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Central Bank of Nigeria

Mandate

- Ensure monetary and price stability
- Issue legal tender currency in Nigeria
- Maintain external reserves to safeguard the international value of the legal tender currency
- Promote a sound financial system in Nigeria
- Act as banker and provide economic and financial advice to the Federal Government

Vision

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

Mission Statement

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

Core Values

- Meritocracy
- Leadership
- Learning
- Customer - Focus

MONETARY POLICY DEPARTMENT

Mandate

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

Vision

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

Mission

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

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STATEMENT BY THE GOVERNOR

Monetary policy in the second half of 2015 was influenced by developments in the global and domestic economic environment. Slowing global growth, the rebalancing of the Chinese economy as well as the gradual normalization of US monetary policy are key global developments that challenged policy-making during the period. In addition, the protracted decline in crude oil and other commodity prices exacerbated pressures on the domestic environment, manifesting in strains on fiscal positions, lower accretion to external reserves and the resultant pressure on the exchange rate. These weakened domestic spending, thus moderating the Gross Domestic Product (GDP) to 2.35 per cent (year-on-year) in the second quarter of 2015, from 3.96 per cent and 6.54 per cent in the preceding and corresponding quarters of 2014, respectively. Pressures on the exchange rate, coupled with disruptions to agricultural production resulting from the insurgency in some parts of the country exerted pressure on the domestic price level as headline inflation rose to 9.6 per cent in December from 9.2 per cent in July 2015.

Accordingly, monetary policy during the review period was designed to address the challenges of declining output growth, rising unemployment and the constrained liquidity position in the domestic banking system. Decline in public and private spending due to severe strains on the fiscal position of the Federal and sub-national governments have brought growth under severe constraints. With two consecutive quarters of slow growth, fears were raised of the economy sliding into recession in 2016 in the absence of proactive steps to restart growth in key sectors of the economy and stimulate employment. Liquidity conditions in the banking system came under severe squeeze, owing to factors including full implementation of the TSA, elongation of the tenor of state government loans as well as their exposure to the distressed oil and gas sector. Consequently, the Bank embarked on monetary easing during the period by reducing the MPR from 13.0 per cent with the symmetric corridor of +/-200 basis points around the midpoint to 11.0 per cent with an asymmetric corridor of +200 and -700 basis points. The Monetary Policy Committee (MPC) also reduced the CRR from 25.0 to 20.0 per cent of total reserve eligible deposits. The Liquidity Ratio was, however, kept unchanged at 30.0 per cent.

The short-to-medium term outlook for the domestic economy indicates that keeping inflation within the Bank's single digit objective may be challenging, considering the import dependent economy, the developments in the external sector and the exchange rates. However, the Bank is still mindful of its mandate to achieve price

stability conducive to growth; therefore monetary policy would remain proactive to the sustenance of efforts towards minimizing these threats.

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

CHAPTER ONE

1.0 OVERVIEW

Monetary policy in the second half of 2015 was shaped by a number of developments in the global environment including declining oil and other commodity prices due to weak demand and tepid recovery in the advanced economies, general slowdown in the emerging market and developing economies, and rebalancing of the Chinese economy. Other factors were the heightened risk of deflation in Japan and the euro area due to weak response of consumer spending to the current stimulus by the European Central Bank (ECB) and the ongoing US monetary policy normalization which led to monetary policy divergence in the advanced economies. The resultant depreciation of currencies of most emerging market and developing economies in the wake of the US monetary policy normalization led to huge capital reversals from countries such as Nigeria. Also, the continued pressure on the exchange rate due to the decline in foreign reserves coupled with the perennial liquidity surfeit in the banking system due to banks' cautious approach to lending, as well as supply-side disruptions of the distribution chain by insurgency in some parts of the country, exerted pressure on the domestic price level. Consequently, headline inflation increased to 9.6 per cent in December from 9.2 per cent in July 2015. The prices of food & non-alcoholic beverages continued to be the major driver of headline inflation in the review period. This was followed by housing, water, electricity, gas and other fuels, transport and clothing & foot wear.

The fragile domestic economic environment caused by declining public and private expenditure as a result of lower oil prices, sustained pressure on the exchange rate, low credit to the employment-generating sectors of the economy combined to dampen economic growth in the review period. Data from the National Bureau of Statistics (NBS) showed that real GDP moderated considerably to 2.11 per cent (year-on-year) in the fourth quarter of 2015, from 2.84 per cent and 5.94 per cent in the preceding quarter of 2015, and the corresponding quarter of 2014, respectively. The development was partly attributed to the contraction witnessed in the industrial sector by the crude petroleum and natural gas sub-sector, owing to continued slide in crude oil prices and receipts. The fourth quarter real GDP growth was driven by the contributions of services, agriculture and trade, with 1.23, 0.83, and 0.76 percentage points, respectively. Overall output growth in

2015 moderated to 2.79 per cent compared with 6.22 per cent in 2014.
Stability in the foreign exchange market was threatened by sustained demand pressure owing to speculative activities, capital reversals following the continued normalization of US monetary policy and rising import of goods and services in the face of declining accretion to external reserves occasioned by lower oil prices. Also, negative investor sentiment surrounding policy direction of the new administration led to reduced foreign inflows. In order to stem these pressures, additional measures to support the closure of rDAS were introduced, including the use of BVN in BDC transactions and the Bank's endorsement of the DMBs' stoppage of foreign currency cash deposits.

Developments in Nigeria's financial market remained volatile in response to changes in global economic conditions. The continued decline in oil and other commodity prices stemming from weak demand and tepid recovery in the advanced economies, slowdown and rebalancing in China, and the ongoing US monetary policy normalization, leading to monetary policy divergence in the advanced economies, heightened vulnerabilities in the global financial market with spillovers to emerging market and developing economies.

In the wake of the monetary policy normalization in the US, the U.S. dollar appreciated against most currencies particularly in response to the November 2015 rate hike by the U.S Federal Reserve. The resultant depreciation of currencies of most emerging market and developing economies accentuated capital reversals from countries such as Nigeria.

The Banks's objective of price and macroeconomic stability continued to underpin the choice of monetary policy instruments in the review period. The instruments included: the Monetary Policy Rate (MPR), the Cash Reserve Ratio (CRR), Open Market Operations (OMO) and Discount Window Operations. During most of the review period, the MPR was retained at 13.0 per cent and adjusted downwards to 11.0 per cent in November 2015. The symmetric corridor of +/-200 basis points around the MPR was also adjusted in November 2015 to an asymmetric corridor of +200/-700 basis points. The CRR was reduced from 25.0 to 20.0 per cent of total reservable deposits with the understanding that the liquidity arising therefrom would be channeled to employment generating activities such as agriculture, infrastructural development, solid minerals and industry. The Liquidity Ratio was, however, kept unchanged at 30.0 per cent to address liquidity surfeit in the banking system.

OMO remained the primary tool of liquidity management, although the Bank reduced the use of this instrument in the review period. In the second half of 2015, actual OMO sales amounted to ₦1,732.55 billion compared with ₦4,261.72 billion in the first half of 2015 and N3,937.76 billion in the corresponding period of 2014. As part of liquidity management, the CRR was used to complement OMO sales, in order to moderate volatility and pressure on the exchange rate. The monetary aggregates largely underperformed relative to their benchmarks during the period, reflecting the continued contraction of net foreign asset (NFA) and the Bank's generally tight monetary policy stance. As in the preceding period, credit to government rose significantly, thereby crowding out private sector investments.

Money market activities were largely influenced by the downward adjustments in the CRR from 31.0 to 20.0 per cent, intensified implementation of the TSA and temporary suspension of OMO/NTB auctions during the early part of the review period. Money market rates were relatively stable with occasional spikes driven by fluctuations in banking system liquidity, maturing government securities and limited transactions in CBN bills. Interbank call and open buy back (OBB) rates remained below the lower band of the MPR corridor of +/- 200 basis points for most of the review period. The Nigerian money market reference rate, the NIBOR, maintained relative stability across tenors in the review period.

At the Nigerian capital market, the bearish trend continued in the second half of 2015. The All-Share Index (ASI) declined by 14.39 per cent to 28,642.25 at end-December 2015, from 33,456.83 at end-June 2015, and by 17.36 per cent, year-on-year. This development was attributed to a number of domestic and global factors, including declining crude oil prices and the impact on external reserves, continued capital outflows owing to US monetary policy normalization, as well as weak corporate earnings.

Activities in the bonds market were dominated by Federal Government of Nigeria (FGN) securities. Sub-national government and corporate bonds also registered some activities, although corporate bonds recorded the least share by market volume. The yield on the 10-year dollar-denominated bond rose to 8.48 per cent at end-December 2015, from 5.91 and 6.23 per cent at end-June 2015 and end-December 2014, respectively, reflecting investors' demand for higher premium to compensate for perceived sovereign risk.

Headline inflation maintained an upward trend above the upper band

of the Bank's inflation threshold of 6 - 9 per cent, though still within single digits. This was despite the Bank's overall tight monetary policy stance. Year-on-year headline inflation has, however, remained in single digits in the last thirty-six (36) months. Inflation inched up marginally from 9.2 per cent in July, 2015 to 9.6 per cent in December, 2015, and was projected by the IMF to rise to 9.7 per cent in 2016 from 9.1 per cent in 2015. Staff estimates suggest that year-on-year headline inflation would inch up slightly but remain in single digits in the first half of 2016, moderating to 9.5 per cent in May 2016. The expected moderation would be driven mainly by anticipated stability in the foreign exchange market, reduced household expenditures from delayed implementation of the 2016 budget, and improvements in the supply of petroleum products across the country.

Domestic output growth slowed to 2.11 per cent in the fourth quarter of 2015 from 2.84 per cent in the third quarter of 2015 and 5.94 per cent in the corresponding quarter of 2014. Overall, the economy is projected to grow by 3.78 per cent in 2016, up from 2.79 per cent in 2015 on the back of anticipated recovery in the non-oil sector (NBS). The IMF projected a subdued growth of 2.3 per cent in 2016, while the estimate of 4.37 per cent in the 2016 FGN budget appears overly optimistic in view of the current gloomy oil price outlook, transition challenges of the new administration and insurgency in the Northeast, with negative impact on agricultural activities. Nonetheless, growth in the non-oil sector is expected to be supported by various initiatives of the CBN and the fiscal authorities to stimulate domestic production. Given the declining oil prices and production challenges in an economy that is predominantly oil based, achieving the growth projection would require greater co-ordination of fiscal, monetary, trade and industrial policies. Also, efforts by sub-national governments to boost internally-generated revenue, prudent fiscal management as well as various measures to improve the investment climate would support growth.

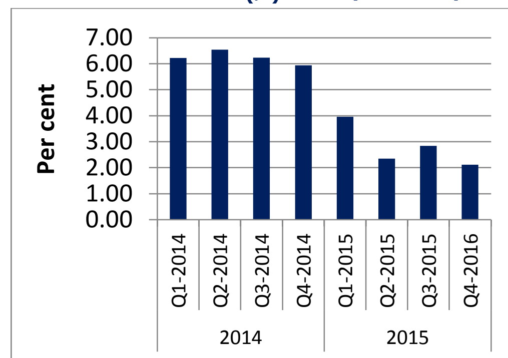
The risk to the outlook continues to be developments in the external environment, particularly the weak global recovery, declining demand for Nigeria's crude oil and slow accretion to external reserves.

CHAPTER 2

2.0 OUTPUT IN THE DOMESTIC ECONOMY

Output growth in the Nigerian economy in the second half of 2015 continued to moderate, driven largely by the persistent decline in crude oil prices, which adversely affected government revenue and expenditure. Real gross domestic product (GDP) declined to 2.84 per cent in the third quarter of 2015 from 6.23 per cent in the corresponding quarter of 2014. This was, however, higher than the growth of 2.35 per cent in the preceding quarter. The major drivers of growth were services (1.27%), agriculture (0.92%) and trade (0.70%). The industrial sector, however, contracted by 0.05 percentage point due largely to the contraction of 0.17 percentage point by the manufacturing sub-sector. The relative shares of the key sectors in the GDP were services (33.94%), agriculture (26.79%), industry (19.80%) and trade (16.24%). The slowdown in growth in the third quarter was attributed to fiscal uncertainties following the transition to a new government and heightened production costs.

Figure 2.1
Real GDP Growth (%) 2014 Q1 – 2015Q4



In the fourth quarter of 2015, output growth softened further to 2.11 per cent compared with 5.94 per cent in the corresponding quarter of 2014, and 2.84 per cent in the preceding quarter. The major drivers of growth in the fourth quarter were services (1.23%), agriculture (0.83%) and trade (0.76%). The contraction in the industrial sector intensified in the fourth quarter by 0.7 percentage point due to a 0.74 percentage point contraction in the crude petroleum and natural gas sub-sector. The development in the industrial sector largely accounted for the slowdown in the fourth quarter. The relative contributions of the main sectors to real GDP in the fourth quarter were services (38.24%), agriculture (24.18%), industry (17.32%) and trade (16.68%). Overall output growth in 2015 was 2.79 per cent compared with 6.22 per cent in 2014.

2.1 Domestic Economic Activity

Economic activities in the non-oil sector continued to drive GDP growth in the second half of 2015, as weaknesses in the oil sector persisted. Nonetheless, non-oil real GDP slowed to 3.05 per cent in the third quarter, compared with 7.51 per cent in the corresponding period of 2014, and 3.46 per cent in the preceding quarter of 2015. Growth in the non-oil sector in the third quarter of 2015 was largely driven by crop production (0.91%), information and telecommunications (0.56%), professional, scientific & technical services (0.22%), finance and insurance (0.20%) and education (0.19%). This compares with 1.23, 0.88, 0.28, 0.25 and 0.20 percentage points in the corresponding quarter of 2014.

In the fourth quarter of 2015, non-oil output also declined to 3.14 per cent compared with 6.44 per cent in the corresponding period of 2014. It was, however, higher than 3.05 per cent recorded in the preceding quarter. Growth in the non-oil sector in the fourth quarter of 2015 was due largely to activities in crop production (0.76%), information and telecommunications (0.51%), professional, scientific & technical services (0.13%), finance and insurance (0.19%) and education (0.22%) sub-sectors.

The oil sector grew by 1.06 per cent (year-on-year) in the third quarter of 2015, representing a remarkable improvement from the contractions of 3.60 and 6.79 per cent in the corresponding quarter of 2014 and the preceding quarter of 2015, respectively. Accordingly, average daily crude oil production increased to 2.17 million barrels per day (mbd) in the third quarter of 2015 compared with 2.15 and 2.05 mbd recorded in the corresponding quarter of 2014 and the preceding quarter of 2015, respectively. The recovery in the sector was attributed largely to reduced incidence of oil theft and pipeline vandalism in the oil producing areas.

In the fourth quarter, however, the oil sector contracted by 8.28 per cent (year-on-year), in contrast to the growth of 1.18 per cent in the corresponding quarter of 2014 and 1.06 per cent in the preceding quarter of 2015. Thus, crude oil production stood at 2.16 mbpd in the fourth quarter, which was lower by 0.30 per cent when compared with the level in the third quarter of 2015. It was also lower by 1.00 per cent compared with the 2.19 mbpd recorded in the corresponding quarter of 2014. The relapse into contraction, after the improvement in the preceding quarter, reflected the sustained weakness in the oil market with prices at their historic lows fuelled by growing uncertainties and supply glut. Consequently, the contribution of the oil sector to total real GDP declined to 8.06 per cent in the fourth quarter from

10.27 per cent in the third quarter of 2015 and 8.97 per cent in the corresponding period of 2014.

Figure 2.2
Non-oil Sector Performance 2014Q1 - 2015Q4

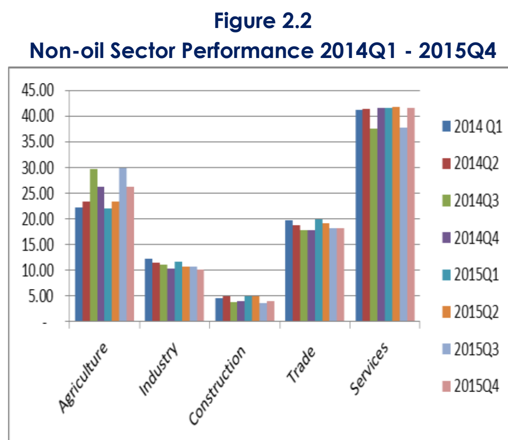
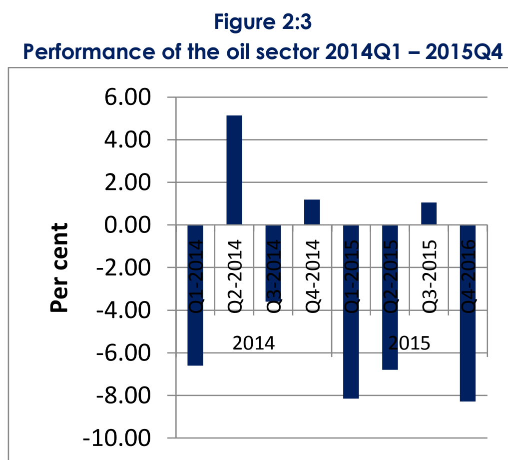


Figure 2:3
Performance of the oil sector 2014Q1 – 2015Q4



2.2 Sectoral Analysis

In this section, the performance of the economy is examined on a sectoral basis, with emphasis on key institutional developments that influenced output growth in the second half of 2015.

2.2.1 Agriculture

2.2.1.1 Agricultural Output

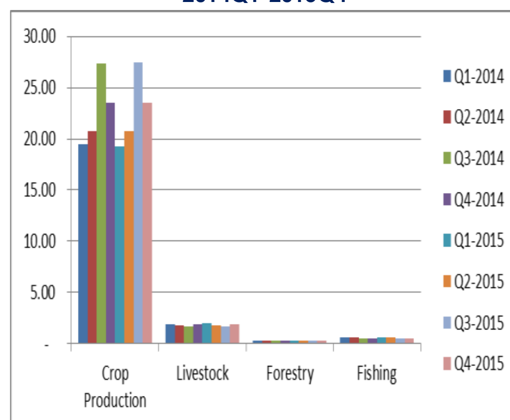
Growth in the agricultural sector moderated by 1.01 percentage points to 3.46 per cent in the third quarter of 2015, from 4.47 per cent in the corresponding period of 2014. It was also lower by 0.03 percentage point when compared with 3.49 per cent in the preceding quarter of 2015.

At 5.59 per cent, activity in the fishing sub-sector was the main driver of growth in the third quarter, followed by livestock (5.50%), crop production (3.31%) and forestry (2.24%). This indicates a slowdown of activities when compared with 6.72, 5.71, 4.38 and 2.36 per cent recorded for fishing, livestock, crop production and forestry, respectively, in the corresponding quarter of 2014. The share of agriculture in real GDP at 26.79 per cent in the third quarter of 2015 was marginally higher than 26.63 per cent recorded in the corresponding quarter of 2014.

During the fourth quarter, real agricultural GDP increased by 0.02 percentage point to 3.48 per cent from 3.46 per cent in the third quarter. It was, however, lower by 0.16 percentage point relative to the 3.64 per cent recorded in the corresponding period of 2014. In the quarter, activity in the livestock sub-sector at 5.64 per cent became the

major driver of agricultural growth. This was followed by fishing (5.41%), forestry (4.05%) and crop production (3.25%). This development also represented a slowdown of activities when compared with 5.74, 6.78, 4.44 and 3.40 per cent recorded for fishing, livestock, crop production and forestry, respectively, in the corresponding quarter of 2014. Similarly, the share of agriculture in real GDP increased marginally to 24.18 per cent in the fourth quarter of 2015 from 23.86 per cent recorded in the corresponding quarter of 2014.

Figure 2.4
Agricultural Sector Contribution by Activity, 2014Q1-2015Q4



2.2.1.2 Agricultural Policies and Institutional Support

During the review period, the sector benefited from a number of policies, reforms and institutional support as discussed below:

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

A total of 40,734 loans valued at N6.00 billion were guaranteed under the Scheme between July and December 2015.

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

The sum of N48.905 billion was released under the Scheme in respect of twenty-six (26) projects in the third quarter and twenty-three (23) projects in the fourth quarter of 2015.

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

In the third quarter of 2015, six (6) projects valued at N432.00 million were guaranteed under the Scheme. No project was guaranteed in the fourth quarter of 2015.

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

In the second half of 2015, a total of N357.487 million was approved as credit risk guarantees for one hundred and eighty nine (189) projects. In addition, the sum of N37.300 million was paid as interest drawback (IDB) claims to thirteen projects.

