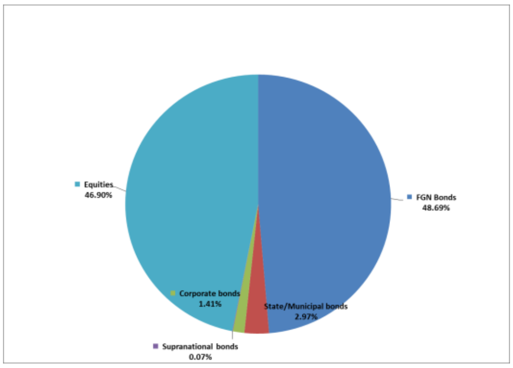
5.3.5.3 Corporate Bonds

Activity in the corporate bonds segment declined during the review period. At N267.72 billion, the value of outstanding corporate bonds at end-June 2018 declined by 1.41 and 7.04 per cent from ₦276.50 billion and ₦297.44 billion in the preceding half year and the corresponding period of 2017, respectively. The development could be attributed to the continued presence of inherent fragilities in the macroeconomy, continued lull in economic activities stemming from low fiscal operations of Government, as well as increasing investor risk perception associated with the forthcoming general elections.

5.3.5.4 Overall Analysis of the Nigerian Capital Market

The value of FGN bonds increased significantly by 9.85 per cent to N9.26 trillion at end-June 2018 from ₦8.43 trillion at end-Dec 2017, and by 38.83 per cent when compared with ₦6.67 trillion at end-June 2017. FGN bonds accounted for 48.69 per cent of aggregate market capitalization as at end-June 2018. The value of state/municipal bonds, corporate bonds and supranational bonds were N565.82 billion, N267.72 billion and N12.95 billion, accounting for 2.97, 1.41 and 0.07 per cent of aggregate market capitalization, respectively, during the same period. The equities market contributed 46.9 per cent of aggregate market capitalization at end-June 2018, while FGN bonds, state/municipal bonds, corporate bonds and supranational bonds accounted for the balance of 53.10 per cent (Figure 5.16).

Figure 5.16
Structure of the Nigerian Capital Market (June, 2018)



Source: NSE

5.4 Global Financial Market Developments

In review period, the global financial market experienced significant volatility due to several factors including: the earlier threat of military action against North Korea by the US; rising trade tensions between the US and its major trading partners; and the withdrawal of the US from the Iranian nuclear deal. Also, the continued uncertainties around the BREXIT negotiations; progressing monetary policy divergence in the advanced economies; and sustained geo-political tensions in the Middle East further heightened market nervousness. The effect of these factors were, however, significantly moderated by the commencement of peace talks on the Korean Peninsula, sustained recovery in oil and other commodity prices, rebound in investment and manufacturing output as well as improving asset prices and long term yields in major financial markets. Consequently, the performance of major global stock markets was mixed on account of intensified monetary policy divergence in the advanced economies and further strengthening of the US dollar against key currencies. The European Central Bank (ECB) and the Bank of Japan (BOJ) continued with a broad stance of monetary accommodation as inflation remained considerably below their targets, while the US Fed raised policy rates on two occasions in the review period. As a consequence, the US dollar appreciated against most currencies. Thus, on account of improving macroeconomic conditions in the advanced economies, commodity prices sustained their recovery in the review period.

5.4.1 Money Market and Central Bank Policy Rates

With improvements in global macroeconomic conditions and continued monetary accommodation across the major advanced economies, asset prices in major financial markets continued their upward trend. In the advanced economies, price development showed a mixed trend with rising prices in the US and the UK, pushing inflation beyond central banks' targets, while in the EU and Japan, inflation remained relatively subdued. In most emerging market and developing economies, relatively stable currencies and moderating inflation rates, resulting from improved oil and other commodity prices, provided extra policy space for monetary adjustment. Key concerns to global macroeconomic stability confronting central bank policy makers with tendency to influence the direction of capital flow in the review period included: the earlier threat of military action against North Korea by the US; rising trade tensions between the US and its major trading partners; withdrawal of the US from the Iranian nuclear deal; continued uncertainties around the BREXIT negotiations; continued monetary policy divergence between the US and the UK on one hand and the euro area and Japan, on the other hand; the strengthening US dollar; and geo-political tensions in the Middle East.

In the light of these developments, the US Federal Reserve Bank continued its monetary policy normalization programme, as indicators suggested the likelihood of further rise in inflation in the medium term, while the Bank of England (BOE) gave strong indications of progressing with its normalization programme in the second half of 2018. The European Central Bank (ECB) and the Bank of Japan (BOJ), however, continued with a broad stance of monetary accommodation as inflation remained considerably below their targets. Accordingly, the US Fed raised its policy rate on two occasions, while the BoE, ECB and BOJ held their rates steady.

Amongst the emerging market and developing economies, Brazil, Russia, Ghana, Kenya and South Africa all lowered their policy rates, as exchange rates stabilized and inflation moderated. In China, however, the policy rate was maintained to support its rebalancing programme, while Nigeria maintained rates to attract foreign inflows and moderate price development.

Table 5.8: Policy Rates of Selected Countries January – June 2018

Country	Jan 18	Feb. 18	Mar. 18	Apr. 18	May. 18	Jun 18
Kenya	10.00	10.00	9.50	9.50	9.50	9.50
S. Africa	6.75	6.75	6.50	6.50	6.50	6.50
Ghana	20.00	20.00	18.00	18.00	17.00	17.00
Nigeria	14.00	14.00	14.00	14.00	14.00	14.00
Brazil	7.00	6.75	6.50	6.50	6.50	6.50
USA	1.25-1.50	1.25-1.50	1.50-1.75	1.50-1.75	1.50-1.75	1.75-2.00
Japan	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10
Euro Area	0.00	0.00	0.00	0.00	0.00	0.00
India	6.00	6.00	6.00	6.00	6.00	6.25
Russia	7.75	7.50	7.25	7.25	7.25	7.25
China	4.35	4.35	4.35	4.35	4.35	4.35
UK	0.50	0.50	0.50	0.50	0.50	0.50
Indonesia	4.25	4.25	4.25	4.25	4.75	5.25

5.4.2 Capital Market

The performance of major global stock markets was mixed during the review period mainly on account of intensified monetary policy divergence in the advanced economies and further strengthening of the US dollar against key currencies. The effect of these factors was further amplified by US-propelled trade tensions arising from the implementation of aggressive tariff regimes against her key trading partners, notably China and the European Union. As a consequence, in Europe, the French CAC 40 increased by 0.21 per cent, while the UK FTSE 100 and German DAX indices decreased by 0.66 and 4.73 per cent, respectively. In North America, the United States S&P 500 and Canadian S&P/TSX Composite indices increased by 1.67 and 0.42 per cent, respectively, while the Mexican Bolsa decreased by 3.43 per cent. In South America, the Columbia COLCAP index increased by 4.9 per cent, while the Brazilian Bovespa and Argentine Merval indices decreased by 4.76 and 13.40 per cent, respectively. In Asia, the Indian BSE Sensex index increased by 4.01 per cent, while the Japanese Nikkei 225 and Chinese Shanghai SE indices decreased by 2.02 and 13.90 per cent, respectively. The African stock markets experienced the effect of capital reversals, as the Nigerian NSE All-Share, South African JSE All-Share and Kenyan Nairobi NSE 20, indices decreased by 1.61, 3.68 and 11.48 per cent, respectively, while the Egyptian EGX CASE 30 and Ghanaian GSE All Share indices increased by 8.85 and 11.59 per cent, respectively, as these countries were under International Monetary Fund (IMF) monitored programmes which helped to restore investor confidence.