- **Agricultural Credit Support Scheme (ACSS)**

The Agricultural Credit Support Scheme was established to finance

large ticket agricultural projects with an interest rebate of 6.0 per cent upon timely repayment of the facility. In the third quarter of 2015, one (1) rebate valued at N33.134 million was paid, bringing the total since inception to 47 projects valued at N910.023 million.

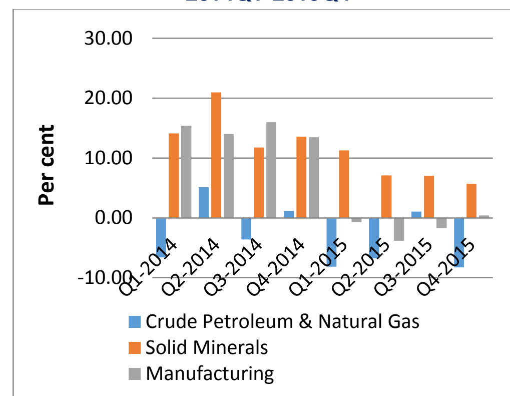
2.2.2 Industry

2.2.2.1 Industrial Output

In the third quarter of 2015, contraction in industrial sector output moderated to 0.26 per cent from a contraction of 5.27 per cent in the preceding quarter, in contrast to the growth of 5.05 per cent in the corresponding quarter of 2014. The contraction in the industrial sector was due largely to the 1.75 per cent contraction of the manufacturing sub-sector which was moderated by a growth of 7.03 and 1.06 per cent in solid minerals and crude petroleum and natural gas sub-sectors, respectively. In the corresponding period of 2014, industrial output was dampened by the contraction of 3.60 per cent in crude petroleum and natural gas, while manufacturing and solid minerals sub-sectors grew by 16.00 and 11.79 per cent, respectively.

In the fourth quarter, the industrial sector contracted further by 3.80 per cent from 0.26 per cent in the preceding quarter. This development was in contrast to the growth of 7.13 per cent in the corresponding period of 2014. The negative performance of the sector was mainly attributed to the substantial contraction of 8.28 per cent in crude petroleum and natural gas sub-sector, and the sluggish growth of 0.38 per cent in the manufacturing sub-sector. The solid mineral sub-sector, however, grew by 5.73 per cent. In the corresponding period of 2014, crude petroleum and natural gas, manufacturing and solid mineral sub-sectors grew by 1.18, 13.47 and 13.57 per cent, respectively.

Figure 2.5
Industrial Sector's Contribution by Activity, 2014Q1-2015Q4



2.2.2.2 Industrial Policy and Institutions Support:

The performance of the sector during the period benefited from the continuation of a number of reforms and incentives. These included:

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

No disbursement was made in the second half of 2015.

- **N213 Billion Nigerian Electricity Market Stabilization Facility (NEMSF)**

No fund was disbursed under Nigeria Electricity Market Stabilization Facility (NEMSF) in the period under review. Cumulatively, the sum of N64.755 billion had been disbursed since inception to eighteen (18) projects.

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

The N200 Billion SME Restructuring/Refinancing Fund (RRF) was discontinued in December, 2015. The RRF repayment account is now under a new scheme called the N300 billion Real Sector Support Facility (RSSF) established in November 2014, to address the funding needs of large ticket SMEs in Nigeria. In the review period, the sum of N9.68 billion was disbursed to the Bank of Industry (BOI). All outstanding repayments under the RRF will now be utilized under the RSSF.

- **N235 Billion Small and Medium Enterprises Credit Guarantee Scheme (SMECGS)**

As at end-December 2015, eighty seven (87) projects valued at N4.22 billion were guaranteed under the Scheme, while forty (40) projects valued at N2.44 billion were fully repaid.

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

The ₦220 billion Micro, Small and Medium Enterprises Development Fund (MSMEDF) was launched on August 15, 2013. The Fund's focus is to channel low interest funds to the MSME sub-sector of the Nigerian economy through Participating Financial Institutions (PFIs). A total of N51.09 billion was disbursed as at end-December 2015 under the project, while N0.89 million was repaid.

- **The Entrepreneurship Development Centres (EDCs)**

The EDC initiative by the Bank was intended to support youth entrepreneurship to set up businesses and create self-employment towards poverty reduction. Currently there are a total of six EDCs, one located in each of the six geo-political zones of the country: North-East (Maiduguri), North-Central (Makurdi), North-West (Kano), South-South (Calabar), South-West (Ibadan) and South-East (Umuahia) with one outreach center located in the North-Central (Minna). Since inception, 19,232 participants have been trained under the scheme and a total of 14,221 jobs created, while 7,145 successful

participants accessed a cumulative sum of N1.090 billion in start-up loans.

2.2.3 Construction

Activity in the construction sector contracted by 0.11 per cent in the third quarter of 2015 in contrast to the growth of 6.42 and 11.32 per cent in the preceding quarter of 2015 and the corresponding quarter of 2014. In the fourth quarter, the sector further contracted by 0.35 per cent compared with 12.66 per cent growth in the corresponding period in 2014.

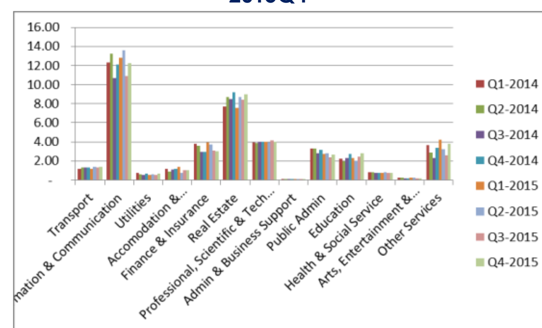
2.2.4 Trade Sector

In the third quarter of 2015, the trade sector grew by 4.40 per cent compared with 5.07 per cent in the preceding quarter of 2015 and 6.81 per cent in the corresponding period of 2014. In the fourth quarter, the sector's growth strengthened further to 4.69 per cent compared with 5.32 per cent in the corresponding period of 2014.

2.2.5 Services Sector

The Services sector grew by 3.78 per cent in the third quarter of 2015 compared with 4.35 and 7.63 per cent in the preceding quarter of 2015 and corresponding period of 2014. The key drivers in the sector were education; finance and insurance; utilities; and information and telecommunication with growth rates of 8.04, 6.57, 5.35 and 5.27 per cent, respectively. This compares with growth of 8.78, 8.56, -12.91 and 8.30, respectively, in the corresponding quarter of 2014. In the fourth quarter, the sector moderated to 3.25 per cent relative to the performance in the preceding quarter. The fourth quarter performance was largely driven by education, finance and insurance and entertainment and recreation, with 8.13, 6.41 and 6.54 per cent, respectively, against their performance of 11.23, 8.14, and 15.60 per cent, respectively, in the corresponding quarter of 2014.

Figure 2.6
Services Sub-Sector Contribution, 2014Q1-2015Q4

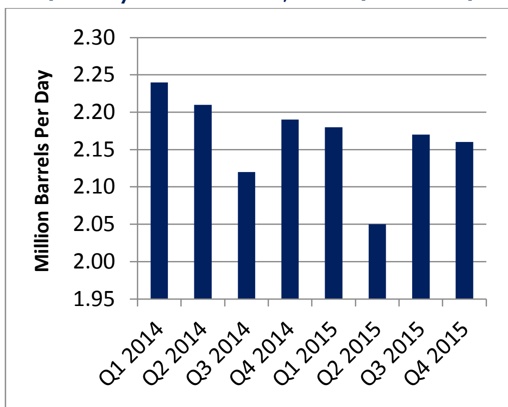


2.2.6 Oil Sector

The sector continued to record weak performance in the second half of 2015, reflecting the persistent softening of the international oil market. In the fourth quarter, average daily crude oil production declined marginally to 2.16 mbpd from 2.17 mbpd in the preceding quarter. This represented a fall of 0.03 mbpd compared with the 2.19 mbpd in the corresponding period

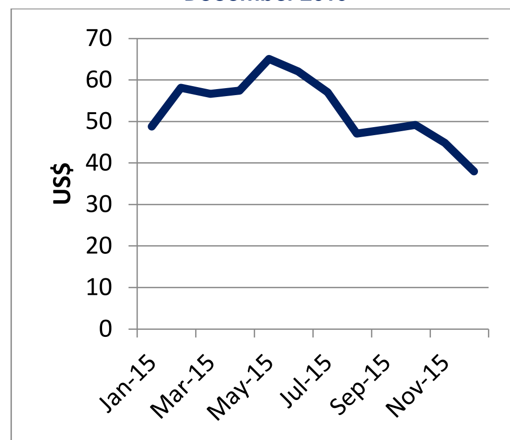
of 2014. The development in the fourth quarter represented a moderation compared with the preceding quarter. In the third quarter, average daily oil production had risen to 2.17 from 2.05 mbpd in the preceding quarter and 2.12 mbpd in the corresponding quarter of 2014.

Figure 2.7
Quarterly Oil Production, 2014 Q1 – 2015 Q4



The global oil price continued its downward movement during the review period. The price of Nigeria's reference crude, the Bonny Light 37⁰API fell from a high of US$57.01 per barrel in July 2015 to US$47.09 per barrel in August and rose to US$49.20 per barrel in October 2015. The price of Bonny light fell further to close the year at a low of US$38.00 per barrel in December 2015. The fall in price of Bonny Light crude (and other global crudes) was largely attributed to the increase in level of oil and gas output by the U.S, supply glut from OPEC and non-OPEC members, expectation of re-entry of Iranian oil into the market and weak demand from Europe and China. The continued decline in oil price had serious implications for government fiscal revenue. Overall, the average Bonny Light price of US$52.70 per barrel in 2015 was below the Federal Government 2015 budget benchmark price of US$53.00 per barrel.

Figure 2.8
Monthly Bonny Light Oil Price, January – December 2015



CHAPTER 3

3.0 PRICE DEVELOPMENTS

In the second half of 2015, the upward pressure on domestic prices continued, despite the generally tight monetary policy stance of the Bank. Headline and food inflation rates maintained an upward trajectory and remained above the Bank's inflation benchmark range of 6 - 9 per cent. Core inflation initially fluctuated upwards and stabilized in the last quarter of the year. This price development indicated that the driving factors were both supply- and demand-related.

On the supply side, the volatility in the foreign exchange market continued. As a result, the depreciation of the naira exchange rate intensified in all segments of the market. The Bank implemented a number of polices and administrative measures to moderate the demand pressures. The Bank's restriction of access to foreign exchange for some 41 import items, introduced in the preceding period, was retained and complemented by the use of the Bank Verification Number (BVN) in Bureau de Change (BDC) transactions. This additional measure was intended to curb excessive demand pressures and reduce the spread between the interbank and BDC rates. Overall, the depreciation of the naira was attributable to falling oil prices, which led to reduced accretion to foreign reserves, thereby weakening the Bank's ability to fund the rising demand in the foreign exchange market.

In the money market, the Inter-Bank Call and Open Buy Back (OBB) rates fell remarkably below the standing facility corridor, signaling the existence of liquidity surfeit in the banking system. The excess liquidity largely arose from the cautious approach to lending by the DMBs and monetary easing measures embarked on by the Bank as well as the full implementation of the Treasury Single Account (TSA), which reduced borrowing by the Federal Government.

3.1 Trends in Inflation

In the second half of 2015, all measures of inflation trended upwards. Food and core measures of consumer price index (CPI) increased progressively between July and December 2015 from 179.5 and 171.6 to 186.2 and 176.7, respectively. Food inflation (year-on-year) increased from 10.1 per cent in July to 10.6 per cent in December 2015. On the other hand, core inflation (year-on-year) fell marginally from 8.8 per cent in July to 8.7 per cent in December 2015. Following this development, headline inflation (year-on-year) increased from 9.2 per cent in July to 9.6 per cent in December 2015. Thus, in terms of its

weight in the consumer basket, the food component remained the major driver of headline inflation. All components of food inflation, except yams, potatoes and other tubers, experienced an increase in the second half of the year. The core component moderated the pressure on headline inflation during the period, due to the marginal decline in some of its components including furnishing, household equipment and household maintenance; health; education and restaurant and hotels (Table 3.1 and figures 3.1 and 3.2).

Table 3.1Inflation Rates, January 2015 – December 2015

	Headline Inflation			Core Inflation			Food Inflation		
	CPI	Y-on-Y	12MMA	CPI	Y-on-Y	12MMA	CPI	Y-on-Y	12MMA
Jan-15	165.77	8.16	8.06	163.72	6.79	6.86	169.85	9.21	9.47
Feb-15	166.90	8.36	8.12	164.83	6.99	6.85	171.10	9.36	9.49
Mar-15	168.40	8.50	8.20	166.20	7.50	6.90	172.80	9.40	9.50
Apr-15	169.70	8.70	8.20	167.20	7.70	6.90	174.40	9.50	9.50
May-15	171.58	9.00	8.33	169.23	8.25	6.97	176.27	9.78	9.51
Jun-15	173.17	9.17	8.42	170.59	8.40	7.01	178.13	10.04	9.53
Jul-15	174.37	9.22	8.50	171.64	8.83	7.15	179.50	10.05	9.55
Aug-15	175.40	9.34	8.57	172.69	9.01	7.38	180.63	10.13	9.57
Sep-15	176.50	9.40	8.70	173.70	8.90	7.60	181.80	10.20	9.60
Oct-15	177.20	9.30	8.80	174.40	8.70	7.80	182.60	10.10	9.70
Nov-15	178.37	9.37	8.88	175.35	8.73	8.02	184.06	10.32	9.78
Dec-15	180.15	9.55	9.01	176.71	8.73	8.22	186.20	10.59	9.90

Figure 3.1
Headline, Core and Food Inflation Rates (July - December 2015

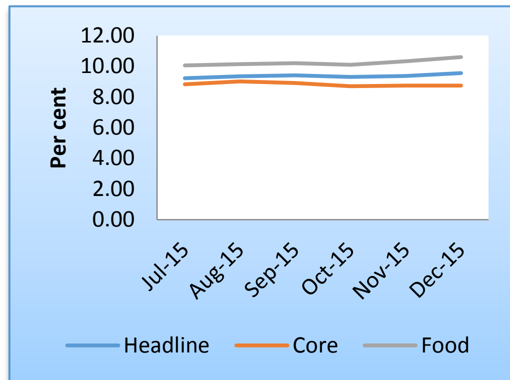
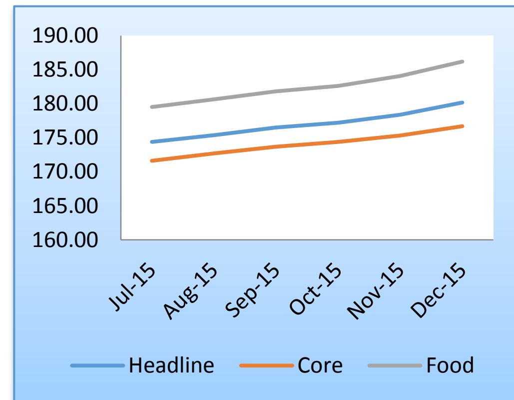


Figure 3.2
CPI Headline, Core and Food (July- December 2015)



In the review period, most components of food inflation continued their upward trend as was experienced in the first half of the year. Farm produce remained the major driver of food inflation, increasing by 0.25 percentage point to 5.41 per cent in December from 5.16 per cent in July 2015. Processed food component increased by 0.28 percentage point to 5.17 per cent in December from 4.89 per cent in July 2015. Other components of food inflation that also recorded price increases include vegetables (0.13 percentage point), fish and sea foods (0.12 percentage point) and meat (0.03 percentage point). Yam, potatoes and other tubers component, however, experienced a decline of 0.06 percentage point in the review period.

3.1.1 Headline Inflation

During the review period, the major components of headline inflation continued their upward movement, reflecting a general increase in domestic prices. Food & non-alcoholic beverages remained the major driver of headline inflation, rising from 5.29 per cent in July to 5.58 per cent in December 2015. This was followed by housing, water, electricity, gas and other fuels, which increased marginally by 0.1 percentage point from 1.29 per cent to 1.30 per cent. Other components such as transport, clothing & foot wear and education also contributed to the uptick (Table 3.2 and Figure 3.3).

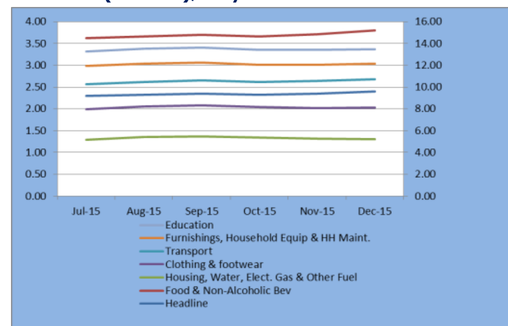
Domestic prices continued to rise in the review period, in spite of the tight monetary policy stance of the Bank. This development was due largely to the continued disruption to the supply

chain, occasioned by insurgency in some parts of the country. The pass-through of exchange rate depreciation in the parallel market to domestic prices also contributed to the observed price increases. In addition, the persistent shortage of petroleum products continued to increase the cost of transportation and other economic activities. The liquidity surfeit in the banking system arising from redemption of maturing instruments and other injections also exerted upward pressure on domestic prices, although their effects were largely moderated by the sustained tight monetary policy stance of the Bank.

Table 3.2
Major Components of Headline Inflation (Y-on-Y), July - December, 2015

Date	Headline	Food & Non-Alcoholic Bev	Housing, Water, Elect. Gas & Other Fuel	Clothing & footwear	Transport	Furnishings, Household Equip & HH Maint.	Education
Jul-15	9.20	5.29	1.29	0.70	0.58	0.42	0.32
Aug-15	9.30	5.33	1.35	0.70	0.57	0.42	0.34
Sep-15	9.40	5.38	1.37	0.71	0.57	0.41	0.34
Oct-15	9.30	5.33	1.34	0.70	0.58	0.39	0.34
Nov-15	9.40	5.43	1.32	0.70	0.62	0.37	0.34
Dec-15	9.60	5.58	1.30	0.73	0.65	0.36	0.33

Figure 3.3
Major Components of Headline Inflation (Y-on-Y), July - December 2015

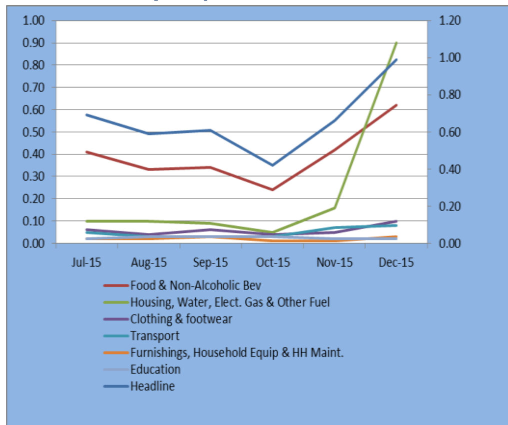


Headline inflation fluctuated upwards on a month-on-month basis during the period under review. It initially trended downwards from 0.69 to 0.42 per cent between July and October, 2015, and rose to 0.66 and 0.99 per cent in November and December, respectively. The major components that accounted for the increase were prices of food and non-alcoholic beverages which ranged from 0.24 and 0.62 per cent; and housing, water, electricity, gas & other fuels, from 0.05 to 0.90 per cent (Table 3.3 and Figure 3.4).

Table 3.3
Major Components of Headline Inflation (M-on-M), July - December, 2015

Date	Headline	Food & Non-Alcoholic Bev	Housing, Water, Elect. Gas & Other Fuel	Clothing & footwear	Transport	Furnishings, Household Equip & HH Maint.	Education
Jul-15	0.69	0.41	0.10	0.06	0.05	0.02	0.02
Aug-15	0.59	0.33	0.10	0.04	0.03	0.02	0.03
Sep-15	0.61	0.34	0.09	0.06	0.03	0.03	0.03
Oct-15	0.42	0.24	0.05	0.04	0.03	0.01	0.03
Nov-15	0.66	0.42	0.16	0.05	0.07	0.01	0.02
Dec-15	0.99	0.62	0.90	0.10	0.08	0.03	0.02

Figure 3.4
Major Components of Headline Inflation (M-on-M), July-December 2015



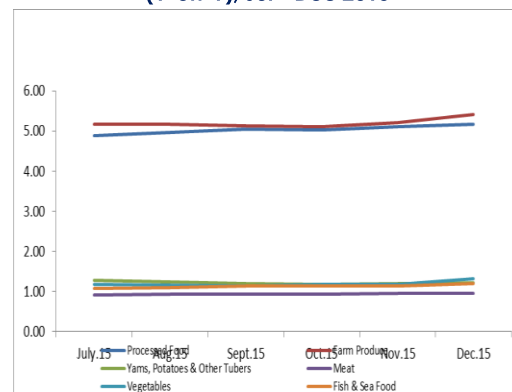
3.1.2 Headline Inflation

Food inflation (year-on-year) trended upwards by 0.54 percentage point from 10.05 per cent in July to 10.59 per cent in December 2015. The rise in food inflation was largely attributed to increase in the prices of its key components, notably processed food and farm produce. The price of processed food increased from 4.89 to 5.17 per cent, and that of farm produce from 5.16 to 5.41 per cent. Thus, of the 0.54 percentage point increase in food inflation, processed food contributed 0.28 percentage point which is slightly larger than the 0.25 percentage point from farm produce. Consequently, both processed food and farm produce drove the food price development during the review period. The major driver of the increase in processed food category was fish and sea foods which increased by 0.12 percentage point, while farm produce was largely driven by the 0.13 percentage point increase in the price of vegetables. This price development could be explained by delayed harvest due to late rains, the effect of higher import costs from exchange rate depreciation and increase in transport costs due to fuel supply shortages during the period (Table 3.4 and Figure 3.5).

Table 3.4
Major Components of Food Inflation (Y-on-Y), July- Dec 2015

	July.15	Aug.15	Sept.15	Oct.15	Nov.15	Dec.15	Change btw Jul - Dec 2015
FOOD	10.05	10.13	10.17	10.13	10.32	10.59	0.54
Processed Food	4.89	4.97	5.05	5.03	5.11	5.17	0.28
Farm Produce	5.16	5.16	5.12	5.10	5.21	5.41	0.25
Yams, Potatoes & Other Tubers	1.27	1.23	1.19	1.18	1.19	1.21	-0.06
Meat	0.92	0.93	0.93	0.94	0.95	0.95	0.03
Vegetables	1.18	1.15	1.14	1.17	1.18	1.31	0.13
Fish & Sea Food	1.08	1.10	1.14	1.14	1.14	1.20	0.12

Figure 3.5
Major Components of Food Inflation (Y-on-Y), Jul - Dec 2015



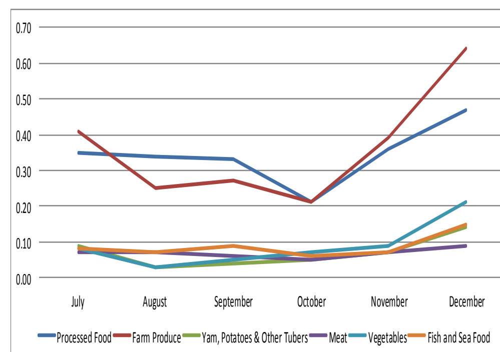
The month-on-month analysis indicated that food inflation also

increased from 0.76 per cent in July to 1.11 per cent in December 2015. The price of processed food increased to 0.47 from 0.35 per cent and farm produce to 0.64 from 0.41 per cent during the period. Accordingly, the 0.35 percentage point increase in food inflation was contributed by the two components - farm produce (0.23%) and processed food (0.12%). The key driver of the increase in the farm produce category was vegetable, which rose by 0.13 percentage points (Table 3.5 and Figure 3.6).

Table 3.5
Major Components of Food Inflation (M-on-M), July-December 2015

	July	August	September	October	November	December	Change btw Jul - Dec 2015
Food	0.76	0.59	0.6	0.42	0.75	1.11	0.35
Processed Food	0.35	0.34	0.33	0.21	0.36	0.47	0.12
Farm Produce	0.41	0.25	0.27	0.21	0.39	0.64	0.23
Yam, Potatoes & Other Tubers	0.09	0.03	0.04	0.05	0.07	0.14	0.05
Meat	0.07	0.07	0.06	0.05	0.07	0.09	0.02
Vegetables	0.08	0.03	0.05	0.07	0.09	0.21	0.13
Fish and Sea Food	0.08	0.07	0.09	0.06	0.07	0.15	0.07

Figure 3.6
Major Components of Food Inflation (M-on-M), July - December 2015



3.1.3 Core Inflation

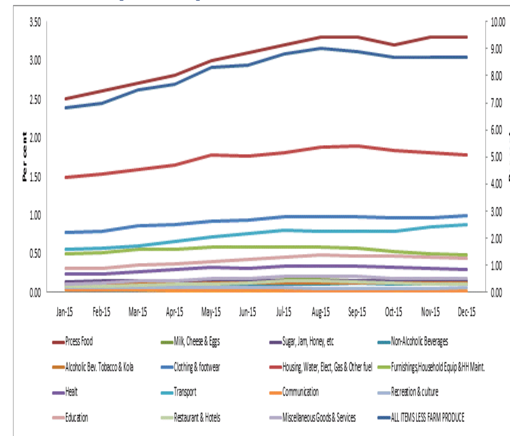
Core inflation (year-on-year) fluctuated downwards from 8.8 per cent in July to 8.7 per cent in December 2015, reflecting a drop of 0.1 percentage point. It, however, rose to a high of 9.0 per cent in August 2015 and declined to 8.9 in September and stabilized at 8.7 per cent between October and December 2015. The 0.1 percentage point decrease in core inflation was largely accounted for by Furnishings, Household Equip & HH Maintenance (0.11 percentage point), Health (0.05 percentage point) and Restaurant and Hotel (0.03 percentage point). This development dampened the increases recorded in Transport (0.07 percentage point); Processed food (0.05 percentage point); and Clothing and foot wear (0.02 percentage point). Other components such as the Non-Alcoholic beverages; Alcoholic beverages and Tobacco; Communication; Recreation and

Culture; and Sugar, Jam and Honey, etc remained unchanged from their position in July 2015 (Table 3.6 and Figure 3.8). The decline in core inflation was largely traceable to reduced government spending which affected general economic activities and household expenditure.

Table 3.6
Major Components of Core Inflation (Y-on-Y) July- December 2015

YEAR-ON-YEAR (CORE)	Weights	Jul'15	Aug'15	Sep'15	Oct'15	Nov'15	Dec'15	Change btw Jul. to Dec. 2015
ALL ITEMS LESS FARM PRODUCE CPI	730.50	8.8	9.0	8.9	8.7	8.7	8.7	-0.10
Processed Food	237.53	3.2	3.3	3.3	3.2	3.3	3.3	0.05
Milk,Cheese & Eggs	12.75	0.2	0.2	0.2	0.1	0.1	0.1	-0.02
Sugar,Jam,Honey,etc	11.10	0.1	0.1	0.1	0.1	0.1	0.1	0.00
Non-Alcoholic Beverages	10.97	0.1	0.1	0.1	0.1	0.1	0.1	0.00
Alcoholic Bev. Tobacco & Kola	10.87	0.1	0.1	0.1	0.1	0.1	0.1	0.00
Clothing & footwear	76.50	1.0	1.0	1.0	1.0	1.0	1.0	0.02
Housing,Water, Elect.Gas & Other Fuel	167.34	1.8	1.9	1.9	1.8	1.8	1.8	-0.01
Furnishings, Household Equip &HH Maint.	50.27	0.6	0.6	0.6	0.5	0.5	0.5	-0.11
Health	30.04	0.3	0.3	0.3	0.3	0.3	0.3	-0.05
Transport	65.08	0.8	0.8	0.8	0.8	0.8	0.9	0.07
Communication	6.80	0.0	0.0	0.0	0.0	0.0	0.0	0.00
Recreation & culture	6.91	0.1	0.1	0.1	0.1	0.1	0.1	0.00
Education	39.44	0.5	0.5	0.5	0.5	0.5	0.4	-0.02
Restaurant & Hotels	12.12	0.1	0.1	0.1	0.1	0.1	0.1	-0.03
Miscellaneous Goods & Services	16.63	0.2	0.2	0.2	0.2	0.2	0.2	-0.03

Figure 3.7
Major Components of Core Inflation (Y-on-Y) Jan-December 2015

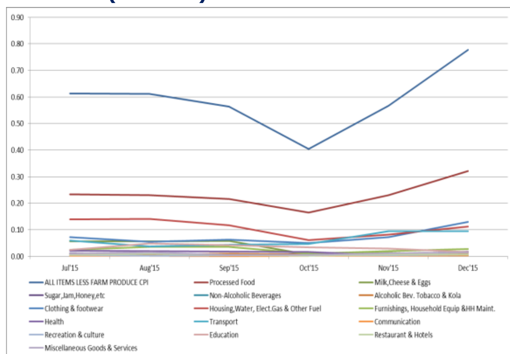


On a month-on-month basis, core inflation rose by 0.17 percentage point from 0.61 per cent in July to 0.78 per cent in December 2015. Processed food remained the major driver of core inflation, increasing from 0.23 to 0.32 per cent in the review period. This was followed by Clothing and footwear which increased from 0.07 per cent in July to 0.13 per cent in December 2015. Transport also increased from 0.06 per cent to 0.10 per cent in the reviewed period. Other components that contributed to the increase in core inflation on a month-on-month basis were: Furnishings, Household Equip &HH Maintenance. (0.02 to 0.03 per cent) and Sugar, Jam, Honey, etc (0.01 to 0.02 per cent) (Table 3.7 and Figure 3.9).

Table 3.7
Major Components of Core Inflation
(M-on-M) July- December 2015

MONTH-ON-MONTH (CORE)	Weight	Jul'15	Aug'15	Sep'15	Oct'15	Nov'15	Dec'15	Change btw Jul. to Dec. 2015
ALL ITEMS LESS FARM PRODUCE CPI	730.50	0.61	0.61	0.56	0.40	0.57	0.78	0.17
Processed Food	237.53	0.23	0.23	0.22	0.17	0.23	0.32	0.09
Milk,Cheese & Eggs	12.75	0.06	0.06	0.06	0.01	0.01	0.00	-0.05
Sugar,Jam,Honey,etc	11.10	0.01	0.01	0.01	0.01	0.01	0.02	0.01
Non-Alcoholic Beverages	10.97	0.01	0.01	0.01	0.01	0.00	0.01	0.01
Alcoholic Bev. Tobacco & Kola	10.87	0.01	0.01	0.01	0.01	0.01	0.01	0.00
Clothing & footwear	76.50	0.07	0.06	0.06	0.05	0.07	0.13	0.06
Housing,Water, Elect.Gas & Other Fuel	167.34	0.14	0.14	0.12	0.06	0.08	0.11	-0.03
Furnishings, Household Equip &HH Maint.	50.27	0.02	0.04	0.04	0.01	0.02	0.03	0.00
Health	30.04	0.02	0.02	0.02	0.02	0.00	0.02	0.00
Transport	65.08	0.06	0.04	0.04	0.05	0.09	0.10	0.04
Communication	6.80	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Recreation & culture	6.91	0.01	0.00	0.00	0.00	0.00	0.01	0.00
Education	39.44	0.02	0.05	0.04	0.03	0.03	0.02	-0.01
Restaurant & Hotels	12.12	0.00	0.01	0.00	0.00	0.01	0.01	0.00
Miscellaneous Goods & Services	16.63	0.01	0.02	0.00	0.00	0.01	0.02	0.00

Figure 3.8
Major Components of Core Inflation
(M-on-M) Jul-December 2015



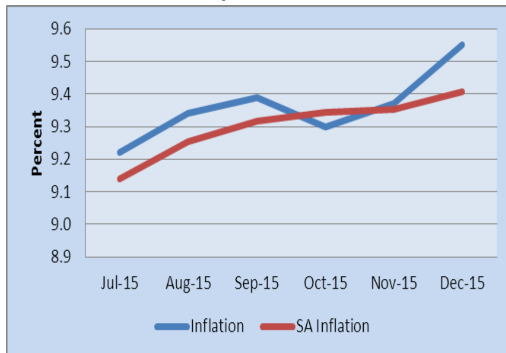
3.1.4 Seasonally-Adjusted Inflation

In the second half of 2015, both actual and seasonally-adjusted headline inflation rates maintained their upward movement, in continuation of the trend observed during the preceding half year (Table 3.8 and Figure 3.9). Notwithstanding the moderation recorded in October, actual headline inflation continued its upward trajectory, reflecting the general level of prices. It trended above the seasonally-adjusted inflation rate in both the third and fourth quarters, except in October when it dipped. This development indicated that seasonal effects affected headline inflation during the period. The general upward trend in both actual and seasonally-adjusted measures of inflation was ascribed to scarcity of petroleum products resulting in increased energy and transport costs; imported inflation due to significant depreciation of the naira as well as food supply bottlenecks and delayed harvest of agricultural produce. The uptick in both measures of inflation in December largely resulted from increased consumption spending associated with social and religious festivities as well as energy supply shortfalls.

Table 3.8
Actual and Seasonally Adjusted Headline Inflation July -December 2015

Date	Inflation	S-A Inflation
Jul-15	9.22	9.14
Aug-15	9.34	9.25
Sept-15	9.39	9.32
Oct-15	9.30	9.34
Nov-15	9.37	9.35
Dec-15	9.55	9.41

Figure 3.10
Actual and Seasonally Adjusted Headline Inflation July - December 2015



3.2 Key Factors that Influenced Domestic Prices

The headline and food measures of inflation in the second half of 2015 trended upwards with core inflation recording marginal decline, reflecting the impact of both demand and supply factors. The fluctuation in all measures of inflation during the period reflected changes in both domestic and global economic environment. Factors such as the liquidity surfeit in the banking system due to some monetary easing measures, scarcity of petroleum products and the pass-through effect of depreciation to import prices exerted upward pressure on the price level. Other factors included increased consumption spending associated with year-end social and religious festivities, the liquidity impact of federal government bailout to states, supplementary budget by the federal government, disruptions to food supply partly due to security challenges and unfavourable agricultural season.

3.2.1 Demand-side Factors

A critical factor that influenced domestic prices during the period was the perennial liquidity overhang in the banking system, which exerted considerable pressure on the exchange rate following the persistent slide in crude oil prices. This was further accentuated by the liquidity effect of the bailout to states by the federal government through the CBN during the early part of the second half of 2015. In addition, the trend towards monetary policy easing by the Bank, which started in July with the harmonization of CRR to 31 per cent and its further reduction to 20 per cent in November, coupled with the reduction in the MPR to 11.0 from 13.0 per cent was expected to stimulate aggregate spending with likely inflationary effects. This was further heightened by the ₦574.5 billion supplementary budget of the federal government. The aggregate effect of these developments was that the liquidity trapped in the banking system put pressure on the foreign exchange market leading to the depreciation in the BDC segment from N236.65/US$ in July to N258.30/US$ in December 2015.

3.2.2 Supply-side Factors

Domestic prices in the second half of 2015 were affected by a number of supply-side factors, which were principally production and distribution related. Industrial production and distribution were affected by the decline in electricity generation due to inadequate supply of gas and vandalism of the transmission lines as well as shortage of petroleum products. Insurgency in the north-east and activities of cattle rustlers led to communal clashes and displacement of farmers, which affected production and distribution of agricultural products. Other factors were delayed harvest due to the late commencement of rain and the outbreak of avian influenza in over 21 states of the Federation and the Federal Capital Territory (FCT). The aggregate effect of these developments was the decline in output growth to 2.84 and 2.11 per cent in the third and fourth quarters of 2015, respectively, compared with 6.23 and 5.94 per cent in the corresponding period of 2014. Another supply side factor was the depreciation of the naira exchange rate, which had a significant pass-through to import prices, particularly the prices of imported raw materials.

3.2.3 Moderating Factors

A number of factors moderated pressures on the domestic price level during the second half of 2015. On the demand side, the moderating factors were the relatively tight monetary policy stance of the Bank as the MPR was maintained at 13.0 per cent up to November 2015 and the full implementation of the TSA which led to the withdrawal of over N2 trillion at end-December 2015. In addition, reduced general government spending due to the decline in oil revenue moderated overall economic activities and household expenditure. Also, the slowdown in government activities due to delayed constitution of the cabinet slowed public spending and private demand. On the supply side, the effect of agricultural harvest on food prices and low global inflation helped to rein in domestic prices.

CHAPTER FOUR

4.0 MONETARY POLICY AND LIQUIDITY MANAGEMENT

Monetary policy in the second half of 2015 was influenced by key global developments such as slowing global growth, the rebalancing of the Chinese economy as well as the gradual normalization of US monetary policy. In addition, the protracted decline in crude oil and other commodity prices and the attendant pressures on fiscal positions, lower accretion to external reserves, depreciation of exchange rates in emerging market and developing economies as well as the divergence of monetary policy in the advanced economies, heightened the risk of capital flow reversals. The persistent tepid growth and threat of deflation in major advanced economies, coupled with the re-entry of Iran into the oil market as well as the reluctance of major OPEC members to agree on output cuts, indicated a grim outlook for the price of crude oil.

On the domestic front, the challenges to monetary policy were the sustained pressure in the foreign exchange market leading to continuing depreciation and the widening of the premium between the interbank and BDC rates. The demand pressures, which heightened the risk of currency substitution, were fueled by liquidity surfeit in the banking system and the DMBs' cautious approach to lending during the period. The continued slowdown in real output and persisting insurgency in certain parts of the country heightened the threat of a recession with adverse effect on investor confidence. These challenges and the need to attain the Bank's mandate of price and exchange rate stability provided the environment for monetary policy decisions in the review period.

4.1 Decisions of the Monetary Policy Committee (MPC)

The Monetary Policy Committee (MPC) decisions in the second half of 2015 were influenced by key global and domestic developments. The global developments were the divergence in monetary policy between the US and the Euro Area; lingering uneven recovery in the global economy; slowdown and rebalancing of the Chinese economy away from manufacturing to consumption and services; softening crude oil and other commodity prices; and the gradual normalization of the US monetary policy. Other global issues included the threat of deflation in some advanced economies; sustained asset purchase programmes of the ECB, Bank of England and the Bank of Japan; tight external financial conditions, deteriorating global trade and geopolitical tensions.

On the domestic front, the major concerns were low accretion to

external reserves and mounting pressures on the exchange rate, declining oil revenue from lower crude oil prices; persistent liquidity surfeit in the banking system and high costs of liquidity management; perennial shortage of petroleum products and heightened inflationary pressures. Other factors included: rising credit to government and the crowding out of private sector investment; uncertainties surrounding the slow take-off of the new government as well as security challenges in some parts of the country.

4.1.1 July 2015 MPC Meeting

The July 2015 MPC meeting reviewed key developments in both global and domestic macroeconomic indices in the first half of 2015.

On the external front, the Committee noted the adverse effect of the protracted decline in crude oil prices on the fiscal operations of government. The committee also noted that the average naira exchange rate was relatively stable at the interbank segment but was significantly volatile in the BDC segment. The committee was concerned about the gradual but steady increase in headline inflation up to June 2015, but observed that some of the drivers of the inflationary pressure were transient and outside the control of monetary policy. The MPC further observed that output growth in the first half of 2015 continued to decelerate from 3.96 per cent in the first quarter to 2.35 per cent in the second quarter mainly as a result of softening oil prices.

On the exchange rate development, the MPC emphasized that financial system stability issues placed key limitations on the extent of price flexibility considerations, thereby creating a compelling need to balance measures to address existing vulnerabilities. There were also concerns about the rising risk of capital flow reversal from emerging markets and developing economies, due to the ongoing monetary policy normalization in the US which exerted pressure on exchange rates. A major consideration of the committee was that the newly elected government required time to settle down and unfold its economic agenda. On the slow output growth, the committee underscored the need for the intensification of various ongoing initiatives to diversify the economy away from oil and expand the base for foreign exchange receipts.

Overall, the Committee expressed optimism that business confidence would improve as government unfolds its economic plans. Accordingly, it highlighted the need for complementary fiscal policies to restart growth and stabilize the economy. The MPC also underscored the imperative of growing and preserving the

country's external reserves and building fiscal buffers.

In the light of the above and considering the need to allow previous policy measures to work through the economy, the MPC voted to: retain the MPR at 13.0 per cent with a symmetric corridor of +/- 200 basis points around the midpoint; and the CRR at 31.0 per cent.

4.1.2 September 2015 MPC Meeting

The September 2015 MPC meeting reviewed key developments in both the global and domestic economic and financial environments as well as the challenges to monetary policy up to the third quarter of 2015.

The Committee noted the continued fragility of the domestic macroeconomic environment, with the economy slowing in the first two quarters of the year. It also observed that growth had come under severe constraints owing to declines in private and public expenditure, accentuated by the impact of non-payment of salaries by some states and local governments. The MPC noted that the uptick in inflation from 9.2 per cent in July to 9.3 per cent in August was mainly traceable to higher energy prices, delayed harvests and pass-through from imports. Other observations included significant demand pressure in the foreign exchange market, fueled by continued decline in oil prices. The Committee further noted that liquidity withdrawals following the intensified implementation of the TSA, elongation of the tenor of state government loans as well as loans to the oil and gas sector could aggravate the liquidity conditions of DMBs. This development could hamper economic growth and therefore indicated the need for immediate actions to ease liquidity conditions in the market. The Committee advised DMBs to aggressively support the effort of government at job creation by targeting lending to growth-enhancing sectors of the economy.