Table 5.9
Selected International Stock Market Indices as at June, 2018

Country	Index	End-Dec 2017	29-Mar-18	29-Jun-18	December 29, 2017-29 June, 2018 % Change	29 March-29 June, 2018 % Change
AFRICA						
Nigeria	ASI	38,243.19	41,504.51	37,625.59	-1.61	-9.35
South Africa	JSE African AS	59,504.67	55,474.52	57,313.88	-3.68	3.32
Kenya	Nairobi NSE 20	3,711.94	3,845.30	3,285.73	-11.48	-14.55
Egypt	EGX CSE 30	15,019.14	17,450.15	16,348.55	8.85	-6.31
Ghana	GSE All Share	2,579.72	3,366.85	2,878.66	11.59	-14.50
NORTH AMERICA						
US	S&P 500	2,673.61	2,604.47	2,718.37	1.67	4.37
Canada	S&P/TSX Composite	16,209.13	15,367.29	16,277.73	0.42	5.92
Mexico	Mexico Bolsa (IPC)	49,354.42	46,124.85	47,663.20	-3.43	3.34
SOUTH AMERICA						
Brazil	Bovespa Stock	76,402.08	85,365.56	72,762.51	-4.76	-14.76
Argentina	Merval	30,065.61	31,114.93	26,037.01	-13.40	-16.32
Colombia	COLCAP	1,513.65	1,455.52	1,577.01	4.19	8.35
EUROPE						
UK	FTSE 100	7,687.77	7,056.61	7,636.93	-0.66	8.22
France	CAC 40	5,312.56	5,167.30	5,323.53	0.21	3.02
Germany	DAX	12,917.64	12,096.73	12,306.00	-4.73	1.73
ASIA						
Japan	NIKKEI 225	22,764.94	21,159.08	22,304.51	-2.02	5.41
China	Shanghai SE A	3,463.48	3,309.98	2,982.00	-13.90	-9.91
India	BSE Sensex	34,056.83	32,968.68	35,423.48	4.01	7.45

Source: Bloomberg

5.4.3 Commodities

Global commodity prices sustained their recovery during the review period, largely on account of improving macroeconomic conditions in the advanced and emerging market and developing economies. In particular, crude oil prices were buoyed by geopolitical tensions in the Middle East, sustained compliance by OPEC and Non-OPEC members on production adjustments, large drawdown of US crude inventories and prospects of higher oil demand. As a result, the OPEC reference basket rose by 17.40 per cent to US$75.69 at end-June 2018 from US$64.47 at end-December 2017. With crude oil being a major component of the global energy mix, the Energy Price Index also rose by 17.65 per cent to 91.57 points in June 2018 from 77.83 points in December 2017.

The non-fuel commodity price index (including aluminum and tin) also rose by 6.27 per cent to 89.83 points in June 2018 from 84.53 points in December 2017, reflecting the strengthening of global demand. The price per metric tonne of metals for aluminum and tin rose to US$2,299.67 and US$20,858.83 in May 2018 from US$2,080.47 and US$19,476.37 in December 2017, respectively.

The prices of food commodities equally rose during the review period. The

Food and Agriculture Organization (FAO) Food Price Index rose by 3.67 per cent from 169.1 points in December 2017 to 175.3 points in June 2018. The sub-indices of meat, dairy and cereals drove the increase, while vegetable oil and sugar fell.

5.4.4 Foreign Exchange Market

In the first half of 2018, most currencies depreciated against the US dollar. This was largely on account of the implementation of the 'America First' policy of the Trump Administration in the United States through bullish trade instruments which helped to increase the flow of foreign investments into the US. Other factors were: the significantly improved economic conditions in the US; and rising treasury yields, following sustained monetary policy normalization by the US Fed. As a result, in North America, the Canadian dollar and the Mexican peso depreciated against the US dollar by 4.28 and 1.25 per cent, respectively. In South America, the Brazilian real and the Argentine peso depreciated against the U.S. dollar by 14.65 and 35.62 per cent, respectively, while the Colombian peso appreciated by 1.92 per cent in the period under review.

In Europe, the British pound, the Euro and the Russian ruble all depreciated against the U.S dollar by 2.25, 2.66 and 8.15 per cent, respectively. In Asia, the Chinese yuan and the Indian rupee both depreciated by 1.61 and 6.72 per cent, respectively, while the Japanese yen appreciated against the U.S dollar by 1.74 per cent.

In Africa, the South African rand, Egyptian pound and the Ghanaian cedi depreciated against the U.S. dollar by 9.78, 0.59 and 4.76 per cent, respectively, while the Nigerian naira and Kenyan shilling appreciated against the U.S dollar by 0.08 and 2.15 per cent, respectively.

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

Exchange Rates of Selected Countries (Value in currency units to US$)				
	Currency	**29-Dec-17**	**29-Jun-18**	**Dec. 17 - Jun 18 (% App/Dep)**
AFRICA				
Nigeria	Naira	306.00	305.75	0.08
South Africa	Rand	12.38	13.73	-9.78
Kenya	Shilling	103.18	101.01	2.15
Egypt	Pound	17.81	17.92	-0.59
Ghana	Cedi	4.51	4.73	-4.76
NORTH AMERICA				
Canada	Dollar	1.26	1.31	-4.28
Mexico	Peso	19.66	19.91	-1.25
SOUTH AMERICA				
Brazil	Real	3.31	3.88	-14.65
Argentina	Peso	18.62	28.93	-35.62
Colombia	Peso	2986.84	2930.50	1.92
EUROPE				
UK	Pound	0.74	0.76	-2.25
Euro Area	Euro	0.83	0.86	-2.66
Russia	Ruble	57.63	62.74	-8.15
ASIA				
Japan	Yen	112.69	110.76	1.74
China	Yuan	6.51	6.62	-1.61
India	Rupee	63.87	68.47	-6.72
Source: bloomberg				

CHAPTER SIX
ECONOMIC OUTLOOK

6.1 OVERVIEW

Global output growth for 2018 was projected to rise to 3.9 per cent, up from 3.7 per cent in 2017 (WEO July, 2018). The development was expected to be driven, among others, by the strengthening of domestic investment demand, relatively easier financing conditions in the advanced economies and sustained recovery in oil and other commodity prices, amid limited spillovers of trade tensions to other markets, particularly in the advanced economies. The downside risks to growth would include: growing protectionist measures; the weakening of the global cooperation mechanism; potential buildup of financial sector vulnerabilities, which could weaken market sentiments and undermine growth; and insufficient fiscal buffers to support recovery.

The growth outcomes, however, differed across regions and markets. In the advanced economies, growth was projected at 2.4 per cent in 2018, same as in 2017, largely reflecting moderations in the euro area and Japan. Output growth in the US was estimated to increase to 2.9 per cent in 2018 from 2.3 per cent in 2017, in response to fiscal stimulus and increased private final demand which propped output further above potential, thereby lowering unemployment. On the other hand, growth in the euro area was projected to decline to 2.2 per cent in 2018 from 2.4 per cent in 2017, owing to widening sovereign spreads in the wake of heightened political uncertainties that weighed down domestic demand. In the United Kingdom, growth was also projected to slow down to 1.4 per cent in 2018 from 1.7 per cent in 2017, as sentiments from BREXIT continued to weigh on investments. Owing to weak private consumption and investment, the Japanese economy was also estimated to grow lower by 1.0 per cent in 2018, compared with 1.7 per cent in 2017.