The Committee expressed concerns that with two consecutive quarters of slow growth, the economy was on the brink of a recession in 2016 if proactive steps were not taken to restart growth in key sectors of the economy. The MPC underscored the imperative of preserving the country's external reserves and rebuilding fiscal buffers to strengthen confidence in the economy. In the face of the prevailing circumstances, the Committee re-emphasized that a synergy between monetary and fiscal policies remained the most viable strategy to achieve macroeconomic stability and sustainable growth.

In consideration of the underlying fundamentals of the economy, particularly the declining output

growth, rising unemployment and the adverse impact on banking system liquidity of the TSA implementation, the MPC decided to: reduce the CRR from 31.0 to 25.0 per cent; retain the MPR at 13.0 per cent with a symmetric corridor of 200 basis points around the mid-point; and retain the Liquidity Ratio at 30.0 per cent.

4.1.3 November 2015 MPC Meeting

At the November 2015 meeting, the MPC acknowledged the continued fragile global economic environment, including the gradual normalization of the US monetary policy; poor commodity price outlook and the indication of a further slowdown in the emerging market and developing economies. The Committee observed the weakening fundamentals of the economy, particularly the low output growth, rising unemployment and the uncertainty of the global economic environment. The MPC observed that real GDP growth declined to 2.84 per cent in the third quarter of 2015 compared with 3.96 per cent in the corresponding period of 2014. It, however, felt that the outlook for economic activities would improve following progress on the counter-insurgency operations, improvement in the supply of petroleum products and the inauguration of the federal cabinet. The Committee expressed delight in the slight decline in year-on-year headline inflation from 9.4 per cent in September to 9.3 per cent in October 2015. Money market rates were largely low due to the increase in net liquidity levels, largely reflecting the cautious approach to lending by deposit money banks. The MPC noted the relative stability in the foreign exchange market, as shown by the marginal depreciations in the interbank and BDC segments due to the sustained supply of foreign exchange by autonomous sources.

On slowing growth, the Committee restated commitment to evolve and implement measures supportive of consolidating and strengthening output while keeping an eye on price developments. The MPC recognized that stimulating the economy required further liquidity injections by the banking system. The Committee was, however, concerned that the previous liquidity injections embarked upon through lowering of the Cash Reserve Ratio (CRR) had not transmitted significantly to improved credit to key growth- and employment-sensitive sectors of the economy. The Committee underscored the need for the DMBs to ensure that measures by the Bank to inject liquidity and stimulate the economy lead to increased lending to employment and growth-promoting sectors. Accordingly, the MPC agreed that going forward efforts by the CBN to ease liquidity in the system would be directed to the real sector, especially

infrastructure, agriculture and solid minerals.

The Committee also weighed various strategies for enhanced credit delivery to key growth sectors of the economy, to create employment opportunities and improve productivity. The MPC further highlighted the imperative of close coordination between monetary and fiscal policies.

In view of the above, the MPC voted to reduce the CRR from 25.0 to 20.0 per cent, emphasizing that the liquidity arising from the reduction would only be available to banks that were willing to lend to employment-generating sectors such as agriculture, infrastructure development, solid minerals and industry. The Committee also reduced the MPR from 13.0 per cent to 11.0 per cent and adjusted the corridor around the MPR to an asymmetric corridor of +200/-700 basis points.

4.2.0 Instruments of Liquidity Management

In accordance with the objectives of price and macroeconomic stability, the Bank employed various instruments to conduct monetary policy during the review period. The instruments were the Monetary Policy Rate (MPR), the Cash Reserve Ratio (CRR), Open Market Operations (OMO) and Discount Window Operations.

4.2.1 Monetary Policy Rate (MPR)

The MPR remained the key instrument for monetary management. For most of the review period, the MPR was maintained at 13.0 per cent and was adjusted downwards to 11.0 per cent in November 2015. The symmetric corridor of +/-200 basis points around the MPR was also adjusted in November 2015 to an asymmetric corridor of +200/-700 basis points. The adjustments were intended to stimulate the flow of liquidity into the economy to spur growth and employment.

4.2.2 Open Market Operations (OMO)

The Bank reduced its reliance on open market operations (OMO) as the main tool in managing banking system liquidity in the second half of 2015. As a result, actual OMO sales fell by 67.61 per cent to ₦1,380.32 billion in the second half from ₦4,261.72 billion in the first half of 2015. On a year-on-year basis, this represented a decrease of 64.95 per cent below the level in the second half of 2014 (Table 4.1). The reason for reduced reliance on OMO was the rising cost of liquidity management.

Table 4.1
OMO Bills Auction (January 2014 – December 2015) (N'million)

Date	2014	2015	% Change
Jan	1,091.49	1,295.88	
Feb	307.40	217.33	
Mar	714.80	543.86	
Apr	285.94	933.74	
May	905.99	524.54	
Jun	1,179.54	746.37	
1st Half	4,485.17	4,261.72	-4.98
Jul	810.92	771.82	
Aug	654.53	73.27	
Sep	989.58	53.08	
Oct	652.50		
Nov	830.23		
Dec	0.00	482.15	
2nd Half	3,937.76	1,380.32	-64.95
Cumulative Figure	8,422.93	4,642.04	

4.2.3 Reserve Requirements

The Bank continued to complement the use of MPR, OMO and other macro-prudential instruments with CRR in liquidity management. During the review period, the MPC also reduced the CRR from 25.0 to 20.0 per cent of total deposits with the understanding that the liquidity arising there-from would be channeled to employment-enhancing activities such as agriculture, infrastructural development, solid minerals and industry. This was aimed at improving the efficacy of monetary policy transmission to the real sector and effectiveness of liquidity management. The liquidity ratio was unchanged at 30.0 per cent in the second half of 2015.

4.2.4 Standing Facilities

In the second half of 2015, the Bank maintained its standing facility (lending/deposit) windows for the use of DMBs and discount houses (DH) to meet their daily liquidity requirements. The request for standing lending facility (SLF) increased by 41.37 per cent to ₦3,555.62 billion in the second half of 2015 from ₦2,515.05 billion in the first half of 2015. The volume of SLF at end-December 2015 compared with N1,664.00 billion in the corresponding period of 2014 represented an increase of 113.68 per cent (Table 4.2). The volume of deposits at the standing deposit facility window increased by 42.86 per cent to ₦13,224.91 billion in the second half of 2015 from ₦9,257.46 billion in the first half of 2015. This, however, represented a decrease of 55.0 per cent relative to the corresponding period of 2014 (Table 4.3). The transactions at the two windows resulted in a net deposit of N9,669.29 billion in the second half of 2015. This development reflected banks' cautious approach to lending and the perennial liquidity surfeit in the banking system despite the effect of the full implementation of TSA and lower FAAC disbursements to the three tiers of government, owing to the

dwindling crude oil receipts. The combination of liquidity management instruments deployed by the Bank, however, helped moderate the liquidity surfeit in the banking system.

Table 4.2
CBN Standing Lending Facility (January 2014 – December 2015) (N'billion)

Date	2014	2015	% Change
Jan	615.59	104.75	
Feb	653.74	922.28	
Mar	560.27	541.13	
Apr	50.29	529.77	
May	44.88	229.36	
Jun	96.42	187.76	
1st Half	2,021.19	2,515.05	24.43
Jul	96.42	48.75	
Aug	55.46	1,415.06	
Sep	133.80	1,154.96	
Oct	23.84	667.62	
Nov	224.59	207.39	
Dec	1,129.89	61.84	
2nd Half	1,664.00	3,555.62	113.68
Total	3,685.19	2,515.05	

Table 4.3
CBN Standing Deposit Facility (January 2014 – December 2015) (N'billion)

Date	2014	2015	% Change over the Preceding/ Corresponding Period
Jan	13,543.87	2,562.15	-81.1
Feb	4,953.72	862.15	-82.6
Mar	5,844.76	1,298.46	-77.8
Apr	8,190.69	864.11	-89.5
May	8,061.09	1,958.72	-75.7
Jun	5,902.50	1,711.87	-71
1st Half	**46,496.63**	**9,257.46**	**-79.6**
Jul	7,049.30	2,005.52	-71.6
Aug	4,309.30	752.78	-82.5
Sep	6,734.45	1,928.37	-71.4
Oct	7,436.35	2,625.93	-64.7
Nov	2,804.84	3,035.04	8.2
Dec	1,076.73	2,877.27	167.2
2nd Half	**29,410.97**	**13,224.91**	**-55.0**
Total	**75,907.60**	**9,257.46**	**-87.8**

4.2.5 Foreign Exchange Intervention

The Bank sustained its intervention in the foreign exchange market to stabilize the naira exchange rate in the review period. The total supply of foreign exchange declined by 22.23 per cent to US$10,867.47 million in the second half of 2015 from US$13,974.27 million in the first half of 2015. It also decreased by 33.18 per cent compared with US$16,263.03 million in the corresponding period of 2014 (Table 4.4). The reduced supply of foreign exchange was largely due to the declining accretion to foreign reserves occasioned by continued fall in oil receipts. The administrative measures introduced by the Bank

were, therefore, intended to moderate the speculative demand in the foreign exchange market, limit arbitrage opportunities and the rate of depletion of the external reserves. The administrative measures included the use of BVN at the BDC segment and the Bank's endorsement of the DMBs' decision to stop accepting foreign currency cash deposits as well as the sustained implementation of the restriction on access to foreign exchange for 41 imported items.

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

Date	2014			2015			
	Sales to rDAS	Sales to BDC	Total Supply (RDAS + BDC)	Sales to rDAS	Sales to interbank	Sales to BDC	Total Supply (rDAS+inter bank + BDC)
Jan	2,989.43	556.30	3,545.73	1,987.40	N/a	184.70	2,172.10
Feb	3,101.87	567.05	3,668.92	1,197.10	2,334.90	371.40	3,903.40
Mar	3,151.59	560.95	3,712.54		1,866.10	301.60	2167.7
Apr	2,663.92	712.80	3,376.72		1,375.70	370.40	1746.1
May	2,928.49	619.84	3,548.33		1,856.60	309.90	2166.5
Jun	2,398.55	501.22	2,899.77		1,448.50	369.97	1818.47
1st Half	**17,233.85**	**3,518.16**	**20,752.01**	**3,184.50**	**8,881.80**	**1,907.97**	**13,974.27**
Jul	2,494.76	184.94	2,679.70		1,801.97	399.99	2,201.96
Aug	3,201.10	169.08	3,370.18		1,694.74	385.51	2,080.25
Sep	2,598.45	143.24	2,741.69		1,348.02	485.04	1,833.06
Oct	3,498.48	178.86	3,677.34		1,220.96	530.09	1,751.05
Nov	2,296.93	145.71	2,442.64		1,545.21	330.74	1,875.95
Dec	1,241.13	110.35	1,351.48		1,018.88	106.32	1,125.20
2nd Half	**15,330.85**	**932.18**	**16,263.03**	**-**	**8,629.78**	**2,237.69**	**10,867.47**
Total	32,564.70	4,450.34	37,015.04	3,184.50	17,511.58	4,145.66	24,841.74

4.3 Developments in Monetary Aggregates

In the second half of 2015, the monetary aggregates largely underperformed relative to their targets. This development reflected the continued contraction of net foreign asset (NFA) and the Bank's generally tight monetary policy stance during the period. As in the previous period, credit to the public sector increased significantly in the review period, thus crowding out the private sector.

4.3.1 Broad Money (M2)

Broad Money (M2) grew by 6.48 per cent to ₦20,029.83 billion at end-December 2015 from ₦18,811.43 billion at end-June 2015. Compared with the end-December 2014 level of ₦18,913.03 billion, M2 increased by 5.90 per cent. The year-on-year growth in M2 of 5.90 per cent was below the 2015 indicative growth target of 15.20 per cent.

Figure 4.1
Money Supply (M1) and (M2) (June 2015 –Dec 2015)

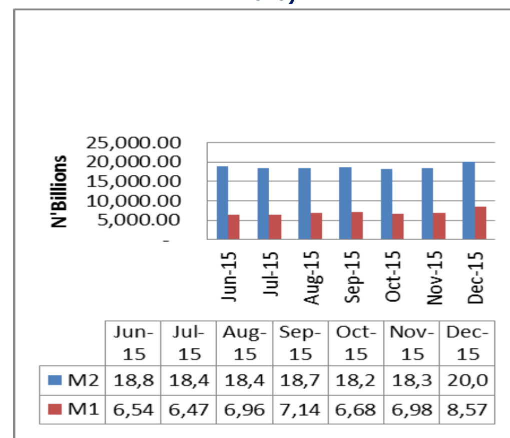
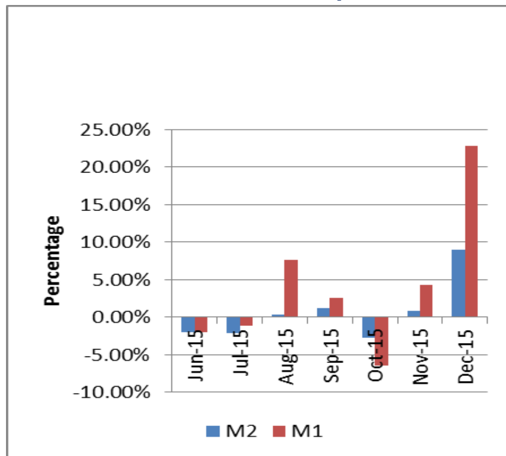


Figure 4.2
Growth in Money Supply (M1) and (M2) (June 2015 –Dec 2015)



4.3.2 Narrow Money (M1)

Narrow Money (M1) increased by 31.02 per cent to ₦8,571.70 billion at end-December 2015 from ₦6,542.39 billion at end-June 2015. Compared with the end-December 2014 figure of ₦6,904.79 billion, M1 grew by 24.14 per cent. The year-on-year growth in M1 of 24.14 per cent was above the indicative growth target of 9.91 per cent (Figures 4.4 and 4.5), indicating that M1 over-performed during the review period.

4.3.3 Net Foreign Assets (NFA)

Net Foreign Assets (NFA) decreased by 5.01 per cent to ₦5,653.32 billion at end-December 2015 from ₦5,951.45 billion at end-June 2015. Compared with the end-December 2014 figure of ₦6,954.21 billion, NFA declined by 18.71 per cent. The year-o-year decline in NFA of 18.71 per cent was below the indicative growth target of 10.60 per cent. The continued weak performance of NFA was attributed to lower receipts from falling oil prices and capital flow reversals to take advantage of improved economic fundamentals in some advanced economies such as the US and the UK as well as uncertainties surrounding the policy direction of the new government.

4.3.4 Net Domestic Assets (NDA)

Net Domestic Assets (NDA) rose by 11.79 per cent to ₦14,376.51 billion at end-December 2015 from ₦12,859.98 billion at end-June 2015. Compared with the end-December 2014 figure of ₦11,958.81 billion, growth in NDA of 20.22 per cent was close to the indicative growth target of 20.37 per cent, largely on account of huge growth in credit to the government.

Figure 4.3
Net Domestic Asset (NDA) (Jun 2015 – Dec 2015)

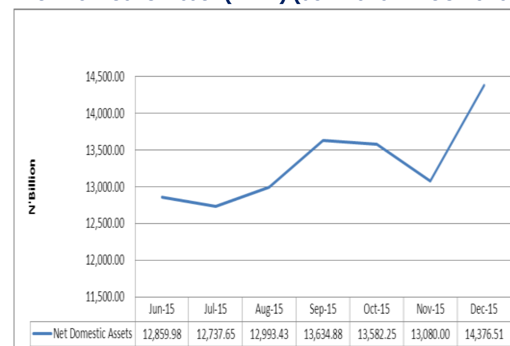
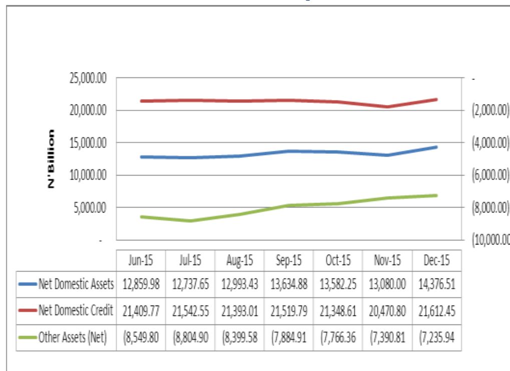


Figure 4.4
NDA, NDC and Other Assets (net) (Jun 2015 – Dec 2015)



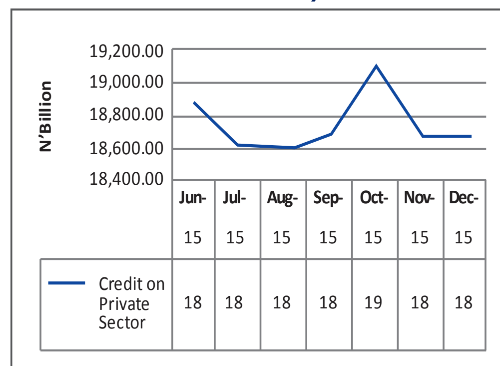
4.3.5 Credit to the Government (C_g)

Credit to government (Cg) grew by 15.15 per cent to ₦2,893.19 billion at end-December 2015 from ₦2,512.46 billion at end-June 2015. When compared with the end-December 2014 figure of ₦1,150.11 billion, Cg grew significantly by 151.56 per cent above the indicative growth benchmark of 36.05 per cent. The development was attributed to government's effort at bridging budget financing gap following the significant drop in government revenues due to lower oil prices.

4.3.6 Credit to the Private Sector (Cp)

Credit to the private sector (Cp) decreased by 0.94 per cent to ₦18,719 billion at end-December 2015 from ₦18,897.31 billion at end-June 2015. Compared with the end-December 2014 figure of ₦18,123.65 billion, Cp rose by 3.29 per cent, which was, however, significantly lower than the indicative growth target of 26.06 per cent for 2015. Over the years, the continued poor performance of credit to the private sector indicates banks' aversion for lending to the real economy in preference for government securities. This could be traced to the tight provisions under Basel 2 in the aftermath of the global financial crisis.

Figure 4.5
Domestic Credit to Private Sector (Dec 2013 – June 2015)



4.3.7 Reserve Money (RM)

Reserve Money (RM) decreased by 2.24 per cent to ₦5,812.74 billion at end-December 2015 from ₦5,945.76 billion at end-June 2015. Compared with its end-December 2014 level of ₦ 5,930.95 billion, RM decreased by 1.99 per cent and was significantly below the indicative benchmark of ₦7,095.49 billion by 16.78 per cent.

The year-on-year decrease in RM was due to the further reduction in CRR to

20.0 per cent in November 2015 after the harmonization of CRR on both public and private sector deposits at 31.00 per cent in May 2015. Furthermore, the transfer of public sector funds from DMBs following the full implementation of the Treasury Single Account (TSA) significantly reduced the required reserves component of RM. A summary of the major monetary aggregates and provisional outcome as at end-December 2015 is presented in Table 4.5.

Table 4.5

Monetary Aggregates Outcomes (Growth in % except otherwise stated)

						Change in H1 2015	Change in H2 2015
	Actual Dec 2014	Actual June 2015	Actual Dec 2015	Benchmark 2015	Deviation (N'b)	Actual	Actual
M2 (N'b)	18,913.03	18,811.43	20,029.83	20,769.04	-1,957.40	-101.60	1,218.40
M2 (%)	20.55	-0.54	5.90	15.20	-15.85	-0.54	6.48
M1 (N'b)	6,904.79	6,542.39	8,571.70	9,480.49	-2,937.89	-362.40	2,029.31
M1 (%)	-1.82	-5.25	31.02	9.91	-15.36	-5.25	31.02
RM (N'b)	5,930.95	5,945.76	5,812.74	7,095.49	-1,149.52	14.82	-133.03
RM (%)	24.62	0.25	-1.99	16.78	-17.10	0.25	-2.24
NDC (N'b)	19,273.76	21,409.77	21,612.45	24,970.45	-3,560.27	2,136.02	202.68
NDC (%)	32.6	11.08	12.13	29.3	-15.85	11.08	0.95
Cg (N'b)	1,150.11	2,512.46	2,893.19	-642.91	3,155.78	1,362.36	380.73
Cg (%)	169.44	118.45	151.56	36.05	195.67	118.45	15.15
Cp (N'b)	18,123.65	18,897.31	18,719.26	25,613.36	-6,716.05	773.66	-178.05
Cp (%)	11.93	4.27	3.29	26.06	-21.74	4.27	-0.94
NFA (N'b)	6,954.21	5,951.45	5,653.32	10,467.19	-4,515.74	-1,002.76	-298.13
NFA (%)	-19.68	-14.42	-18.71	10.6	-26.75	-14.24	-5.01

BOX 1

Rebalancing of the Chinese Economy

The Chinese economy for almost three decades remained the fastest growing in the world, averaging 10 per cent annual growth in real terms. Notwithstanding, the policy discussions since the mid-2000s focused on China's twin imbalances, i.e., the disproportionally high investment-to-GDP ratio existing alongside a low consumption-to-GDP ratio, with a high current account surplus. Thus, growth in China was driven by investment in heavy industries and manufacturing. This growth path was not sustainable in the long run, without a change to the structure of demand and a rise in the efficiency of investment. Rapid growth is sustainable when generated by domestic consumption demand by households rather than investment for the export market, as was the case in China.

Indications that investment-led growth in China can only go on for so long without unsustainable increases in debt levels became apparent following diminishing returns to investment over time. Furthermore, rapid economic growth and longer-term demographic changes precipitated rising labour costs, leading to a gradual erosion of China's competitive advantage in labour-intensive manufacturing.

The realization that rapid growth of this kind was not sustainable in the long run, informed the Chinese authorities' new commitments to maintaining GDP growth targets of 7 per cent, with a range of measures designed to fundamentally alter the sources of growth by transitioning from an investment and export led development to a growth path that relies more on expanding domestic consumption. Thus, economic rebalancing in China encompasses policies aimed at achieving a reduction in the ratio of investment-to-GDP and increasing the consumption-to-GDP ratio. These measures, amongst others, include the promotion of urban and rural development aimed at fueling domestic consumption, implementation of consumption oriented policies to lowering of domestic savings and investment, and reduction in the influence of Chinese State-owned Enterprises through the promotion of competition.

The gradual rebalancing of aggregate demand from fixed investment to consumption in China has started manifesting in decelerating and tepid growth since 2011. Growth has continued to slow to an annual average of 7 per cent, and it is widely anticipated that this gradual slowing will continue in coming years to around 5–6 per cent. Opportunities for productive investment are becoming limited as the traditional investment-led growth strategy is giving way to consumption demand propelled sustainable growth strategy. Besides, China's

production structure continues to evolve increasingly from industry to services, as more Chinese have become richer and many can afford to increase their consumption beyond basic necessities.

Change in China's growth paradigm has implications on the global economic landscape, given its enormous global influence as the world's second largest economy and importer of most primary commodities. China is the world's largest importer of iron ore and copper, and the second largest importer of crude oil. Worries over China's slowing growth and rebalancing of demand is already causing anxiety in global commodity and financial markets.

For Africa, there are both knock-on and upside effects of the slowing growth and rebalancing in China. The slowing and less resource-intensive Chinese growth has resulted in slackening demand and falling commodity prices, with unfavorable effects on African commodity exporters. For example, metals and coal prices have fallen, causing problems for mineral exporters like Mozambique and Tanzania. The Chinese slowdown and the possibility of a further deterioration in China's growth prospects portend severe implications for African countries heavily dependent on commodity exports to China.

The review of the state-led developmental models under the rebalancing strategy has led to a drastic review of China's SOE-led outbound investment expeditions. This will particularly be the case with China's policy banks and their financing of SOEs abroad. This could well have an adverse effect on Chinese state-driven investment in Africa. On the upside, rising labour costs in China may tilt Chinese manufacturing away from competing with Africa's nascent manufacturing industry. The tripling of Chinese labor costs over the over the years will enable most African countries with large labor forces and low wage rates to compete with Chinese producers and even attract investment from Chinese firms. In recent times, Chinese firms have started to relocate some of their low-skilled production lines to other countries, and African countries with abundant and inexpensive labor stand to be beneficiaries.

CHAPTER FIVE

5.0 DEVELOPMENTS IN THE FINANCIAL MARKETS

The Nigerian financial market was largely influenced by a number of economic and financial developments in the review period. These included declining oil and other commodity prices due to weak demand and tepid recovery in the advanced economies, general slowdown in the emerging market and developing economies and rebalancing of the Chinese economy from investment and manufacturing to consumption and services. Others were: the heightened risk of deflation in Japan and the euro area due to weak response of consumer spending to the current stimulus by the European Central Bank (ECB) and the ongoing US monetary policy normalization which led to monetary policy divergence in the advanced economies. In the wake of this normalization, the U.S. dollar appreciated against most currencies particularly in response to the November 2015 rate hike by the U.S Federal Reserve. The resultant depreciation of currencies of most emerging market and developing economies led to huge capital reversals from countries such as Nigeria.

Money market rates were generally volatile but later moderated due to the progressive reduction of the CRR from 31.0 to 20.0 per cent which increased liquidity in the banking system. In the foreign exchange market, the demand pressure intensified leading to the introduction of additional administrative measures to stem the depreciation of the naira. The measures included the use of BVN in BDC transactions and the endorsement by the Bank of the DMBs' decision to stop accepting foreign currency cash deposits. As a result, the bearish trend in the equities market moderated.

5.1 The Money Market

Money market activities were largely influenced by the reduction in CRR from 31.0 to 20.0 per cent, intensified implementation of the TSA and temporary suspension of OMO/NTB auctions in the earlier part of the period under review. Money market rates were relatively stable with occasional spikes driven by fluctuations in banking system liquidity, maturing government securities and limited transactions in CBN bills. Interbank call and open buy back (OBB) rates remained below the lower band of the MPR corridor of +/-200 basis points for most of the period. The corridor was, however, adjusted in November 2015 to an asymmetric corridor of +200/-700 basis points to stabilize money market rates. Between

July and September, 2015, interbank call and OBB rates, however, soared occasionally above the upper band of the corridor.

At the beginning of the review period, the market witnessed persistent rebound of activities in the uncollateralized segment, with frequent OMO/NTB transactions used to manage liquidity surfeit arising from FAAC injections. OMO/NTB transactions were, however, suspended until 23rd December, 2015 when auctions resumed. Thus, to effectively manage liquidity conditions in the banking system as well as improve credit delivery to the real sector, the Bank reduced the CRR from 31.0 to 25.0 per cent in September, 2015, and further to 20.0 per cent in November 2015. In addition, the MPR was reduced from 13.0 to 11.0 per cent and the corridor adjusted from +/-200 to +200/–700 basis points around the MPR while maintaining the liquidity ratio at 30.0 per cent.

5.1.1 Short-term Interest Rate Developments

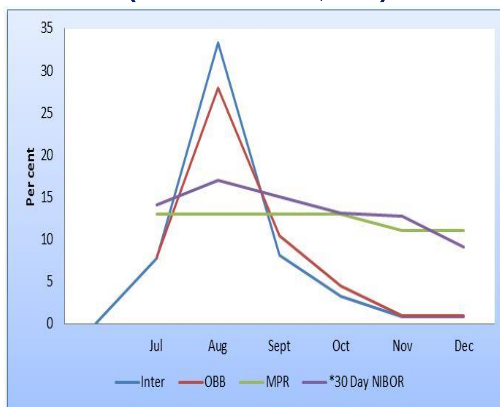
In the second half of 2015, money market rates were largely influenced by the liquidity level in the banking system. The liquidity was from frequent OMO/NTB transactions, FAAC disbursements, maturing government securities and temporary suspension of OMO transactions, but was moderated by the intensified implementation of the TSA. The Bank also began monetary easing during the period by lowering the CRR progressively from 31.0 to 20.0 per cent and the MPR from 13.0 to 11.0 per cent. The interbank call rate rose from 7.79 per cent in July and peaked at 33.26 per cent in August, and subsequently moderated substantially to 0.84 and 0.77 per cent in November and December, respectively. Similarly, the OBB rate rose from 7.86 per cent in July to peak at 27.92 per cent in August before moderating to 0.89 and 0.98 per cent in November and December 2015, respectively. The average OBB rate which was 8.76 per cent, ranged between 0.89 and 27.92 per cent, while the interbank call rate which averaged 9.00 per cent, ranged between 0.77 and 33.26 per cent. Consequently, the OBB rate was higher than the interbank call rate for most of the period. The 30-day NIBOR was between 14.10 and 9.11 per cent (table 5.1).

Table 5.1
Weighted Average Money Market Interest Rates (July – December 2015)

Date	Inter bank	OBB	MPR	*30 Day NIBOR
Jul	7.79	7.86	13	14.1
Aug	33.26	27.92	13	16.94
Sept	8.12	10.43	13	15.09

Oct	3.22	4.45	13	13.15
Nov	0.84	0.89	11	12.71
Dec	0.77	0.98	11	9.11
Average	9.00	8.76	-	13.52

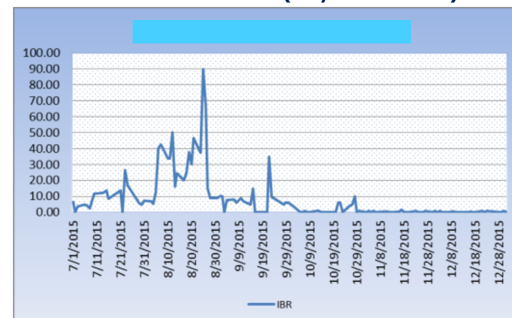
Figure 5.1
Weighted Average Money Market Interest Rates (June – December, 2015)



(i) The Interbank Call Rate

Activity in the interbank market increased between July and August 2015, leading to a hike in the call rate from 7.79 per cent in July to 33.26 per cent in August, 2015. The substantial increase in rate was due, primarily, to the full implementation of the TSA. The rate, however, declined significantly to 8.12 per cent in September, 2015. The observed volatility in interbank market rates persisted until the later part of the period with rates decreasing to as low as 0.77 per cent in December, 2015. The sharp decline witnessed at the interbank call segment at the later part of the review period was attributed to the liquidity surfeit in the banking system, due to liquidation of matured CBN Bills, and reduction in CRR and MPR (Figure 5.2).

Figure 5.2
Interbank Call Rate (July– Dec. 2015)

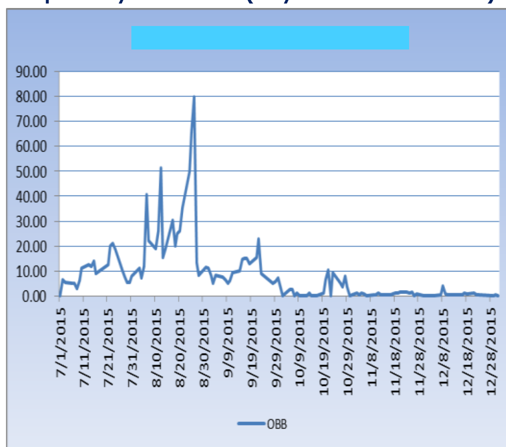


(ii) The Open Buy Back Rate

The OBB rate fluctuated between 0.89 and 27.92 per cent, averaging 8.76 per cent in the second half of 2015. The weighted average rate rose sharply from 7.86 per cent in July to 27.92 per cent in August, before decreasing to 10.43, 4.45, 0.89 and 0.98 per cent in September, October, November and December, 2015, respectively. Transactions in the OBB segment were moderate, but remained active in the review period. The improved activity in the segment at the initial stage of the review period was largely due to enhanced confidence by DMBs in the collateralized segment of the market. The full implementation of the TSA squeezed banking system liquidity in the third quarter, accounting for the hike in OBB rate during the period. The

substantial monetary easing by the Bank in addition to the maturity of CBN bills in the fourth quarter of 2015, accentuated liquidity surfeit in the banking system; causing marked decline in rates during the period.

Figure 5.3
Open Buy Back Rate (July – December 2015)



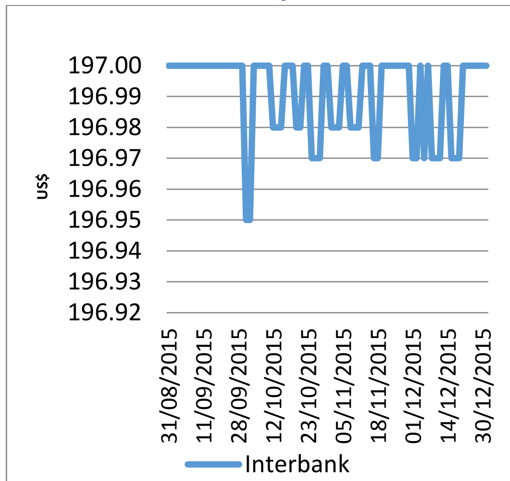
(iii) The Nigeria Interbank Offered Rate (NIBOR)

During the review period, the Nigerian money market reference rate, the NIBOR maintained relative stability across tenors. The weighted average 30-day NIBOR, rose from 14.10 per cent in July to 16.94 per cent in August 2015. It, however, decreased progressively to 15.09 and 9.11 per cent in September and December, respectively, owing largely to the excess liquidity in the banking system from the liquidation of matured CBN Bills, and reduction in CRR and MPR (Table 5.1).

5.2 Foreign Exchange Market

The Bank sustained its commitment to maintaining stability in the foreign exchange market during the review period. Accordingly, the interbank foreign exchange market opened and closed at ₦196.99/US$. Stability in the foreign exchange market was, however, threatened by sustained demand pressure owing to speculative activities, capital reversals following the normalization of US monetary policy and rising import of goods and services in the face of low accretion to external reserves due to lower oil prices. Also, negative investor sentiment surrounding the policy direction of the new administration led to reduced foreign exchange inflows. In order to stem these pressures, additional measures to support the sustained closure of rDAs earlier in the year were introduced, including the use of BVN at the BDC segment and the Bank's endorsement of the DMBs' stoppage of foreign currency cash deposits. These actions helped to curb demand and stabilize the interbank foreign exchange market in the review period.

Figure 5.4
Daily Naira/US Dollar Exchange Rate (Jul - Dec 2015)



5.2.1 Average Exchange Rates

The Interbank foreign exchange rate at an average of ₦196.99/US$ depreciated by 1.52 per cent in the second half from ₦194.04/US$, in the first half of 2015. Over the same period, the BDC rate equally depreciated by 7.96 per cent from an average of ₦213.55/US$ to an average of ₦232.03/US$ (Table 5.2).

Table 5.2
Average Monthly Spot Exchange Rates (January – December 2015) (N/US$)

Month/Year	Interbank Rate	BDC 'B' Rate
Jan-15	181.78	196.13
Feb-15	194.48	213.03
Mar-15	197.07	222.93
Apr-15	197.00	210.70
May-15	197.00	219.55
Jun-15	196.92	218.98
Average	**194.04**	**213.55**
Jul-15	196.97	237.15
Aug-15	197.00	216.64
Sep-15	197.00	222.68
Oct-15	196.99	224.98
Nov-15	196.99	232.40
Dec-15	196.99	258.30
Average	**196.99**	**232.03**

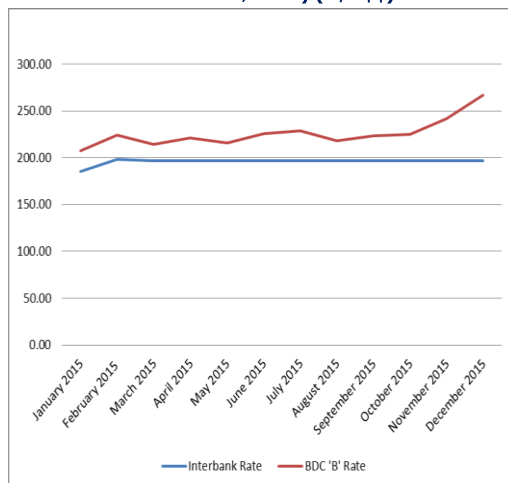
5.2.2 End-Period (Month) Exchange Rates

The naira depreciated by 15.54 per cent to N267.00/US$ at the BDC segment of the foreign exchange market at end-December 2015, compared with the N225.50/US$ at end-June 2015. At the interbank foreign exchange market, the depreciation moderated by 0.03 per cent to ₦197.00/US$ at end-December, 2015 from ₦196.95/US$ at the end-June 2015 (Figure 5.5 and Table 5.3).

Table 5.3
End-Month Exchange Rates (January – December 2015) (N/US$)

Month/Year	Interbank Rate	BDC 'B' Rate
Jan-15	185.20	207.50
Feb-15	198.00	224.00
Mar-15	197.00	214.50
Apr-15	197.00	221.00
May-15	197.00	216.00
Jun-15	196.95	225.50
Average	**195.19**	**218.08**
Jul-15	197.00	229.00
Aug-15	197.00	218.00
Sep-15	196.95	223.00
Oct-15	197.00	225.00
Nov-15	197.00	242.00
Dec-15	197.00	267.00
Average	**196.99**	**234.00**

Figure 5.5
End-Month Exchange Rates (January – December, 2015) (N/US$)



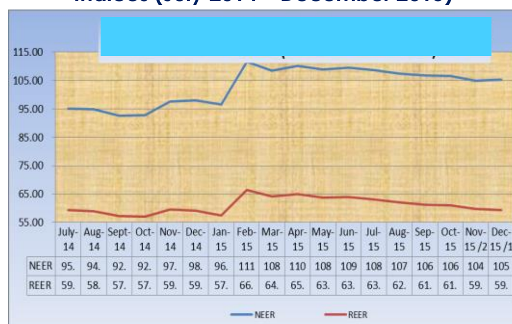
5.2.3 Nominal and Real Effective Exchange Rates

The Nominal Effective Exchange Rate (NEER) appreciated by 0.89 per cent to 106.86 in the second half of 2015 from 107.82 in the first half. It, however, depreciated by 10.71 per cent when compared with the corresponding period of 2014. The Real Effective Exchange Rate (REER) appreciated by 4.00 to 71.86 in the second half from 74.74 in the first half of 2015. The REER, however, depreciated by 4.36 per cent when compared with the corresponding period of 2014 (Table 5.4). Therefore, the trend towards stability of the naira, as measured by the NEER and REER, indicated that the pass-through of inflation from Nigeria's major trading partners to the naira is largely subdued, thus accounting for the appreciation (table 5.4 and figure 5.6).

Table 5.4
Nominal and Real Effective Exchange Rates Indices (July 2014 – December 2015)

Date	NEER	REER
Jul-14	95.37	69.67
Aug-14	94.92	69.03
Sep-14	92.96	67.28
Oct-14	92.95	66.93
Nov-14	97.96	69.94
Dec-14	98.37	69.54
2014:H2 Av	**95.42**	**68.73**
Jan-15	96.97	67.82
Feb-15	111.94	78.15
Mar-15	108.72	75.66
Apr-15	110.56	76.62
May-15	109.09	75.11
Jun-15	109.62	75.08
2015:H1 Av	**107.82**	**74.74**
Jul-15	108.89	74.22
Aug-15	107.79	73.05
Sep-15	106.76	71.91
Oct-15	106.7	71.74
Nov-15	105.42	70.43
Dec-15	105.58	69.78
2015:H2 Av	**106.86**	**71.86**

Figure: 5.6
Nominal and Real Effective Exchange Rates Indices (July 2014 – December 2015)



5.2.4 Foreign Exchange Flows through the CBN

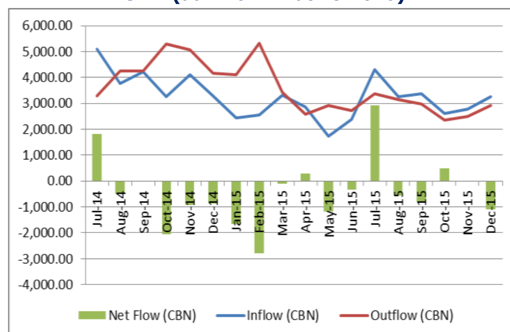
Foreign exchange inflow through the CBN on a gross basis, increased significantly by 27.98 per cent to US$19,559.89 million in the second half, from US$15,283.00 million in the first half of 2015. When compared with the figure of US$23,753.92 million in the corresponding period of 2014, it dropped by 17.66 per cent. Gross foreign exchange outflow decreased by 17.98 per cent to US$17,281.62 million in the second half, from US$21,070.36 million in the first half of 2015. When compared with US$26,327.84 million in the corresponding period of 2014, it decreased significantly by 52.35 per cent. Thus, in the review period, foreign exchange flows turned to a net inflow of US$944.74 million compared with net outflows of US$5,787.40 million and US$2,573.93 million in the preceding period of 2015 and corresponding period of 2014, respectively (see Table 5.5 and Figure 5.7).