In the emerging market and developing economies (EMDEs), growth was uneven, reflecting the combined influences of rising oil prices, higher yields in the United States, spillover effects of trade tensions coupled with political uncertainties in the domestic environment. Accordingly, growth in the EMDEs was estimated at 4.9 per cent in 2018 up from 4.7 per cent in 2017. Growth in India was projected to rise to 7.3 per cent in 2018 from 6.7 per cent in 2017, as the effects of the goods and services tax and currency demonetization exercise waned. Output growth in Brazil was estimated to expand to 1.8 per cent in 2018 from 1.0 per cent in 2017. Similarly, output growth in Russia was projected to rise by 1.7 per cent in 2018 up from 1.5 per cent in 2017, owing to stabilizing oil prices, improved confidence, and recovering domestic and external demand. China's growth was estimated at 6.6 per cent in 2018 down from 6.9 per cent in 2017, as the tightening of the financial sector was sustained along with weaker external demand.

In Sub-Saharan Africa (SSA), growth was estimated to increase to 3.4 per cent in 2018 from 2.8 per cent in 2017, due to improved performance in Nigeria and South Africa, the region's largest economies. The Nigerian economy was estimated to grow by 2.1 per cent in 2018 up from 0.8 per cent in 2017, sustained by improved prospects for oil prices and production. Growth of the South African economy was also projected to rise by 1.5 per cent in 2018 up from 1.3 per cent in 2017, as the change in the country's leadership ushered in a climate of improved confidence, thus strengthening private investment.

6.2 Outlook for Global Output

Global output is expected to strengthen to 3.9 per cent apiece in 2018 and 2019 from 3.7 per cent in 2017. The projection is premised on growth recovery in the emerging market and developing economies (EMDEs) and still strong growth in the advanced economies. The factors expected to drive the global growth projection would include: the broadly accommodative financial conditions in the advanced economies; the global spillovers of the current US expansionary fiscal policy; sustained recovery in commodity prices; and favorable market sentiment despite the looming trade war between the US and some of her major trading partners.

Growth in the advanced economies is expected to remain unchanged at 2.4 per cent in 2017 and 2018, easing slowly to 2.2 per cent in 2019, largely reflecting moderations in the euro area and Japan. In the United States, growth is projected to strengthen to 2.9 and 2.7 per cent in 2018 and 2019, respectively, from 2.3 per cent in 2017, due largely to the ongoing fiscal stimulus that is expected to further strengthen private final demand and lower unemployment. The euro area economy is, however, projected to slow gradually from 2.4 per cent in 2017 to 2.2 and 1.9 per cent in 2018 and 2019, respectively. Similarly, Japan is forecast to slow down by 1.0 and 0.9 per cent in 2018 and 2019, respectively, from 1.7 per cent in 2017, following a contraction traceable to weaker private consumption and investment in the first quarter of 2018. The economy would, however, strengthen over the remainder of 2018 and further in 2019, supported by stronger private consumption, external demand, and investment.

In the emerging market and developing economies, growth is forecast to expand to 4.9 and 5.1 per cent in 2018 and 2019, respectively, from 4.7 per cent in 2017. The expansion would be supported by several factors including: rising crude oil prices; and an appreciating US dollar, making goods from emerging market economies more competitive.

China is forecast to further slowdown to 6.6 and 6.4 per cent in 2018 and 2019, respectively, from 6.9 per cent in 2017, due to the ongoing economic rebalancing programme. Growth forecast for India is expected to improve to 7.3 and 7.5 per cent in 2018 and 2019, respectively, from 6.7 per cent in 2017, due to improved private and government consumption as well as fixed investment. In Brazil, growth is projected to rise to 1.8 and 2.5 per cent in 2018 and 2019, respectively, from 1.0 per cent in 2017, following the recovery of crude oil prices as well as political stability.

In Sub-Saharan Africa, the prospects for output recovery is likely to continue, supported by rising commodity prices. Growth in the region is expected to expand to 3.4 and 3.8 per cent in 2018 and 2019, respectively, from 2.8 per cent in 2017. The improved growth forecast reflects favourable prospects for the Nigerian and South African economies. Nigeria's growth is forecast to expand to 2.1 and 2.3 per cent in 2018 and 2019, respectively, from 0.8 per cent in 2017. The improved outlook is largely attributable to favourable oil prices and restoration of stability in economic management. Despite the perennial labour and energy crises, the South African economy is expected to recover from the weak performance in the first quarter into stronger growth over the rest of 2018 and into 2019, largely on account of improved confidence associated with the new political leadership. Consequently, the South African economy is forecast to expand by 1.5 and 1.7 per cent in 2018 and 2019, respectively, from 1.3 per cent in 2017.

Growth in the Middle East and North Africa (MENA) region is projected to strengthen to 3.5 and 3.9 per cent in 2018 and 2019, respectively, from 2.2 per cent in 2017. The growth outlook is premised on the expectation that many countries in the region will benefit from the improved outlook for oil prices, although, the outlook for oil importing countries remains fragile. Several economies in the region would need to implement fiscal consolidation programmes, even as the threat of heightened geopolitical conflict remains a key drag on growth in the region.

6.3 Downside Risks to Global Outlook

The growth projections, although promising, are laden with significant risks, the balance of which is tilted to the downside in the medium term. These include: the possibility of tighter financial conditions in some vulnerable economies; the possibility of escalating and sustained trade actions; the growing trend towards protectionism; and weakening of global cooperation frameworks. The recently announced tariff increases by the United States and retaliatory measures by trading partners have increased the likelihood of escalating trade tensions, which could undermine economic recovery and growth prospects.

In the advanced economies, financial market conditions remain accommodative with low volatility, resulting in narrowing spreads, which is prone to sharp changes under adverse market conditions. The factors expected to trigger this adverse market conditions would include: heightened trade tensions; conflicts, and geopolitical instability; and growing political uncertainty as well as lingering disagreements over migration policies and BREXIT negotiations in Europe. These will likely hurt investment activity, capital flows and growth in the short –to- medium term.

In emerging markets and developing economies, the ongoing normalization of monetary policy in the US could result in sharp capital outflows, leading to shortage of capital in the domestic economies. The response of this group of countries would be to raise policy rates to stem capital reversals, resulting in tighter financial conditions, which may potentially lead to disruptive portfolio adjustments and sharp movements in the exchange rate. This would likely be pronounced in countries with heightened political risks and weak economic fundamentals. The net effect of these adjustments would undermine growth.
The key risks to the outlook in the Middle East and sub-Saharan Africa regions include: domestic political risks; insurgency and armed conflicts; as well as extreme weather and other natural disasters, which could potentially undermine growth.