Table 5.5
Monthly Foreign Exchange Flows through the CBN (July 2014 – December 2015)

Dates	Inflow (CBN)	Outflow (CBN)	Net Flow (CBN)
Jul-14	5,103.82	3,299.90	1,803.92
Aug-14	3,760.04	4,254.45	(494.41)
Sep-14	4,229.24	4,250.56	(21.32)
Oct-14	3,255.20	5,298.36	(2,043.16)

Nov-14	4,120.82	5,060.15	(939.34)
Dec-14	3,284.80	4,164.42	(879.62)
2014: H2 Total	**23,753.92**	**26,327.84**	**-2,573.93**
Jan-15	2,442.00	4,108.06	(1,666.10)
Feb-15	2,554.50	5,338.00	(2,783.50)
Mar-15	3,310.50	3,429.70	(119.20)
Apr-15	2,859.50	2,569.10	290.30
May-15	1,744.50	2,916.40	(1,171.80)
Jun-15	2,372.00	2,709.10	(337.10)
2015: H1 Total	**15,283.00**	**21,070.36**	**-5,787.40**
Jul-15	4,313.26	3,383.08	2,929.08
Aug-15	3,266.24	3,153.98	(555.93)
Sep-15	3,360.96	2,987.06	(806.33)
Oct-15	2,603.42	2,341.09	480.13
Nov-15	2,767.66	2,499.76	(18.54)
Dec-15	3,248.35	2,916.65	(1,083.67)
2015: H2 Total	**19,559.89**	**17,281.62**	**944.74**

Figure 5.7
Monthly Foreign Exchange Flows through the CBN (Jan 2014 – June 2015)



5.2.5 Foreign Exchange Flow through the Economy

Gross foreign exchange inflow to the economy declined by 8.75 per cent to US$47,610.47 million in the second half, from US$52,172.80 million in the first half of 2015. Compared with the figure of US$78,398.49 million in the corresponding period of 2014, it decreased significantly by 39.27 per cent. Similarly, gross foreign exchange outflow declined by 10.43 per cent to US$19,559.89 million in the second half, from US$21,837.20 million in the first half of 2015. When compared with US$27,161.04 million in the second half of 2014, it declined significantly by 27.99 per cent.

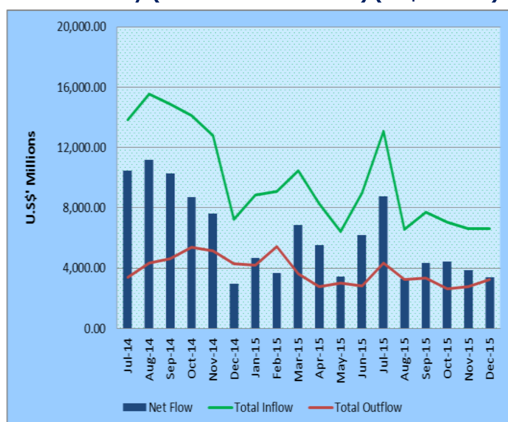
Thus, during the second half of 2015, foreign exchange flows through the economy resulted in a reduced net inflow of US$28,050.58 million, compared with US$30,335.60 million in the preceding period, and US$51,238.62 million in the corresponding period of 2014. This represented decreases of 7.53 and 45.26 per cent relative to the preceding and corresponding periods, respectively. The lower net inflow during the period reflected the impact of decreased oil receipts, due to lower oil prices and the decline in invisible inflows through autonomous sources (Table 5.6 and Figure 5.8).

Table 5.6
Monthly Foreign Exchange Flows through the Economy (Jan 2014 – Jun 2015) (US$ Million)

Dates	Total Inflow	Total Outflow	Net Flow
Jul-14	13,837.28	3,377.44	10,459.84
Aug-14	15,536.52	4,342.52	11,194.00

Sep-14	14,886.02	4,606.46	10,279.56
Oct-14	14,113.71	5,400.97	8,712.74
Nov-14	12,781.36	5,152.69	7,628.67
Dec-14	7,243.60	4,280.96	2,962.64
2014: H2 Total	**78,398.49**	**27,161.04**	**51,237.45**
Jan-15	8,861.70	4,190.30	4,671.40
Feb-15	9,091.50	5,415.20	3,676.30
Mar-15	10,470.40	3,620.80	6,849.60
Apr-15	8,299.80	2,784.80	5,515.00
May-15	6,447.50	3,002.40	3,445.10
Jun-15	9,001.90	2,823.70	6,178.20
2015: H1 Total	**52,172.80**	**21,837.20**	**30,335.60**
Jul-15	13,081.61	4,313.26	8,768.35
Aug-15	6,547.27	3,266.24	3,281.03
Sep-15	7,687.11	3,360.96	4,326.15
Oct-15	7,033.96	2,603.42	4,430.54
Nov-15	6,625.76	2,767.66	3,858.10
Dec-15	6,634.76	3,248.35	3,386.41
2015: H2 Total	**47,610.47**	**19,559.89**	**28,050.58**

Figure 5.8
Monthly Foreign Exchange Flows through the Economy (*Jul 2014 – Dec 2015*) (US$ Million)



5.3 Capital Market

The bearish trend in the Nigerian capital market continued in the second half of 2015. This development was attributed to a number of domestic and global influences, including declining crude oil prices and the impact on external reserves and continued capital outflows due to US monetary policy normalization. In addition, the depreciation of the naira exchange rate at the BDC segment; ongoing insurgency and communal tensions in various parts of the country as well as general economic downturn, affected activities in the market. Furthermore, the level of uncertainty surrounding the slow transition to a new administration hampered investor confidence in the market.

5.3.1 Equities Market

The All-Share Index (ASI) declined by 14.39 per cent to 28,642.25 at end-December 2015, from 33,456.83 at end-June 2015, and by 17.36 per cent compared with 34,657.15 at end-December 2014. Market Capitalization (MC) also declined by 13.75 per cent to ₦9.85 trillion at end-December 2015, from ₦11.42 trillion at end-June 2015, and by 14.20 per cent compared with ₦11.47 trillion at end-December 2014 (Table 4.8 and Figure 4.9).

The year-on-year decline of 17.36 per cent in the ASI was driven mainly by

weak performance in the banking, consumer goods, insurance and oil and gas sectors, which declined by 23.6, 17.4, 4.7 and 6.2 per cent, respectively, below their levels at end-December 2014.

Table 5.7
NSE All-Share Index (ASI) and Market Capitalization (MC) (December 2014 – December 2015)

Date	ASI	MC (Equities) (N' Trillion)
Dec-14	34,657.15	11.48
Jan-15	29,562.07	9.85
Feb-15	30,103.81	10.04
Mar-15	31,744.82	10.72
Apr-15	34,708.11	11.79
May-15	34,310.37	11.66
Jun-15	33,456.83	11.42
Jul-15	30,180.27	10.34
Aug-15	29,684.84	10.21
Sep-15	31,217.77	10.73
Oct-15	29,177.72	10.03
Nov-15	27,385.69	9.42
Dec-15	28,642.25	9.85

Figure 5.9
NSE ASI and MC (December 2014 – December 2015)

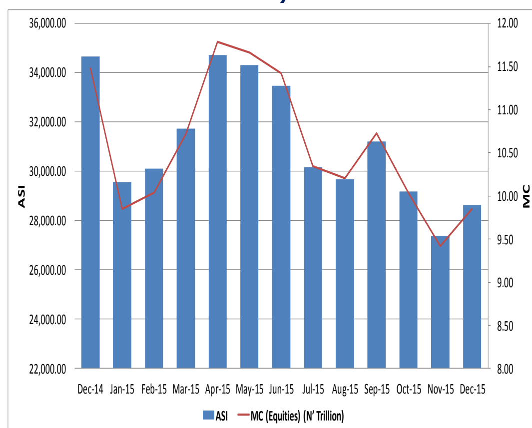
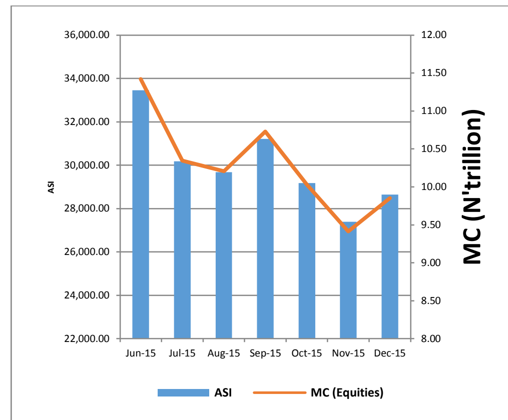


Figure 5.10
NSE ASI and MC (June 2015 – December 2015)



Source: NSE

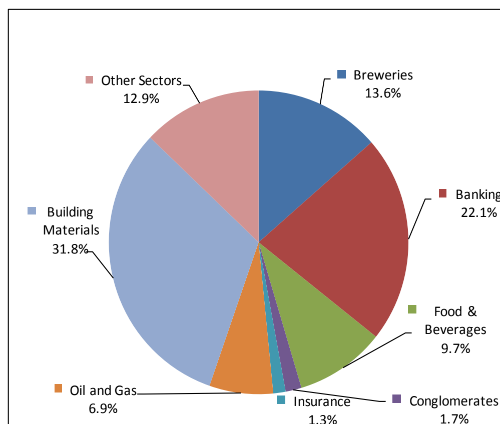
5.3.2 Market Turnover

Aggregate stock market turnover in the second half of 2015 decreased by 16.57 per cent to 42.13 billion shares, valued at N395.83 billion, in 409,818 deals, compared with 50.50 billion shares, valued at N556.99 billion, in 534,624 deals in the first half of 2015. Compared with the second half of 2014, market turnover also decreased by 24.75 per cent from 55.99 billion shares valued at N761.40 billion, in 595,915 deals. Foreign portfolio investment outflow exceeded inflow by N83.41 billion in the second half of 2015. This was due largely to sell-off and divestment from the stock market owing to the persistent decline in oil prices which increased the pressure on the exchange rate.

5.3.3 Sectoral Contribution to Equities Market Capitalization

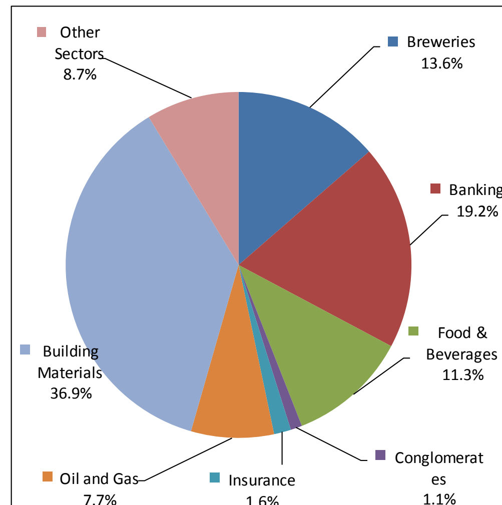
The construction sector continued to dominate market capitalization, primarily due to the valuation of the building materials sub-sector. The sub-sector's share in overall market capitalization increased to 36.9 per cent at end-December 2015 from 31.8 per cent in the first half of 2015. This was due to the market share of Dangote cement. Other major sub-sectors were banking, breweries, and food & beverages, with respective market shares of 19.2, 13.6 and 11.3 per cent, at end-December 2015 (Figure 5.12).

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



Source: NSE

Figure 5.12
NSE Market Capitalisation by Sector as at End-December 2015



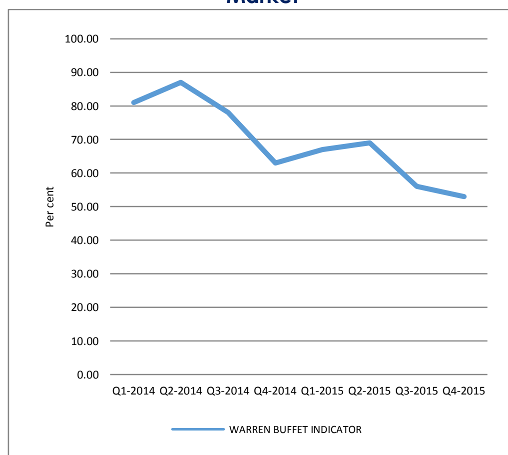
Source: NSE

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

Analysis of the Nigerian stock market indicated an undervaluation in the fourth quarter of 2015 based on the Warren Buffett valuation metric of 53.0 per cent, which was below the threshold of 75.0 to 115.0 per cent. The Warren-Buffet valuation measures the market value of securities as a ratio of GDP. In the third quarter, the metric stood at 55.78 per cent, also indicating an undervaluation. The development can be attributed to a number of factors, such as capital reversals and low crude oil prices leading to depreciation of the exchange rate, perceived sovereign risk of the Nigerian economy and normalization of the US monetary policy, resulting in

sell-off by foreign portfolio investors. The undervaluation of equities holds out investment opportunities for domestic and foreign investors to increase their stakes in the Nigerian stock market in expectation of recovery.

Figure 5.13
Warren Buffet Valuation of Nigerian Equities Market



5.3.5 Bond Market

Activities in the bonds market was dominated by Federal Government of Nigeria (FGN) securities. Sub-national government and corporate bonds also registered some activity. The corporate bonds segment recorded the least share by market volume.

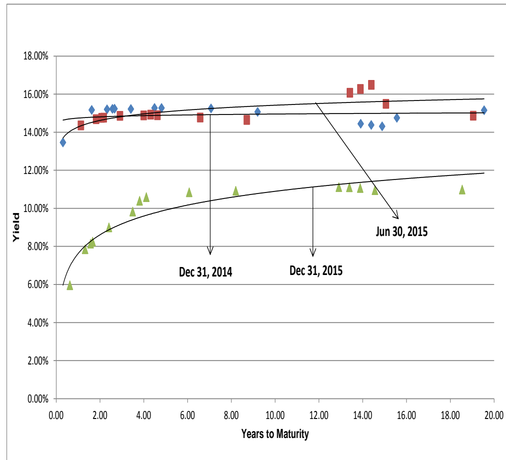
5.3.5.1 FGN Eurobond

The yield on the 10-year dollar-denominated bond increased to 8.48 per cent at end-December 2015, from 5.91 and 6.23 per cent at end-June 2015 and end-December 2014, respectively (Figure 5.14). This development was attributed to investor preference for higher premium to reflect perceived sovereign risk, owing to the delisting of Nigeria from the JP Morgan's Government Bond Index for Emerging Markets in September, 2015.

Figure 5.14
10-Year U.S. Dollar-denominated Bond Yield for Nigeria (Jan 1, 2014 – Dec 31, 2015)

The FGN bond yield curve as at end-December 2015 trended downwards by 531 basis points to 9.80 per cent compared with 15.11 per cent at end-June 2015. It also trended downwards by 509 basis points when compared with 14.89 per cent at end-December 2014 (Figure 5.15). This implied that FGN bond yields were positive and exceeded the December 2015 rate of inflation, reflecting the generally tight monetary policy stance of the Bank.

Figure 5.15
FGN Bonds Yield Curves: end-Dec. 2014 vs. end-Jun. 2015 vs. end- Dec. 2015



5.3.5.2 State/Local Government Bonds

The sub-national bonds market recorded low activity during the review period. At end-December 2015, the total value of outstanding state/local governments bonds stood at ₦536.47 billion, compared with ₦544.43 billion at end-June 2015 and ₦524.67 billion at end-December 2014.

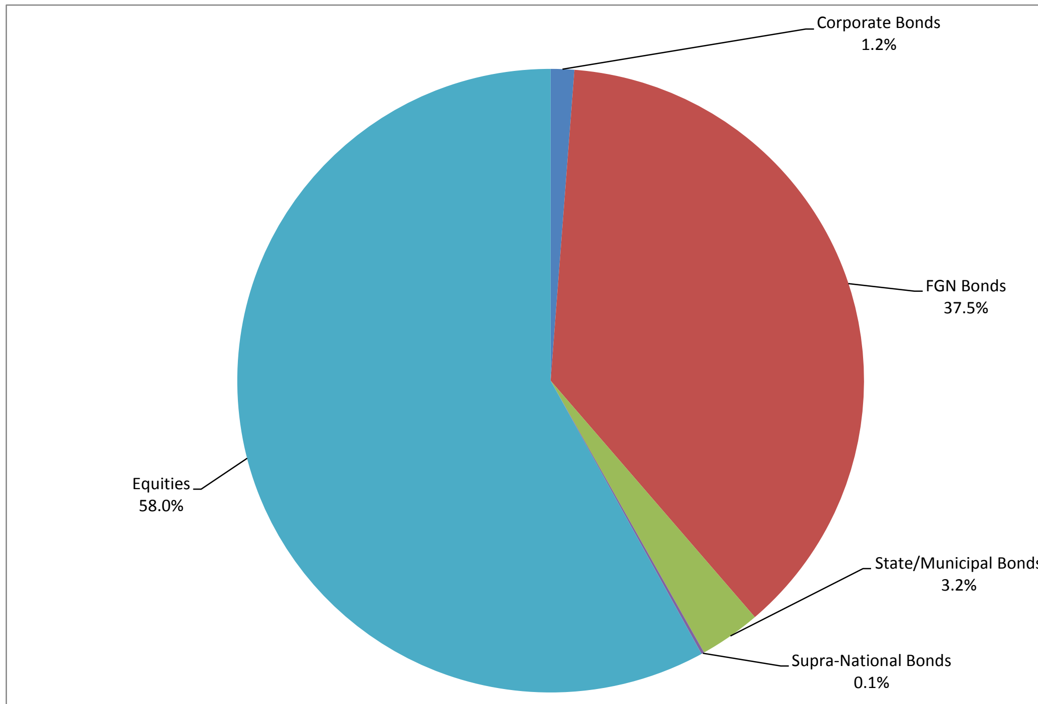
5.3.5.3 Corporate Bonds

In the review period, activity in the corporate bonds segment moderated. The value of outstanding corporate bonds at end-December 2015 was ₦205.89 billion, compared with ₦220.39 billion at end-June 2015 and ₦144.96 billion at end-December 2014. The decline in activity was due to lower crude oil prices resulting in the depreciation of the exchange rate, perceived sovereign risk of the Nigerian economy and increase in the US policy rate, leading to sell-off and capital reversal by foreign portfolio investors.

5.3.5.4 Overall Analysis of the Nigerian Capital Market

The value of FGN bonds increased by 35.49 per cent to ₦6.49 trillion at end-December 2015 from ₦4.79 trillion at end-June 2015, and by 35.49 per cent over the level at end-December 2014. FGN bonds accounted for 37.5 per cent of aggregate market capitalization as at end-December 2015. The value of state/municipal bonds, corporate bonds and supranational bonds were ₦536.47 billion, ₦205.89 billion and ₦24.95 billion, accounting for 3.2, 1.2 and 0.1 per cent of aggregate market capitalization, respectively. The equity market constituted 58.0 per cent of aggregate market capitalization at end-December 2015, while the combined shares of FGN bonds, state/municipal bonds, corporate bonds and supranational bonds accounted for the balance of 42.0 per cent (Figure 5.16).

Figure 5.16 Structure of the Nigerian Capital Market (December, 2015)



BOX 2

Implications of the Delisting of Nigeria from JP Morgan Government Bond Index for Emerging Markets (GBI-EM)

The Federal Government of Nigeria (FGN) Bond was recently delisted from the JP Morgan's Government Bond Index for Emerging Markets (GBI-EM). The Index, launched in June 2005, is the first comprehensive global emerging markets debt instrument, which tracks local government currency bonds. The rating institution added Nigeria to the index on January 16, 2012, following the existence of an active domestic market for FGN bonds, supported by a two-way quote system, dedicated market makers and diverse investor base. Until its delisting, Nigeria was the second African country, beside South Africa, to be included in the JP Morgan's bond index. Nigeria's inclusion added Nigeria's 2014, 2019, 2022 and 2024 bonds, a whopping 1.8 per cent weight to the index, indicating the significance of Nigeria's bond in the index. In its delisting decision, the rating institution warned that Nigeria would not be eligible for re-inclusion in the index until after a minimum of 12 months; and to get back in its reading, Nigeria would have to satisfy the consistent liquid currency criteria.

The rating institution placed Nigeria on a negative watch in January 2015, before finally delisting it on September 8, 2015. According to the rating agency, the delisting of Nigeria from its Government Bond Index was due to perceived restrictions on the country's foreign exchange transactions, which were alleged to have prompted investor concerns regarding liquidity situation in the market as well as the lack of transparency in exchange rate determination. The rating agency's decision was also hinged on a number of measures by the Central Bank of Nigeria (CBN) to moderate the demand pressure in the foreign exchange market. The decision to exclude Africa's biggest economy, according to the rating institution, was also based on the fact that foreign investors who track the Index have continued to face challenges and uncertainties when transacting in the naira.