Table 6.1
Global Output and Inflation Outlook

	Year on Year			
			Projections	
	2016	**2017**	**2018**	**2019**
A. World Output				
World Output	**3.2**	**3.7**	**3.9**	**3.9**
Advanced Economies	**1.7**	**2.4**	**2.4**	**2.2**
USA	1.5	2.3	2.9	2.7
Euro Area	1.8	2.4	2.2	1.9
Japan	1.0	1.7	1.0	0.9
UK	1.8	1.7	1.4	1.5
Canada	1.4	3.0	2.1	2.0
Other Advanced Economies	2.3	2.7	2.8	2.7
Emerging & Developing Economies	**4.4**	**4.7**	**4.9**	**5.1**
Commonwealth of Independent States	0.4	2.1	2.3	2.2
Latin America and the Caribbean	-0.6	1.3	1.6	2.6
Middle East and North Africa	5.0	2.2	3.5	3.9
Sub-Saharan Africa	1.5	2.8	3.4	3.8
B. Commodity Prices (US' Dollars)				
Oil	-15.7	23.3	33.0	-1.8
Non-fuel	-1.5	6.8	6.0	0.5
C. Consumer Prices				
Advanced Economies	0.8	1.7	2.2	2.2
Emerging & Developing Economies	4.3	4.0	4.4	4.4

Source: IMF WEO Update, July 2018

6.4 Global Inflation Outlook

Globally, consumer prices are projected to rise modestly in 2018, partly reflecting increase in crude oil and other commodity prices. Global inflation is projected to rise to 3.5 and 3.4 per cent in 2018 and 2019, respectively, from 3.0 per cent in 2017. In the advanced economies, the expected increase in headline inflation would largely be on account of firming growth, thereby gradually closing the negative output gap. The outlook for inflation in the emerging market and developing economies is to maintain an upward trend. Among the EMDEs, oil exporting countries may witness moderation in prices of goods and services, while oil importing countries are likely to experience rising inflation from the recovery of oil and other commodity prices.

In the Advanced Economies, headline inflation is projected at 2.0 and 1.9 per cent in 2018 and 2019 respectively, from 1.7 per cent in 2017, due to the modest recovery of oil and other commodity prices and the ongoing quantitative easing programme in the Euro area, the United Kingdom and Japan. In Germany, inflation is projected to moderate to 1.6 per cent in 2018 from 1.7 per cent in 2017, but rise to 1.7 per cent in 2019.

In the United States, inflation is forecast to rise to 2.5 and 2.4 per cent in 2018 and 2019, respectively, up from 2.1 per cent in 2017. This rise is expected on the back of the government's ongoing expansionary fiscal policy. In the Euro area, headline inflation is expected to stabilize at 1.5 per cent in 2018 the same as in 2017, and rise to 1.6 per cent 2019. Headline inflation in Japan is projected at 1.1 per cent apiece in 2018 and 2019 from 0.5 per cent in 2017, as the BOJ maintains its quantitative easing programme.

In the emerging market and developing economies, inflation is expected to rise to 4.6 and 4.3 per cent in 2018 and 2019, respectively, from 4.0 per cent in 2017, due to the impact of rising commodity prices on some large emerging market economies such as China and India. In China, inflation is forecast to increase to 2.5 and 2.6 per cent in 2018 and 2019, respectively, from 1.6 per cent in 2017. In India, inflation is projected at 5.0 per cent apiece in 2018 and 2019, from 3.6 per cent in 2017. In Brazil, inflation is estimated to rise to 3.5 and 4.2 per cent in 2018 and 2019, respectively, from 3.4 per cent in 2017. On the other hand, inflation in Russia is forecast to decline to 2.8 per cent in 2018 from 3.7 per cent in 2017, but rise to 3.8 per cent in 2019. Similarly, inflation in Nigeria is expected to fall from 16.5 per cent in 2017 to 14.0 per cent in 2018, and marginally rise to 14.8 per cent 2019, driven by relative exchange rate stability.

In South Africa, inflation is projected at 5.3 per cent apiece in 2018 and 2019, same as in 2017. Similarly, in Sub-Saharan Africa, inflation is expected to fall to 9.5 and 8.9 per cent in 2018 and 2019, respectively, from 11.0 per cent in

2017. In the MENA region, including Afghanistan and Pakistan, headline inflation is expected to rise to 8.2 and 6.8 per cent in 2018 and 2019, respectively, from 6.3 per cent in 2017.

6.5 Outlook for Domestic Output Growth

The domestic economy is expected to continue on the path of recovery. Real GDP grew by 1.95 per cent (year-on-year) in the first quarter of 2018. This represents a stronger growth of 2.87 percentage points compared with -0.91 per cent in Q1 2017. The outcome was, however, a decline of 0.16 percentage point compared with 2.11 per cent recorded in the preceding quarter. During the second quarter, real output declined to 1.50 per cent from the 1.95 per cent recorded in the first quarter. The development was, however, an expansion by 0.78 percentage point when compared with the growth of 0.72 per cent in the corresponding period of 2017. Nonetheless, the outlook for 2018 and beyond is positive, as the economy is projected to grow by 2.1 per cent in 2018 and 1.9 per cent in 2019 (IMF, 2018). Similarly, the World Bank projects a growth of 2.5 per cent in 2018 and 2.8 per cent in 2019. The outlook is anchored on higher crude oil prices and production, improved electricity supply, prospects for improved agricultural performance and continuing reforms in the foreign exchange market, among others. Nevertheless, the unemployment rate remained high at 18.8 per cent, requiring targeted fiscal spending to further strengthen output and create jobs.

As a key driver of the outlook for output, oil prices which rebounded to an average of US$52 per barrel in 2017 are projected to rise to over US$71 per barrel in 2018 and beyond (US Energy Information Administration). Oil production also increased from 1.81 million barrels per day in 2016 to 1.89 million barrels per day in 2017 and 2.0 by Q1, 2018 following sustained peace in the Niger Delta region. The trend is expected to continue in 2018 and 2019, in tandem with the production agreement between OPEC and some non-OPEC members.

In addition, the renewed anti-corruption campaign, reduction of leakages in government revenues, and fiscal consolidation, among other on-going reforms, present improved prospects for targeted government spending. Nigeria's increased leadership and visibility in the regional economy would, among others, reduce trade barriers, cut down costs, improve manufacturing, and expand opportunities for employment.

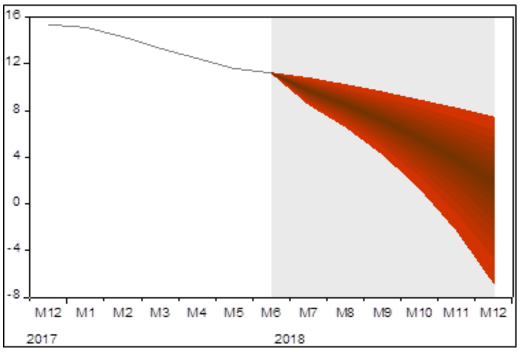
Furthermore, the activities of the Presidential Enabling Business Environment Council (PEBEC) are expected to continue to improve Nigeria's ranking in the World Bank Ease of Doing Business Report, thereby attracting Foreign Direct Investments. Also, the sustained collaboration between the CBN and State Governments for expansion of agricultural output as reflected in the Anchor Borrowers Programme (ABP) is expected to continue to boost agricultural production.

The downside risks to the outlook are: ongoing security challenges; loss of market share for Nigeria's crude oil export; increased political uncertainty due to electioneering activities which may trigger capital outflows; and weak private sector credit growth.