The CBN actions were largely due to current limitations facing the country's economy, notably, falling oil receipts on the back of the declining global oil prices. Oil is the main source of foreign exchange to the Nigerian government, and with the plunge in oil receipts, the CBN continued to adopt demand management measures to stabilize the naira, stem the depletion of external reserves. The measures by the CBN were also aimed at curbing speculative demand, round tripping, and rent-seeking in the market foreign exchange market. The Bank's use of administrative measures besides policy has largely succeeded in

stabilizing rates in the inter-bank segment, although strong and persistent pressure lingers in the parallel segment.

Implications of the Delisting

The delisting led to widespread debate and analysis of the implications including the following:

The delisting of Nigeria's bond was popularly expected to exert pressure on Nigeria's external reserves and foreign exchange market. Since the country was delisted, it has been popularly expected that the action would lead to a significant loss of portfolio capital inflows. This was expected to further weaken the country's external position, due to additional upward pressure on the exchange rate and domestic bond yields;

The increase in bond yields as a result of withdrawal of foreign portfolio investors is expected to lead to additional pressure on the naira. Although the Naira has been stable in the interbank market, it continues to fluctuate and depreciate in the parallel market. The delisting was also expected to lead to significant sell-off of Nigerian bonds, triggering capital outflows and raising government borrowing costs; and

The inclusion of Nigeria in the Index was generally seen as a further step towards the country's integration into global financial markets, opening its market to new investment opportunities and raising its profile worldwide. The recent delisting was expected to reverse these benefits.

On the upside, however, it has been argued that the impact of the delisting would not be pronounced as widely envisaged as the delisting cannot be interpreted as a downgrade. The Standard and Poor's (S&P) recent affirmation of the country's 'B+/B' long- and short-term foreign and local currency sovereign credit ratings is expected to help moderate the perceived investment risks associated with the delisting.

5.4 Global Financial Market Developments

The global financial market was relatively stable, although risks heightened in the euro area following US monetary policy normalization and the ongoing rebalancing of the Chinese economy. Liquidity concerns were largely shaped by the continued monetary policy divergence between the US and other major advanced

economies, reflected in the gradual normalization of the US monetary policy and the continued qualitative and quantitative easing (QE) programmes in the euro area, the UK and Japan. As a result, monetary conditions remained generally accommodative, with most currencies depreciating against the US dollar. Global commodity prices continued their decline due to sluggish demand in the environment of excess supply arising from earlier investments in response to the commodity price boom of the 2000s. The continued slide in global commodity prices, particularly crude oil fuelled capital reversals and the depreciation of emerging market and developing economy currencies. In the environment of growing fragilities, the performance of major stock markets became bearish during the review period.

5.4.1 Money Market and Central Bank Policy Rates

Global liquidity conditions were largely shaped by the continued monetary policy divergence between the US and other major advanced economies, reflected in the gradual normalization of the US monetary policy and the continued quantitative easing (QE) programme in the euro area, the UK and Japan. Monetary conditions remained generally accommodating in the advanced economies following a number of measures to expand or extend ongoing QE programmes. In the review period, the European Central Bank (ECB) reaffirmed its commitment to increase the quantum and duration of its QE programme if prices do not move towards the 2 per cent inflation target. Accordingly, the ECB lowered its overnight deposit rate further into the negative territory to -0.30 per cent. Similarly, the Bank of Japan (BOJ) adjusted its QE programme to provide more liquidity in the market by extending the maturity of Japanese government bonds (JGB) in its portfolio from 7 – 10 years to 7 – 12 years. The BOJ also added ¥300 billion to its already existing annual ¥3 trillion exchange traded fund and extended the asset purchase programme to real estate investment trusts. In the same vein, the Bank of England (BOE) sustained its £375 billion QE programme throughout the review period. Consequently, with the exception of the US, policy rates in the advanced economies were largely unchanged during the second half of 2015.

The volatility induced in the financial market by the trend towards US policy normalization was evident in the behavior of policy rates in the emerging market and developing economies (EMDEs). China, India, Russia and Nigeria lowered their policy rates to stimulate growth as oil and other commodity prices weakened further against an appreciating US dollar. South Africa and Kenya, on the other hand, raised their policy rates to

stem inflationary pressures and depreciation of their currencies, while other economies such as Ghana and Brazil maintained their rates.

Table 5.8
Policy Rates of Selected Countries July-December 2015

COUNTRY/MONTH	JULY	AUGUST	SEPTEMBER	OCTOBER	NOVEMBER	DECEMBER
USA	0.25	0.25	0.25	0.25	0.25	0.5
UK	0.50	0.50	0.50	0.50	0.50	0.50
EU	0.05	0.05	0.05	0.05	0.05	0.05
JAPAN	0.01	0.01	0.01	0.01	0.01	0.01
S. AFRICA	5.75	6.00	6.00	6.00	6.00	6.20
KENYA	10.00	11.50	11.50	11.50	11.50	11.50
GHANA	26.00	26.00	26.00	26.00	26.00	26.00
RUSSIA	11.5	11.0	11.0	11.0	11.0	11.0
CHINA	5.10	4.80	4.80	4.60	4.60	4.40
INDIA	7.20	7.20	7.20	7.20	6.75	6.75
BRAZIL	13.70	14.25	14.25	14.25	14.25	14.25
NIGERIA	13.00	13.00	13.00	13.00	11.00	11.00

5.4.2 Capital Market

Globally, performance of major stock markets was mostly negative during the review period. In Europe, the UK FTSE 100, French CAC 40 and German DAX indices decreased by 4.3, 3.2 and 1.8 per cent, respectively, while the Russian MICEX index increased by 6.5 per cent. In North America, the United States S&P 500, Canadian S&P/TSX Composite and Mexican Bolsa indices decreased by 0.9, 10.6 and 4.6 per cent, respectively.

In Asia, the Japanese Nikkei 225, the Chinese Shanghai SE and the Indian BSE Sensex indices decreased by 5.9, 17.3 and 6.0 per cent, respectively. In Africa, the Nigerian NSE All-Share, South African JSE All-Share, Kenyan Nairobi NSE 20, Egyptian EGX CASE 30 and Ghanaian GSE All Share Indices decreased by 14.4, 2.1, 17.6, 16.3 and 15.2 per cent, respectively.

Table 5.9: Selected International Stock Market Indices as at December 30, 2015

Country	Index	End-Dec, 2014	End-June, 2015	End-December, 2015	% Change Jun - Dec 15
AFRICA					
Nigeria	ASI	34,657.15	33,456.83	28,642.25	-14.4
South Africa	JSE African AS	49,770.60	51,806.95	50,693.76	-2.1
Kenya	Nairobi NSE 20	5,112.65	4,906.07	4,040.75	-17.6
Egypt	EGX CSE 30	8,926.58	8,371.53	7,006.01	-16.3
Ghana	GSE All Share	2,261.02	2,352.23	1,994.91	-15.2
NORTH AMERICA					
US	S&P 500	2,058.90	2,063.11	2,043.94	-0.9
Canada	S&P/TSX Composite	14,632.44	14,553.33	13,009.95	-10.6
Mexico	Mexico Bolsa (IPC)	43,145.66	45,053.70	42,977.50	-4.6
SOUTH AMERICA					
Brazil	Bovespa Stock	50,007.41	53,080.88	43,349.96	-18.3
Argentina	Merval	7,830.30	11,656.81	11,675.18	0.2
Colombia	COLCAP	1,512.98	1,331.35	1,153.71	-13.3
EUROPE					
UK	FTSE 100	6,566.09	6,520.98	6,242.32	-4.3
France	CAC 40	4,272.75	4,790.20	4,637.06	-3.2
Germany	DAX	9,805.55	10,944.97	10,743.01	-1.8
Russia	MICEX	1,396.61	1,654.55	1,761.36	6.5
ASIA					
Japan	NIKKEI 225	17,450.77	20,235.73	19,033.71	-5.9
China	Shanghai SE A	3,389.39	4,479.90	3,704.29	-17.3
India	BSE Sensex	27,499.42	27,780.83	26,117.54	-6.0
Source: Bloomberg					

5.4.3 Commodities

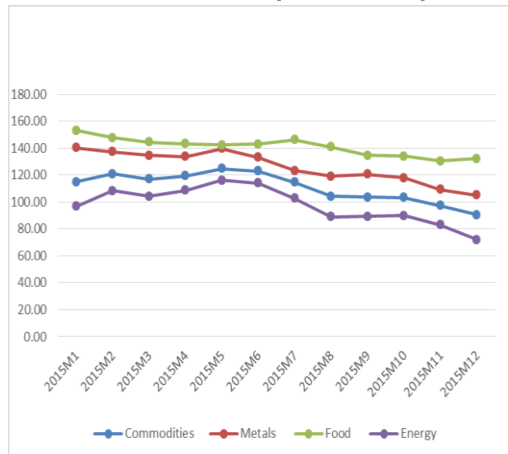
In the second half of 2015, global commodity prices continued their decline due to sluggish demand and ample supply. The weak global demand stemmed from continued slow growth in most regions in the environment of excess supply arising from earlier investment response to the commodity price boom of the 2000s. This development led to a general softening of commodity prices. In addition, the appreciation of the US dollar following moves to normalize US monetary policy, coupled with the reduction of the commodity positions of financial investors (owing to the downturn in commodity prices and returns), further weakened the commodity market.

Energy prices as measured by the Energy Price Index fell by 36.49 per cent to 72.4 points in December from 114.0 points in June 2015. In terms of actual prices, crude oil prices decreased by 37.32 per cent from US$76.35 per barrel at end-June to US$47.86 per barrel at end-December 2015. This development was driven by several factors, including large stock of oil inventories in the US, Organization of the Petroleum Exporting Country (OPEC)'s reaffirmation of its market share strategy as opposed to production cuts at its December 2015 meeting, and expected re-entry of Iran into the oil market following the lifting of sanctions.

Non-Fuel commodity prices also fell by 11.28 per cent to 121.9 points in December from 137.4 points in June 2015, owing to continued weak global demand. Metal prices fell by 19.87 per cent in response to softening growth prospects in China and continued increases in supply due to earlier investments. Cost reductions, notably for energy, and exchange rate depreciation in many producing countries delayed the closure of high-cost mines. The fall in metal prices was also attributed to weaker demand prospects in emerging market economies leading to reduced investments.

The Food and Agriculture Organization (FAO) Price Index declined by 6.97 per cent to 153.4 points in December from 164.9 points in June 2015. On a year-on-year basis, the Index fell by 17.44 per cent from 185.8 in the corresponding period of 2014. Apart from sugar, all sub-indices of meat, dairy, cereal, and vegetable oil declined in the review period. The implications of weak growth prospects in emerging market economies, especially combined with financial stress, would be a further reduction in commodity prices, thereby lowering growth prospects amongst commodity exporters.

Figure 5.17:
Indices of Primary Commodity Prices January-December, 2015 (2005=100 US$)



Source:IMF

5.4.4 Foreign Exchange Market

In the review period, the depreciation of most currencies against the US dollar continued, reflecting the effect of the US monetary policy normalization, which led to the appreciation of the dollar and dollar-denominated assets. The ongoing QE programmes of the ECB and BOJ as well as intervention by the Chinese government to stabilize the yuan, helped to further strengthen the dollar through the outflow of capital from these economies into the US. Also, the continued slide in global commodity prices, particularly crude oil fuelled capital reversals and the depreciation of currencies of most emerging market and developing economies. Consequently, the euro, the British pound and the Canadian dollar depreciated by 2.17, 5.88 and 12.32 per cent, respectively, while the Japanese yen appreciated by 1.60 per cent.

Among the emerging market and developing economies, the Brazilian real, the Mexican peso and Indian rupee depreciated by 21.72, 8.94 and 3.78 per cent, respectively. In sub-Saharan Africa, the Nigerian naira, South African rand, Kenyan shillings, and Egyptian pound depreciated by 0.03, 21.51, 2.98 and 2.55 per cent, respectively, while the Ghanainan cedi appreciated by 14.17 per cent.

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

	Currency	31-Dec-14	30-Jun-15	31-Dec-15	June 30, 2015 - Dec 31, 2015 %App/Dep
AFRICA					
Nigeria	Naira	169.68	196.95	197.00	-0.03
South Africa	Rand	11.57	12.15	15.48	-21.51
Kenya	Shilling	90.60	99.25	102.30	-2.98
Egypt	Pound	7.15	7.63	7.83	-2.55
Ghana	Cedi	3.22	4.35	3.81	14.17
NORTH AMERICA					
Canada	Dollar	1.16	1.21	1.38	-12.32
Mexico	Peso	14.75	15.69	17.23	-8.94
SOUTH AMERICA					
Brazil	Real	2.66	3.10	3.96	-21.72
Argentina	Peso	8.47	9.09	12.93	-29.70
Colombia	Peso	2376.51	2606.00	3174.50	-17.91
EUROPE					
UK	Pound	0.64	0.64	0.68	-5.88
Euro Area	Euro	0.83	0.90	0.92	-2.17
Russia	Ruble	60.74	55.27	72.85	-24.13
ASIA					
Japan	Yen	119.78	122.12	120.20	1.60
China	Yuan	6.21	6.20	6.49	-4.47
India	Rupee	63.04	63.65	66.15	-3.78
Source: bloomberg					

BOX 3

Monetary Policy Divergence in the Advanced Economies

Across the globe, various economies operate at different stages of the business cycle. At a particular point in time some economies may be in the expansionary phase, while others may be at their peak, commencing the contractionary phase or sitting in the trough of the cycle. Divergent monetary policy simply refers to the adoption of broadly different stance of monetary policy by countries or group of countries, such that while some are raising interest rates to reduce money supply; others are lowering interest rates to increase money supply and stimulate economic activity.

During the 2007/08 financial crisis, a number of advanced economies including the US, Euro Area, Japan, and the United Kingdom, lowered their interest rates to aggressively increase money supply as the crisis caused most of these economies to slowdown rapidly. These countries were very close to the contractionary phase and the action by the central banks was targeted at pulling them back into the productive and expansionary phase. Many of the economies unfortunately failed to respond to this stimulus due to negative investor sentiment, causing a further slowdown.

With the passage of time, however, pockets of recovery was noted in economies such as the US and the UK, while Europe and Japan continued in the contractionary phase. This implied that the US and UK had moved to a different phase of the business cycle (expansion) from Europe and Japan (contraction). Thus, these two sets of countries required different monetary policies to manage their macroeconomic aggregates. The US and UK required measures to ensure that their economies did not overheat in the near term due to rapid expansion, while Europe and Japan required measures to reverse the contraction of their economies. Accordingly, the European Central Bank (ECB) adopted various measures to help pull the euro area economy out of the contractionary phase. Such measures included quantitative easing, a process whereby outright monetary injections are made by the central bank to stimulate economic activities. The ECB injected liquidity into the economy by purchasing various instruments such as government and corporate bonds, mortgage-backed securities and a host of other instruments. In Japan, the Bank of Japan (BoJ), also injected a significant amount of liquidity into the economy in a bid to reverse the contraction of the economy. Monetary Policy divergence began when at the same time that Europe and Japan were injecting liquidity into their economies, the US Federal Reserve commenced normalization of monetary policy by raising its benchmark policy rate from 0.0-0.25 to 0.25-0.50 per cent. This trend towards policy divergence created significant challenges for policy makers in the advanced economies.
In today's globalized economy where several emerging market economies such as Brazil, Russia, India, China, South Africa and Nigeria have become well

integrated and interconnected, the monetary policy of advanced economies such as the US exerts a significant impact on the flow of capital around the globe.

The first impact is on the flow and allocation of capital. As the US economy returns to growth while the Euro Area recedes deeper into recession, a mild contraction or some inflationary pressure presents risk-averse investors with fairly difficult choices. Higher interest rates in the US implies higher return for the somewhat milder risk posed by investment in US assets compared with similar assets in Europe and other emerging market economies. This means that capital will flow away from Europe and emerging market and developing economies into the US where investors feel safer as asset values appreciate with the rise in US policy rate. As capital flows away from these areas, the economies will be pushed deeper into the contractionary phase, making recovery even more painful.

Second is the impact on exchange rates across the globe. As investors move their capital away from Europe and emerging market and developing economies into the US, the demand for US dollar increases forcing it to appreciate rapidly against other currencies. These countries are thus forced to depreciate their currencies in order to reduce pressure This would inadvertently cause investors to panic further and increase their demand for safer US dollar, forcing further depreciation of the currencies. The third aspect to note is the price of commodities. While the above strategy ensures that more capital flows to the US, it tends to hurt US exports as US goods become more expensive compared with goods elsewhere due to the appreciation of the US dollar. The economies that earlier depreciated their currencies will now have an advantage over the US as their exports become cheaper. US citizens and residents will then be confronted with the choice of importing cheaper goods from those economies compared with purchasing the more expensive goods produced in the US. This will stimulate activity in economies with a strong manufacturing sector while the US experiences a slower-than-expected recovery.

In conclusion, monetary policy spillovers resulting from divergent monetary policies can no longer be ignored. The spillovers have the ability to reinforce volatility in money, capital and commodity markets as they cause global assets and commodities to be rapidly re-priced. The implication of this analysis is that fiscal policy now has a more crucial role to play in re-balancing market swings as limitations of monetary policy is brought to light. The good news, however, is that the recent spate of volatility across markets, due to divergent monetary policies, is forcing increased coordination between the monetary and fiscal authorities.

CHAPTER 6

ECONOMIC OUTLOOK

6.1 OVERVIEW

In 2015, the global economy grew by 3.1 per cent, reflecting a downward revision of 0.2 percentage point from the earlier projection of 3.3 per cent in July by the IMF (WEO Update, July 2015). The revised growth estimate was lower than the 3.4 per cent in 2014. The subdued growth in 2015 was primarily due to the lower prices of energy and commodities, slowdown and rebalancing of the Chinese economy and gradual normalization of the US monetary policy.

Growth in the advanced economies was projected at 1.9 per cent in 2015 up from 1.8 per cent in 2014, driven by increase in consumption and investment in the US, as the labour and housing market conditions continue to improve as well as easier financing conditions. In the United States, growth was estimated at 2.5 per cent in 2015, above the 2.4 per cent recorded in 2014. Growth in the Euro area rose to 1.5 per cent in 2015 from 0.9 per cent in 2014, driven by stronger private consumption supported by lower oil prices and easy financing conditions.

Growth in the emerging markets and developing economies was estimated to slow to 4.0 per cent in 2015 from 4.6 per cent in 2014. The decline was attributed to the impact of the continued lower commodity prices, tighter external financing environment, the rebalancing of the Chinese economy away from manufacturing to consumption and services, structural bottlenecks as well as the effect of geo-political tensions in some countries of the Commonwealth of Independent States (CIS) and the MENA region.

Among the emerging markets, growth in China was projected to decline to 6.9 per cent in 2015 from 7.3 per cent in 2014. Russia is expected to remain in recession as it continues to adjust to low oil prices and economic sanctions from the Western countries. The contraction of the Russian economy by 3.7 per cent in 2015 from 0.6 per cent in 2014, affected the performance of other economies in the Commonwealth of Independent States (CIS). In Latin America and the Caribbean, the Brazilian economy contracted by 3.8 per cent in 2015 compared with a growth of 0.1 per cent in 2014 as a result of low oil prices and lagged effect of several tax increases targeted at balancing the overall budget deficit. The Venezuelan economy contracted further by 7.0 per cent in 2015 from a contraction of 3.0 per cent in 2014 due mainly to the impact of the fall in crude oil prices at the international market.

In sub-Saharan Africa (SSA), growth was projected to slow to a revised estimate of 3.5 per cent in 2015 from 5.0 per cent in 2014. This mainly reflected the continued adjustment to lower commodity prices and lower demand from China (the region's largest trading partner) as well as tighter external financing conditions, leading to higher borrowing costs. Growth of the Nigerian economy was projected at 2.79 per cent in 2015 from 6.22 per cent in 2014. The slowdown was due to the continued weakness in oil and other commodity prices. In South Africa, growth was projected at 1.3 per cent in 2015 down from 1.5 per cent in 2014, due to the effect of electricity supply challenges, labour market issues and declining business confidence.

6.2 Outlook for Global Output

Global growth forecast for 2016 will be determined by a number of developments. The slow and uneven recovery is expected to continue in the advanced economies to gradually narrow output gaps. The outlook for emerging market and developing economies varies but in many cases remains challenging. The slowdown and rebalancing of the Chinese economy, lower commodity prices, and heightened risks in some large emerging market economies will continue to weigh on the growth outlook. The gradual improvement of growth rates in countries currently in economic strains, notably Brazil, Russia, and some countries in the Middle East and North Africa (MENA) would account for the projected rise in global growth over the next two years, despite the ongoing slowdown in China. Accordingly, global economic growth is forecast to rise to 3.4 and 3.6 per cent in 2016 and 2017, respectively from 3.1 per cent in 2015. Growth in 2016 is expected to be driven by gradual recovery in advanced economies on account of relaxed financial conditions, increased consumption spending, lower fuel cost, and improving labour market conditions.