6.6 Outlook for Domestic Inflation

Staff estimates suggest that year-on-year headline inflation is projected to moderate to 10.94, 10.66, 10.41, 10.26 and 10.01 per cent in July, August, September, October and November 2018, respectively. Thereafter, inflation is forecast to inch up slightly to 10.36 per cent in December 2018. Upside risks to inflation include the implementation of the 2018 budget and increased spending towards the 2019 general elections. Others are: poor power supply; increased cost of transportation; and persistent clashes between herdsmen and farmers, leading to disruptions in the food supply and distribution chain. As the Bank continues to manage liquidity conditions in the domestic economy, inflationary developments will also continue to be monitored to ensure that the risks to inflation and growth are minimized.

YEAR-ON-YEAR INFLATION RATE					12-MMA INFLATION RATE				
Status	Month	Headline	Food	Core	Status	Month	Headline	Food	Core
Actual	Jan-18	15.13	18.92	12.09	Actual	Jan-18	16.22	19.62	13.01
	Feb-18	14.33	17.59	11.71		Feb-18	15.93	19.52	12.67
	Mar-18	13.34	16.08	11.18		Mar-18	15.60	19.29	12.33
	Apr-18	12.48	14.80	10.92		Apr-18	15.20	18.89	12.02
	May-18	11.61	13.45	10.71		May-18	14.79	18.36	11.83
	Jun-18	11.23	12.98	10.39		Jun-18	14.37	17.75	11.65
Forecast	Jul-18	10.94	12.73	9.84	Forecast	Jul-18	13.93	17.09	11.45
	Aug-18	10.66	12.24	9.74		Aug-18	13.48	16.41	11.23
	Sep-18	10.41	12.00	9.38		Sep-18	13.01	15.71	11.00
	Oct-18	10.26	12.17	8.56		Oct-18	12.54	15.05	10.69
	Nov-18	10.01	12.06	7.78		Nov-18	12.06	14.39	10.32
	Dec-18	10.36	12.44	8.22		Dec-18	11.66	13.84	10.00



6.7 Outlook for Monetary Policy in 2018

Monetary Policy will continue to be anchored on the Medium-Term Framework. This will enable the Bank consistently anchor expectations and prevent market agents from overly engaging in speculative activities, in response to temporary shocks. While the primary objective of monetary policy remains the maintenance of price stability, the Bank will sustain its focus on the reduction of inflationary pressures through effective liquidity management, thereby creating an environment conducive to inclusive and sustainable growth.

The Bank will continue to monitor developments in the global economy which influences the direction of monetary policy in the near to medium term. The U.S. Fed raised its rate by 0.5% in June 2018 to a target range of 1.75 – 2.00% following strengthening labour market conditions. The renewed certainty around the steady pace of normalization of US monetary policy has implications for the appreciation of the U.S. dollar and thus, depreciation of the naira. Other challenges to monetary policy include: exchange rate movements, financial market volatility and constrained credit growth. Furthermore, headline, food and core inflation are likely to trend slightly upwards in the near term, due to the election spending towards 2019 general elections and the end of the base effect in July 2018. These issues will continue to demand close attention and monitoring in monetary policy implementation.

The thrust of monetary policy in the near term would be supported by the expectations of moderate rise in crude oil price and accretion to reserves, renewed peace in the Niger-Delta and improved agricultural production. Moreover, sustained stability in exchange rate supported by increased foreign portfolio inflow is expected to bolster the Bank's efforts at controlling inflation during the rest of 2018

Appendices

CENTRAL BANK OF NIGERIA COMMUNIQUÉ NO 117 OF THE MONETARY POLICY COMMITTEE MEETING OF TUESDAY 3RD AND WEDNESDAY 4TH APRIL, 2018

1.0 Background

The re-constituted Monetary Policy Committee (MPC) held its maiden meeting, the 260th meeting of the Committee, its first in 2018, on 3rd and 4th of April, 2018 against the backdrop of strengthening global growth and improving domestic economic conditions. The Committee assessed the developments in the global and domestic economic environments during the first quarter of 2018, including the risks to price stability, financial stability, and economic growth in the short-to-medium term. Nine members of the Committee attended the meeting.

Global Economic Developments

The strong headwinds which confronted the global economy in 2017 showed signs of moderation, giving way to prospects for stronger growth in 2018. Consequently, global output is projected to grow by 3.9 per cent in 2018 from 3.7 per cent in 2017 on the heels of rebound in investment as a result of improvements in investor confidence, strengthening commodity prices, rising aggregate demand and accommodative monetary policy, especially in some advanced economies. With the sustained recovery in oil prices, aggregate demand is expected to continue to firm up. Growth in the advanced economies is projected at 2.3 per cent in 2018, and 4.9 per cent for emerging markets and developing economies (EMDEs). The Monetary Policy Committee noted some downside risks to the outlook for global growth to include: continuing normalization of monetary policy in the advanced economies; new U.S. trade policy; uncertainties associated with the BREXIT negotiations; and rising geo-political tensions in the Middle-East and on the Korean Peninsula.

In the advanced and emerging market economies, inflation is projected at 1.9 and 4.5 per cent in 2018, respectively. However, the broad indication from the IMF is that over the medium to long term, inflation may rise at a modest pace as general economic conditions remain subdued. Asset prices and long-term yields in major financial markets are also on the increase, confirming the possibility of a future rise in the price level.

Domestic Output Developments

Data from the National Bureau of Statistics (NBS) indicate that real Gross Domestic Product (GDP) grew by 1.92 per cent in the fourth quarter of 2017, up from 1.40 and 0.72 per cent in the third and second quarters, respectively. The economy grew overall by 0.83 per cent in 2017. The main drivers of real GDP growth were agriculture (1.08%), industry (0.56%) and trade (0.35%). Non-oil real GDP grew by 1.45 per cent in the fourth

quarter of 2017 compared with a contraction of 0.76 per cent in third quarter of 2017, indicating that the economy is gradually returning to a path of sustainable positive growth.
The Committee also noted the continuous positive outlook based on the Manufacturing, and Non-manufacturing Purchasing Managers' Index (PMI), which stood at 56.7 and 57.2 index points, respectively, in March 2018, indicating expansion for the twelfth and eleventh consecutive months. The Committee believes that effective implementation of the Economic Recovery and Growth Plan (ERGP) by the Federal Government and quick passage of the 2018 budget will continue to enhance aggregate demand and confidence in the Nigerian economy.

Developments in Money and Prices

The Committee noted that money supply (M2) grew marginally by 0.07 per cent in February 2018 (annualised to 0.42%), in contrast to the provisional growth benchmark of 10.29 per cent for 2018. The development in M2 largely reflected growth in net domestic credit (NDC) of 4.05 per cent (annualised to 24.30%), emanating majorly from net credit to government, which grew by 19.99 per cent (annualised to 119.94%) against the provisional benchmark of 33.12 per cent. Credit to the private sector also grew by 1.49 per cent (annualised to 8.94%) in February 2018, compared with the provisional annual benchmark of 14.88 per cent. Net foreign assets (NFA), contracted by 2.82 per cent, annualized to 16.92 per cent, compared with the provisional benchmark of -29.31 per cent. Narrow money (M1), also contracted by 2.77 per cent (annualised to 16.62%). The Committee urged the Federal Government to strongly exercise restraint on domestic borrowing in order to lower the cost of credit to the private sector.

The Committee noted that the continued low level of lending by banks remains a constraint to growth of the real sector of the economy. The Committee advised the Management of the CBN to continue to provide the required policy impetus to engender improved credit delivery by the deposit money banks to the economy.

Inflationary pressures in the economy continued to moderate with headline inflation (year-on-year) receding for the thirteenth consecutive month to 14.33 per cent in February 2018 from 18.72 per cent in January 2017. Month-on-month food inflation fell by 133 basis points to 17.59 per cent in February 2018, and core inflation also declined marginally by 38 basis points to 11.71 per cent during the same period.

Money market interest rates reflected liquidity conditions in the banking system as the average inter-bank call rate increased to averagely 12.42 per cent in February 2018 from 9.49 per cent in December 2017. The Open buy back (OBB) rate also increased to 13.19 per cent in February 2018 from

8.46 per cent in December 2017. The movement in the net liquidity position and interest rates reflected the combined effects of OMO auctions, foreign exchange interventions and statutory allocation to state and local governments.

The Committee also noted the continuous improvement in the level of external reserves, which stood at US$46.699 billion as at March 29, 2018. Similarly, the All-Share Index (ASI) rose by 8.5 per cent from 38,243.19 on December 29, 2017, to 41,504.51 on March 29, 2018. Market Capitalization (MC) improved by 10.2 per cent from N13.61 trillion on December 29, 2017, to N14.99 trillion during the same period. The Committee observed that, while this development may be a reflection of improved investor confidence in the economy, it cautioned that the Management of the Bank should carefully monitor the developments and to establish mechanisms for safeguarding the stability of the foreign exchange market in the event of a sudden capital reversal. The Committee observed the continued rise in oil prices, but acknowledged the inherent volatility in commodity prices and urged the Bank not to relent in building external reserves buffers against any future price downturns and as a means of sustaining investor confidence in the economy.

The Committee noted the relative stability in the foreign exchange market, with declining premia across all segments of the market. It observed with satisfaction, the sustained high level of activity at the Investors' and Exporters' (I&E) window of the foreign exchange market. The window continues to attract more investors, thus boosting foreign exchange supply. Consequently, total foreign exchange inflow through the central bank increased by 73.00 per cent in February 2018, compared with the previous month. This was attributed to the increase in receipt of proceeds from Petroleum Profit Tax (PPT), royalties and crude oil & gas. Total outflow also increased in February 2018 by 15.69 per cent, as a result of higher payments for invisibles, interbank transactions as well as JVC cash call payments.

2.0. Overall Outlook and Risks

Forecasts of key macroeconomic indicators give a positive outlook for the Nigerian economy in 2018. This is predicated on the quick passage and effective implementation of the 2018 budget, improved security, foreign exchange market stability as well as favourable crude oil prices. On the downside, the Committee noted the potential impact of the 2019 election-related spending, against the weak backdrop of tax revenue efforts, herdsmen related violence and rising yields in the advanced economies. Indications in the US and the UK point to higher interest rates in the short to medium term.

3.0. The Considerations of the Committee

The Committee noted with satisfaction the gradual return to macroeconomic stability as reflected in the third consecutive quarterly growth in real GDP in the fourth quarter of 2017. It also noted the continued moderation in all measures of inflation as well as sustained stability in the naira exchange rate and urged the Bank to sustain the stability to avoid a mission drift. In particular, the Committee welcomed the narrowing of the exchange rate premium between the BDC segment and the Investors' and Exporters' (I&E) window of the foreign exchange market. Overall, the Committee noted that the recovery of the economy was strengthening, in view of the return to growth of the Services Sector. As the fiscal sector continues to settle its outstanding liabilities, it reduces its domestic debt profile, thus increasing the liquidity of the banking system. However, the Monetary Policy Committee observed increasing monetization of oil proceeds as evident in the growing FAAC distribution, relative to the 2017 level of disbursements. The Committee urged the Government to initiate strong stabilization programmes and to freeze the growth in its aggregate expenditure and FAAC distributions in order to create savings; needed to stabilize the economy against future oil price related shocks.

Notwithstanding the general improvement in macroeconomic conditions, the Committee noted the rather slow pace of moderation in food inflation. It also took note of the potential risk of a pass-through from rising global inflation to domestic prices. Members, however, expressed confidence that the tight stance of monetary policy would continue to complement other policies of government in addressing some of the structural issues underlying the stickiness of food prices. The Committee noted that at 14 per cent, the policy rate was tight enough to rein-in current inflationary pressures. The Committee, therefore, reaffirmed its commitment to price stability conducive to sustainable and inclusive growth.

The Committee noted with satisfaction the gradual implementation of the Economic Recovery and Growth Plan, in an effort to stimulate economic recovery. In the same vein, the Committee urged quick passage of the 2018 Appropriation Bill by the National Assembly, so as to keep fiscal policy on track and deliver the urgently needed reliefs in terms of employment and growth for the citizenry.

The Committee noted the relatively strong balance sheets of the deposit money banks' and the stable outlook. This is in spite of the concentration of non-performing loans in a few sectors, which the Committee observed was satisfactorily being addressed by adequate mechanisms established by the Bank to address the phenomenon. The Committee also noted that as Government pays off its huge contractor debts, a sizeable portion of these non-performing loans will be addressed. The Committee urged the Bank to strengthen its supervisory oversight and early warning systems to promptly identify, monitor compliance with extant prudential regulations, sustain macro-prudential policy and manage emerging vulnerabilities in the banking system.

The Committee reiterated the Bank's commitment to delivery of low interest credit as evidenced in its bold steps to adopt unconventional monetary policy to aid credit flow to vulnerable and growth enhancing sectors of the Nigerian economy. The Committee, therefore, enjoined the Bank to continue to support and encourage credit delivery at single digit interest rate through other mechanisms in the interim, while encouraging the banking system to establish frameworks to increase credit delivery to the employment generating sectors of the economy. In consideration of available data and evolving macroeconomic indicators, the Monetary Policy Committee is committed to revisiting its decisions in the short to medium term as the fundamentals evolve.

4.0. The Committee's Decisions

In reaching its decision, the Committee appraised potential policy options in terms of the balance of risks. The Committee also took note of the gains made so far as a result of its earlier decisions; including the stability of the foreign exchange market, the moderation in inflation rate as well as the restoration of economic growth. The launching of the Food Security Council by the Federal Government to improve food sustainability is a step in the right direction. The Committee was concerned about the fiscal distortions associated with absence of buoyancy between GDP growth and tax revenue, and urged the fiscal authorities to deploy appropriate corrective measures to address this phenomenon.

The Committee was of the view that further tightening would strengthen the impact of monetary policy on inflation with complementary positive effects on capital flows and exchange rate stability. Nevertheless, it could potentially dampen the positive outlook for growth and financial stability. However, the Committee is of the view that loosening would strengthen the outlook for growth by stimulating domestic aggregate demand through reduced cost of borrowing. This may, however, lead to a rise in consumer prices, generating exchange rate pressures on the currency in the process. The Committee also believes that loosening could worsen the current account balance through increased importation. On the argument to hold, the Committee believes that key macroeconomic variables have continued to evolve in a positive direction in line with the current stance of macroeconomic policy and should be allowed more time to fully manifest. In consideration of the foregoing, the Committee decided unanimously by a vote of all members present to retain the Monetary Policy Rate (MPR) at 14.0

per cent alongside all other policy parameters.
Consequently, the MPC voted unanimously to retain the
(i) MPR at 14.0 per cent;
(ii) CRR at 22.5 per cent;
(iii) Liquidity Ratio at 30.0 per cent; and
(iv) Asymmetric corridor at +200 and -500 basis points around the MPR.

Thank you for listening.

Godwin I. Emefiele
Governor, Central Bank of Nigeria
4th April, 2018

CENTRAL BANK OF NIGERIA COMMUNIQUÉ NO 118 OF THE MONETARY POLICY COMMITTEE MEETING OF MONDAY 21ST AND TUESDAY 22ND MAY, 2018

1.0 Background

The Monetary Policy Committee (MPC) met on the 21st and 22nd of May, 2018 against the backdrop of optimistic global growth outlook and sustained recovery in the domestic economy. The Committee examined the performance, risks, vulnerabilities in the global and domestic economies up to May 2018, and the outlook for the rest of the year. In attendance were nine members of the Committee.

Global Economic Developments

The momentum of global economic activities remained broadly sustained, with outcomes likely to be shaped by emerging geo-political issues including: easing geo-political tensions on the Korean Peninsula; reduced trade tensions between China and the United States; United States withdrawal from the 2015 Iranian Nuclear Deal; easy financing conditions in the Euro Area, the UK and Japan; as well as difficulties associated with the BREXIT negotiations. Accordingly, global output is projected to grow at 3.9 per cent in 2018, up from 3.8 per cent in 2017. Growth in the advanced economies is projected to strengthen to 2.5 per cent in 2018 from 2.3 per cent in 2017 premised on improved investments and consumption spending. Similarly, output growth in the emerging markets and developing economies (EMDEs) is projected to rise marginally at 4.9 per cent in 2018 reflecting improvements from 4.8 per cent in 2017, led by oil exporters, such as Russia, Brazil, and Nigeria. The Committee noted that despite these optimistic developments, the downside risks to global growth include: the geo-political tensions in the Middle-East; lingering uncertainties from BREXIT negotiations; and growing trend towards trade protectionism.

Inflation in the advanced economies is projected to rise by 2.0 per cent and would remain subdued relative to the long term trend. In the emerging markets and developing economies, price developments could surge by 4.6 per cent in 2018. The International Monetary Fund (IMF) forecasts that inflation may rise modestly over the medium to long-term, due to rising asset prices and long-term yields in the major financial markets.

Domestic Output Developments

The Committee noted improvements in the domestic economy, attributable to the steady decline in inflation, rebound in oil prices and increase in production level, as well as the continued stability in the foreign exchange market. According to data from the National Bureau of Statistics (NBS), real Gross Domestic Product (GDP) for Q4 2017 was revised upwards from 1.92 per cent to 2.11 per cent, while a growth of 1.95 per cent was recorded in the first quarter of 2018, up from a contraction of 0.91 per cent in the corresponding period of 2017. The development was due to growth in the oil and non-oil sectors by 14.77 and 0.76 per cent, respectively. The Monetary Policy Committee also noted the sustained positive outlook based on the Manufacturing, and Non-manufacturing Purchasing Managers' Indices (PMI), which rose for thirteenth and twelfth consecutive months to 56.9 and 57.5 index points, respectively, in April 2018. The Committee welcomed this development but believes that growth remains largely fragile and could benefit from further reforms and stimulus. In this regard, the MPC urged the various levels of government to accelerate the settlement of contractor debt and salary arrears as well as facilitate the quick implementation of the 2018 Federal Government budget.

Developments in Money and Prices

The Committee noted that broad money supply (M2) grew by 2.16 per cent in April 2018 from 1.26 per cent in March 2018, annualised to 6.48 per cent. This was in contrast to the provisional growth benchmark of 10.48 per cent for 2018. The performance of M2 was mainly driven by the growth in Net Domestic Credit (NDC) of 6.24 per cent (annualised to 18.72%), owing largely to net credit to government, which grew by 46.13 per cent (annualised to 138.39%) against the provisional benchmark of 54.97 per cent. Credit to the private sector, however, contracted by 0.16 per cent (annualised to -0.47%) in April 2018, in contrast to the provisional annual benchmark of 5.64 per cent. Net Foreign Assets (NFA) grew by 7.38 per cent in April 2018, annualized to 22.13 per cent, compared with the provisional benchmark of 18.15 per cent. Narrow money (M1), however, contracted by 3.31 per cent (annualised to -9.94%), compared with the provisional benchmark of 8.04 per cent.

Inflationary pressures continued to moderate with headline inflation (year-on-year) declining for the fifteenth consecutive month to 12.48 per cent in April 2018 from 13.34 per cent in March 2018. Food and Core inflation also decelerated to 14.80 and 10.92 per cent from 16.08 and 11.18 per cent, respectively, during the same period.
The average inter-bank call rate decreased to 3.34 per cent in April 2018 from 9.49 per cent in December 2017. Similarly, the average Open Buy Back (OBB) rate fell to 2.96 per cent in April 2018 from 8.46 per cent in December 2017. The movement in the net liquidity position and interest rates reflected the combined effects of Open Market Operations (OMO) auctions, foreign exchange interventions and statutory allocation to state and local governments.

The Committee welcomed the sustained improvement in the level of external reserves, which stood at US$47.79 billion on May 18, 2018, compared with US$46.73 billion at the end of March 2018. The Committee urged the Bank to sustain this momentum and continue to boost investor confidence in the economy.

The Committee also welcomed the continued rise in the price of crude and called on the Federal Government to seize the opportunity to build fiscal buffers against future oil price shocks.

The All-Share Index (ASI) decreased by 6.6 per cent from 43,330.54 on February 28, 2018 to 40,472.45 on May 18, 2018, owing largely to profit taking activities of investors, and capital reversals in response to monetary policy normalization in some advanced economies particularly, the United States. Similarly, Market Capitalization (MC) fell by 5.7 per cent from N15.55 trillion on February 28, 2018 to N14.66 trillion on May 18, 2018. The Committee noted the need to maintain remunerative domestic rates to stem the trend towards huge capital outflow.

The MPC welcomed the continued stability in the foreign exchange market, promoted by improved dollar liquidity in the market due to the high level of activity at the Investors' and Exporters' (I&E) window, that is equally driving rates towards convergence at all segments of the market. Total foreign exchange inflow through the economy from January to March 2018 stood at US$24.719 billion, of which funding from the CBN was US$8.81 billion or 28.5 per cent, while autonomous sources accounted for the larger balance of US$15.91 billion or 71.5 per cent of the total. In addition, the Committee welcomed the US$2.5 billion or RMB 15 billion Currency Swap between the Central Bank of Nigeria (CBN) and the People's Bank of China (PBoC). This swap, the Committee noted, will ease pressure in the foreign exchange market by the reduction in reliance on a third currency for trade settlement between Nigeria and China. They further noted that this swap arrangement could be the basis for an expanded and mutually beneficial economic relationship between Nigeria and China.

2.0. Overall Outlook and Risks

The macroeconomic environment that propelled the economy's exit from recession has remained positive and is likely to continue in the near-term. The expectation was premised on speedy implementation of the 2018 budget, improved security, continued stability in the foreign exchange market as well as increase in crude oil production and prices. The Committee noted the downside risks to the outlook to include: the late approval and implementation of the 2018 budget; farmers-herdsmen conflict; weak demand and consumer spending associated with outstanding salaries and contractor debt; and the growing level of sovereign debt.

The outlook for inflation indicates continued moderation in the price level, even though the risks include huge liquidity injections that is expected to arise from the implementation of the proposed N9.12 trillion 2018 FGN budget; expenditure towards the 2019 elections; monthly

FAAC injections, approval and implementation of the proposed new national minimum wage, possibly finance by a supplementary budget. These could impact aggregate demand and put pressure on domestic prices in the remaining months of 2018 and may dampen the gains already made by the Bank in stabilizing prices.
Staff forecasts, given the anticipated liquidity injections into the economy, indicates upward trending pressure on domestic prices from the second half of fiscal 2018. Consequently, the Committee advocates an orderly injection of the anticipated liquidity by the fiscal authorities to prevent a negative shock to prices that would derail the positive but fragile recovery so far achieved.

Given the CBN's interventions, the current level of oil prices and developments in the global economy, we expect rates to remain stable in the foreign exchange market in the near-term. However, the bearish signs in the capital market associated with profit taking activities of investors, call for a careful calibration of policy so as to moderate the trend of capital outflows in an era of monetary policy normalization in the United States. This is given that there are already indications of severe attacks on the foreign exchange markets of some emerging economies.

Nevertheless, there is significant high level of uncertainties that could arise from the fiscal operations of government in the near term. Amongst these are: when the implementation of the 2017 budget will end; dwindling revenue projections; as well as the possibilities of full implementation of the 2018 Federal budget. Consequently, we expect a likely bunching of government spending in view of the late passage of the budget and government's commitment to honour prior obligations. This could pose a serious challenge to the Bank's price stability mandate.

Revenue is expected to increase in view of the favourable prices of crude oil and improvements in non-oil revenue, particularly taxes. In addition, production levels have also increased in recent times and this is expected to be maintained. However, the implications of a China-US trade deal on China's oil imports from Nigeria remain unclear, especially as the US has included energy imports on the list of items for negotiation with China.

3.0. The Considerations of the Committee

The Committee expressed satisfaction on the positive outlook in the domestic economic environment as the real GDP grew for the fourth consecutive quarter by the first quarter of 2018 and the positive trend in the Manufacturing and Non-manufacturing Purchasing Managers' Indices in the first quarter of 2018. It noted the continued deceleration in headline inflation as well as stability in the foreign exchange market and therefore, called on the Bank to sustain the momentum in order to further subdue inflation and ensure growth. The Committee expressed satisfaction with the level of activities in the Investors' and Exporters' (I&E) window of the foreign exchange market.

The Committee further noted the overall upward growth momentum of the economy with key activity sectors returning positive growth. Despite the improving macroeconomic environment, the Committee noted that disruptions to the supply chains in major food producing states of the country remains a concern as food prices remained sticky downwards. It also noted the potential adverse effect of the rising global inflation on domestic prices and therefore, urged the Government not to relent on curtailing the security challenges to advance controlling inflation to its historical path.

Members of the Committee were satisfied with the progress made with the implementation of the Economic Recovery and Growth Plan, but were concerned on the effect of delay in the passage of the 2018 Appropriation could derail the programme and urged the Federal Government to sustain its implementation to further accelerate the economic recovery thus far achieved. The Committee urged the Government to set the machinery for the effective implementation of the 2018 budget to further stimulate the economy. It also encouraged the Government to sustain current efforts at boosting tax revenue generation notwithstanding the increase in crude oil and other commodity prices. The MPC, however, noted the potential effects of expansionary fiscal budget of 2018 and the liquidity impact of rising FAAC distribution, following increase in the prices of crude oil as well as the build up in election related spending towards the 2019 general elections.

The Committee took note of the improved performance of deposit money banks and observed that the relatively high levels of non-performing loans in the industry was moderating and urged Government to promptly settle outstanding contractor arrears as earlier promised. The Committee commended the effort of the Bank in achieving the positive outlook for the industry and advice the Bank to intensify efforts to further improve banking sector soundness. It called on the Bank to sustain its monitoring apparatus to ensure compliance with existing prudential regulations and early detection and management of emerging vulnerabilities. Also, it similarly encouraged the Bank not to relent in ensuring that liquidity continues to flow from the banking sector to the real sector to further strengthen economic recovery and employment generation.

4.0. The Committee's Decisions

The Committee critically evaluated the policy options in terms of developments in the international and domestic environments, noting in particular progress made in stimulating output growth, including stability in the foreign exchange market increase in the level of foreign exchange reserves, and sustained deceleration in the rate of inflation.

The Committee considered the forecast of high liquidity injection in the second half of 2018, upward pressure on prices, driven largely by substantial expansionary fiscal policy, which will arise from the late passage of the 2018 appropriation bill, outstanding balance from the 2017 budget and the pre-election expenditures. Thus, tightening would ensure the mop-up of excess liquidity. Mindful that despite the moderation in inflation, the current inflation rate is still above targeted single digit and that real interest rate only turned positive in the review period. The objective of the policy stance therefore, would be to accelerate a reduction in the inflation rate to single digit to promote economic stability, boost investor confidence, and promote foreign capital flows with complementary impact on exchange rate stability.
Conversely, the Committee believes that raising interest rate would, however, depress consumption and increase the cost of borrowing to the real sector. Moreover, such policy would make deposit money banks to re-price their assets.

In reviewing the choice of loosening, the Committee evaluated the potential impact of stimulating aggregate demand through lower cost of credit. Nevertheless, the Committee deliberated on the effectiveness of the choice at a time when liquidity injection had been forecast to rise tangentially in the second half of the year. The outcome therefore, would most likely exacerbate inflationary pressure, cause higher pressure on the exchange rate as demand for forex increases and return real rate into negative territory as nominal interest rate fall lower than the inflation rate. Owing to the poor transmission mechanism as a result of structural rigidities, the reduction in the MPR may not necessarily transmit to lowering market lending rate on account of the high cost of doing business. The Committee further noted that loosening could worsen the current account balance through increase in importation, margin lending, lowering of risk evaluation in accessing loans which will drive up loans and likely increase in NPLs with potential negative consequence on the stability of the banking industry. The cost of liquidity management would also rise considerably.

The Committee, while arguing for a hold, observed that the downside risk to growth and upside risk to inflation appears balanced as growth is improving while inflation is moderating. Maintaining the current policy stance would sustain gradual improvements in both indices. It was noted that there is need to see how all the components of GDP would evolve in the second quarter of 2018 in order to gain greater clarity on the direction of monetary policy. In summary, the predominant argument for a hold at this time is to await more clarity on the evolution of key indicators i.e. the passage and implementation of the budget, economic activities, and traction in fiscal policy in 2018.

Overall, the Committee was convinced that the economy needed a new impetus of increased lending by the banking system and would work with the Bank to adopt innovative ways to encourage the deposit money banks (DMBs) to adopt innovative ways to accelerate credit growth, including a reduction in the policy rate when conditions for such a decision arise. The MPC noted that at single digit inflation and higher reserve levels, the risks associated with a policy rate reduction under conditions of wavering foreign capital inflows and an unstable oil market, including other severe uncertainties, could be better managed to deliver macroeconomic stability in Nigeria. In consideration of the foregoing, therefore, the Committee decided by a vote of 8 members to retain the Monetary Policy Rate (MPR) at 14.0 per cent alongside all other policy parameters. One (1) member, however, voted to increase the MPR by 50 basis points.

Consequently, the MPC voted to retain the:

(i) MPR at 14.0 per cent;
(ii) CRR at 22.5 per cent;
(iii) Liquidity Ratio at 30.0 per cent; and
(iv) Asymmetric corridor at +200 and -500 basis points around the MPR.

Thank you for listening.

Godwin I. Emefiele
Governor, Central Bank of Nigeria
22nd May, 2018