Growth in the advanced economies is forecast to improve and stabilized at 2.1 per cent in 2016 and 2017 from 1.9 per cent in 2015. This will be driven by expected strong performance in the US of 2.1 per cent in 2016 from 1.9 per cent in 2015 and in the UK by 2.2 per cent apiece in 2015 and 2016. The expected strong activity in the US would be supported by relatively easy financing, improved labour market conditions and the recovering housing market. The appreciating US dollar could weigh down manufacturing activity while lower oil prices would curtail investment in the oil sector. In the Euro Area, growth is forecast to rise from 1.5 per cent in 2015 and stabilize at 1.7 per cent in 2016 and 2017, respectively. The improved outlook is

expected to be driven by stronger private consumption, fuelled by lower oil prices and relaxed financing conditions. Japan is forecast to grow by 1.0 and 0.3 per cent in 2016 and 2017, respectively, due largely to favourable fiscal measures, lower oil prices, continued financial accommodation and improving incomes.

In the emerging market and developing economies (EMDEs), growth is projected to rise from 4.0 per cent in 2015 to 4.3 and 4.7 per cent in 2016 and 2017, respectively. The development would be driven by expected improvement in economic conditions in a number of countries, some of which are currently in recession, notably Russia and Brazil, as well as some economies in the MENA region. Growth in China is forecast to moderate to 6.3 and 6.0 per cent in 2016 and 2017, respectively, from 6.9 per cent in 2015, reflecting slower investment growth as the economy continues to undergo a rebalancing. Slower Chinese growth is expected to have spillover effects on Emerging Asia and its trading partners. The contraction in Brazil is expected to moderate from 3.8 per cent in 2015 to 3.5 and 0.0 per cent in 2016 and 2017, respectively, due to improving political and economic environment.

In sub-Saharan Africa, growth is forecast to rise from 3.5 per cent in 2015 to 4.0 and 4.7 per cent in 2016 and 2017, respectively, as the region implements prudent macroeconomic policies to counteract the effect of lower commodity prices. In South Africa, growth is projected at 0.7 and 1.8 per cent in 2016 and 2017, respectively, while Nigeria's growth is expected to rise to 3.78 per cent in 2016 from 2.79 per cent in 2015.

In the Middle East and North Africa (MENA) region, growth is forecast at 3.6 per cent apiece in 2016 and 2017 from 2.5 per cent in 2015. Lower oil prices and geopolitical tensions continue to weigh on the outlook (Table 6.1).

6.3 Downside Risks to Global Outlook

Risks to the global outlook include the continued normalization of the US monetary policy in the face of divergent policies in other major advanced economies, continued slowdown and rebalancing of the Chinese economy and persistent lower commodity prices. Global growth could be hampered if these bottlenecks and key transitions in the world economy are not successfully managed.

The progressive exit of the United States from monetary accommodation could create corporate balance sheet problems and currency depreciation for countries with ongoing QE

programmes. Also, the associated capital reversals from emerging market and developing economies would further weaken their currencies.

In the euro area, the fear of deflation poses a risk to recovery through confidence channels. Weaker business confidence would create uncertainties and distortions in the financial market. Also, the continued slowdown in total factor productivity poses a further risk to output growth.

In the emerging market and developing economies, the key downside risk is higher-than-anticipated slowdown in China coupled with its transition to a more balanced growth model. Also, the associated spillovers through trade, commodity prices, and confidence channels would impact adversely on global financial markets and currencies.

In order to overcome the downside risk to growth, a number of measures may be necessary including demand support and structural reforms as canvassed by the IMF. In the advanced economies, low inflation rates, which are generally below central banks' targets, provide policy headroom for continuing monetary accommodation. Addressing the migrant crisis in Europe through integration programmes would allay concerns about social exclusion, labour force participation and long-term fiscal costs, while harnessing the economic benefits of migrant inflow.

In emerging market and developing economies, policy priorities vary, reflecting country-specific peculiarities. Policies, therefore, need to address vulnerabilities and manage shocks in order to support growth. The trend towards economic rebalancing in China as well as diversification away from primary commodity exports should be encouraged.

Table 6.1
Global Output and Inflation Outlook

	2014	2015	2016	2017
A. World Output				
World Output	**3.4**	**3.1**	**3.4**	**3.6**
Advanced Economies	**1.8**	**1.9**	**2.1**	**2.1**
USA	2.4	2.5	2.6	2.6
Euro Area	0.8	1.5	1.7	1.7
Japan	-0.1	0.6	1.0	0.3
UK	2.9	2.2	2.2	2.2
Canada	2.4	1.2	1.7	2.1
Other Advanced Economies	2.8	2.1	2.4	2.8
Emerging & Developing Economies	**4.6**	**4.0**	**4.3**	**4.7**

Commonwealth of Independent States	1.0	-2.8	0.0	1.7
Latin America and the Caribbean	1.3	-0.3	-0.3	1.6
Middle East and North Africa	2.7	2.5	3.6	3.6
Sub-Saharan Africa	5.0	3.5	4.0	4.7
B. Commodity Prices (US' Dollars)				
Oil	-7.5	-47.1	-17.6	14.9
Non-fuel	-4.0	-17.4	-9.5	0.4
C. Consumer Prices				
Advanced Economies	1.4	0.3	1.1	1.7
Emerging & Developing Economies	5.1	5.5	5.6	5.9

Source: IMF WEO Update, July 2015

6.4 Global Inflation Outlook

Global inflation is expected to remain subdued in 2016 relative to historical averages, on account of lower oil prices and weak demand. Inflation in the advanced economies is projected to rise in 2016 compared with 2015, but remain below central banks' targets. This would be on account of the persisting output gap due to sluggish recovery. In emerging market and developing economies, inflation outlook is projected to be mixed, with some countries experiencing low inflation due to weak demand and lower commodity prices. Others such as Russia and Brazil may, however, continue to experience high inflation as their currencies depreciate.

In the advanced economies, inflation is expected to rise to 1.1 per cent in 2016 from 0.3 per cent in 2015, due largely to continued implementation of the qualitative and quantitative easing programmes in the region as well as expected moderation in the pace of the US monetary policy normalization. In the US, inflation is projected at 1.1 per cent in 2016 up from 0.1 per cent in 2015. In the euro area, headline inflation is projected to increase to 1.0 per cent in 2016 from 0.2 per cent in 2015. Inflation in Japan is, however, forecast to fall to 0.4 per cent from 0.7 per cent in 2015.

In the EMDEs, inflation is projected to rise marginally to 5.6 per cent in 2016 from 5.5 per cent in 2015. China's inflation is expected to rise to 1.8 per cent in 2016 from 1.5 per cent in 2015, reflecting the depreciation of the renminbi. In India, inflation is projected to rise to 5.5 per cent in 2016 from 5.4 per cent in 2015. However, inflation in Brazil is expected to moderate to 8.7 per cent in 2016 from 9.0 per cent in 2015, as the economy continues to adjust to lower oil prices. In the same vein, Russia's inflation is projected to moderate to 8.3 per cent in 2016 from 15.5 per cent in 2015.

In sub-Saharan Africa (SSA), inflation is forecast to edge up to 7.3 per cent in 2016, from 6.9 per cent in 2015. This development reflects the effect of currency weaknesses which would result in higher inflation in many countries. The continued appreciation of the dollar makes imports more expensive in the region, which fuels inflationary pressures in addition to lower investment and slowing growth.

6.5 Outlook for Domestic Output Growth

Real GDP grew by 2.84 and 2.11 per cent in the third and fourth quarters of 2015, respectively, with an overall growth of 2.79 per cent in 2015 compared with 6.22 per cent in 2014 (NBS, 2016). The sluggish growth in GDP in 2015 has been attributed to the decline in oil prices, which adversely affected government revenue.

In 2016, the economy is expected to grow by 3.78 per cent (NBS) on the back of anticipated recovery in the non-oil sector relative to 2015. The IMF projected a growth of 4.1 per cent for Nigeria in 2016, while the African Development Bank (AfDB) projected a growth of 6.0 per cent. The estimate of 4.37 per cent in the 2016 FGN budget appears overly optimistic. Growth in the non-oil sector is expected to be supported by various initiatives of the Central Bank of Nigeria and the fiscal authorities to stimulate domestic production. The improved growth outlook is hinged largely on sustained implementation of on-going economic reforms in the power, aviation, transport, agriculture and SME sectors. Also, efforts by state governments to boost internally-generated revenue, prudent fiscal management as well as various measures to improve investment climate will support output growth.

The potential risks to growth in the near-term include developments in the external environment, particularly the decline in oil price which poses a threat to public sector revenue in the medium-term with negative consequences for achieving fiscal stability, and accretion to reserves. The risks from the domestic front are the continuing insurgency in some parts of the country, whose prosecution is already draining the resources required for growth as well as the recession in the oil sector due to vandalism and oil theft. In addition, the delayed 2016 budget process will hamper the flow of necessary spending to stimulate the economy.

The quarterly outlook indicates that the economy is expected to continue on its growth trajectory in the first quarter of 2016, with less robustness compared with the corresponding quarter of 2015. The relatively weak

growth outlook is based largely on the current low oil price which is likely to remain low in the medium-to-long term. Crude oil price prospects appear bleak as OPEC production quota decision remains inconclusive in the face of supply glut, and oil prices are expected to be low for long.

6.6 Outlook for Domestic Inflation

Headline inflation maintained an upward trajectory above the upper band of the Bank's inflation threshold of 6 - 9 per cent, though still within single digits. This was despite the Bank's overall tight monetary policy stance. Year-on-year headline inflation has remained in single digits in the last thirty-six (36) months. Headline inflation inched up marginally from 9.22 per cent in July, 2015 to 9.6 per cent in December, 2015. Keeping inflation within single digits will, however, remain challenging for the monetary authority in view of the import-dependent nature of the Nigerian economy and developments in the external sector.

The IMF forecasts inflation to rise to 9.7 per cent in 2016 from 9.1 per cent in 2015 (IMF's Regional Outlook, Oct. 2015). CBN estimates suggest that year-on-year headline inflation would inch up slightly but remain within single digits in the first half of 2016, moderating to 9.5 per cent in May 2016. The expected moderation would be driven mainly by the anticipated stability in the foreign exchange market, delayed passage and implementation of the 2016 budget, resulting in reduced household spending, and improvements in the supply of petroleum products. The risks to inflation outlook, however, are the pass-through effect of depreciation on imported food and expected increase in electricity tariff.

Receding global inflation is expected to moderate the impact of import costs on the domestic price level. The Bank would continue to manage liquidity conditions in the domestic economy to ensure that inflationary developments will not constitute downside risks to growth.

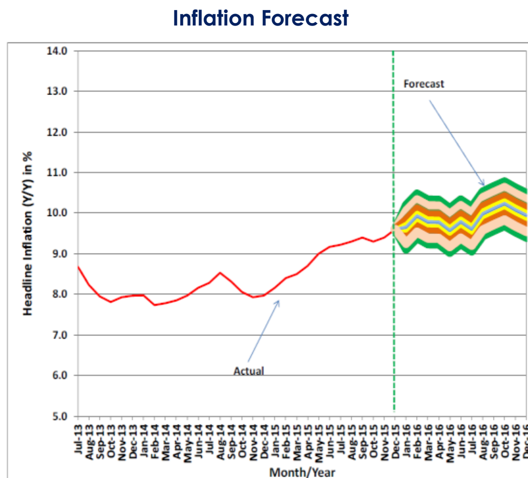
Table 6.2

YEAR-ON-YEAR INFLATION RATE

Status	Month	Headline	Food	Core
Actual	Jul-15	9.22	10.05	8.8
	Aug-15	9.30	10.13	9.0
	Sep-15	9.40	10.17	8.9
	Oct-15	9.30	10.13	8.7
	Nov-15	9.4	10.32	8.7
	Dec-15	9.6	10.59	8.7
Forecast	Jan-16	9.7	10.4	9.0
	Feb-16	9.9	10.5	9.1
	Mar-16	9.8	10.2	9.4
	Apr-16	9.8	10.3	9.3
	May-16	9.6	9.9	9.5
	Jun-16	9.8	10.1	9.8
	Jul-16	9.6	9.9	9.8
	Aug-16	10.0	10.2	9.9
	Sep-16	10.1	10.4	10.2
	Oct-16	10.2	10.5	10.1
	Nov-16	10.1	10.3	9.8
	Dec-16	9.9	10.3	9.5

Source: CBN Statistics Dept.

Figure 6.1



Source: CBN Statistics Dept.

6.7 Outlook for Monetary Policy in 2016

Global and domestic developments will continue to shape the formulation, implementation and outcomes of monetary policy in 2016 and beyond. Current global imbalances present significant headwinds to macroeconomic policy management. The persistent decline in crude oil prices continue to impact on public finances, external reserves and the general price level, resulting in lower-than-expected growth in the domestic economy. Also, the reversal of capital flows following the trend towards monetary policy normalization in the advanced economies is impacting adversely on the naira exchange rate. Similarly, the trend towards monetary policy divergence in the advanced economies is likely to heighten financial market risks and volatility. The coordination of monetary and fiscal policies is therefore necessary as monetary policy has a limited range of instruments.

The persistent decline in global crude oil prices and its impact on fiscal revenue continue to pose near-term challenges to monetary policy. In addition, the market share of Nigeria's crude oil has been shrinking due to sustained global over-supply, compelling the authorities to offer further discounts in order to attract buyers. With crude oil receipts accounting for over 90 per cent of foreign exchange earnings and the price of bonny light below the benchmark of $US38/barrel in the 2016 appropriation bill, accretion to reserves continued to be threatened, resulting in sustained pressure on the exchange rate with high pass-through to domestic prices.

The normalization of the US monetary policy and divergence between its monetary policy and other advanced economies will likely accentuate capital flow reversals and heighten instability in the financial markets. This will thus exert greater pressure on exchange rates. Monetary policy is likely to respond to this development with further tightening measures to stem the outflow of capital. But this could harm growth due to the expected rise in interest rates.

The perennial liquidity in the banking system remains despite the various tightening measures. Most recently, liquidity injections by the CBN through the banking system targeted at the real economy was invested by the DMBs in treasury securities and the foreign exchange market. The implication is that the real sector continues to be starved of funds leading to rising cost of credit. The Bank will continue to encourage the flow of credit to the real sector through targeted interventions and proactive polices.

Going forward, there appears to be stronger optimism that investor confidence will improve in the economy as the new government unfolds its agenda following the expansionary 2016 budget proposal in the National Assembly. In addition, the reassuring efforts of the new administration to resolve fiscal challenges at the sub-national level, combat graft and corruption, intensify counter-insurgency and improve foreign relations, are expected to unlock economic recovery, boost inflows and stem the reversal of capital. Nonetheless, improved coordination between the fiscal and monetary authorities is necessary to minimize risks.

Appendices

Central Bank of Nigeria Communiqué' No. 102 of the Monetary Policy Committee Meeting of Thursday and Friday, July 23 and 24, 2015

The Monetary Policy Committee met on 23rd and 24th July, 2015 against the backdrop of lingering uneven recovery in the global economy and slowing growth in the domestic economy. In attendance were all 12 members. The Committee reviewed the global and domestic economic and financial environment in the first half of 2015 as well as the outlook for the rest of the year.

International Economic Developments

The Committee observed that global output recovery remained largely sluggish although with strong promise in the United States and the Euro area. The IMF maintained its growth forecast of 3.5 per cent for 2015 with improved outlook for the advanced economies but weak performance in the emerging and developing economies. Softening oil prices continued to present improved growth opportunities for the advanced economies and oil importing countries while dampening growth prospects in oil exporting economies. The United States led growth in the advanced economies largely on account of lower energy prices, increased consumer spending and housing market recovery. The expectations of US monetary policy normalization in the medium term continued to fuel investor expectations. Growth outlook for the US remains steady as inflation stays below the Federal Reserve's 2 per cent target.

The Bank of Japan continued its accommodative monetary policy stance by injecting ¥6.7 trillion ($55.83 billion) monthly under its assets purchase programme. In the Euro area, the Greek debt crisis crystalized into uncertain and difficult negotiations with the tripartite group of creditors and altered the underlying confidence in the survival of Greece in the Eurozone.

Meanwhile, the ECB's €61 billion monthly asset purchase programme continues, in an effort to combat the effects of deflation and high unemployment in the peripheral economies. The Bank of England has maintained its £375 billion asset purchase programme in the face of the downward trend in inflation, in most of the surrounding euro area economies. These expansionary policies by the ECB, Bank of England and the Bank of Japan, could moderate the threat of capital reversal posed by the imminent normalization of US monetary policy.

Amongst the emerging markets and developing economies, growth is expected to slow considerably but resume moderately in 2016. Growth in China is projected to slow at 6.3 per cent in 2016 from 6.8 per cent in 2015 due to continued financial market vulnerabilities, declining productivity, excess capacity and weakening domestic demand.

Growth in the developing economies is expected to remain uneven in the short-to-medium-term, largely reflecting their weak demand, lower commodity prices and tight financial conditions.

Global inflation is expected to remain moderate at 3.5 per cent in 2015 but projected to accelerate to 3.7 per cent in 2016, due to rising downside risks, particularly in the Euro area, as well as the tailwinds arising from the sharp drop in oil prices, excess capacity in the advanced economies and the appreciation of the US dollar.

Domestic Economic and Financial Developments

Output

Output growth in the first half of 2015 continued to decelerate compared with the end-December 2014 level, mainly as a result of softening oil prices. According to the National Bureau of Statistics (NBS), growth in real GDP declined to 3.94 per cent in the first quarter of 2015, from 5.94 and 6.21 per cent in the preceding quarter and corresponding period of 2014, respectively. Real GDP growth is projected at 5.54 per cent for fiscal 2015, reflecting a 68 basis point decrease compared with the 6.22 per cent in 2014. At 5.59 per cent, the non-oil sector continued to be the main driver of output growth in the first quarter of 2015, at 5.59 per cent with the leading growth sectors being construction, services, agriculture and trade which grew by 11.17, 6.85, 4.70 and 4.47 per cent, respectively. On the other hand, the oil and gas sector declined by 8.15 per cent, in contrast to the modest growth of 1.2 per cent achieved in the last quarter of 2014.

While the successful conduct of the 2015 general elections was a stabilizing factor for the economy, persistent scarcity of fuel products as well as slow improvements in electricity supply could be a drag on output growth in the near term. The Committee underscored the need for the intensification of various ongoing initiatives to diversify the economy away from oil, and expand the base for foreign exchange receipts.

Prices

The Committee was concerned about the gradual but steady increase in headline inflation up to June 2015, and noted that this reflected a rise in both

the core and food components of inflation. Core inflation rose to 8.4 per cent in June from 8.3 per cent in May, and food inflation increased to 10.0 per cent from 9.8 per cent, over the same period.

The Committee observed that the uptick in year-to-date inflation rates was traceable to transient factors such as energy, arising from scarcity of petroleum products around the country, poor electricity supply and increased demand for transportation and food, from the build-up to the general elections and the ensuing Easter and Sallah celebrations.

The Committee reiterated its commitment to price stability, and observed that monetary policy would remain tight because of the high liquidity in the system. It however, noted that the drivers of the current upward inflationary spiral were of a transient nature and mostly outside the direct control of monetary policy. Consequently, the opportunity for further policy maneuver remains largely constrained in the absence of supporting fiscal measures. It therefore, urged for coordination of monetary, fiscal and structural policies to stimulate output growth, and stabilize the exchange rate.

Monetary, Credit and Financial Market Developments

Broad money supply (M2) declined by 0.61 per cent in June 2015, below the level at end-December 2014. The modest decline in money supply reflected the decreases in the net foreign assets of 16.15 per cent and other assets (net) of 21.40 per cent. Net domestic credit (NDC), however, grew by 13.45 per cent. Annualized, NDC grew by 27.90 per cent over the end-December 2014 level but essentially within the provisional benchmark of 29.30 per cent for fiscal 2015. The growth in aggregate credit was attributable to growth in Federal Government borrowing which reached 40.81 per cent in June 2015.

During the period under review, money market interest rates were relatively volatile, owing to fluctuations in banking system liquidity. Average inter-bank call and OBB rates opened at 6.55 and 6.45 per cent on 1st July, 2015 and closed at 26.51 and 21.00 per cent, respectively, on July 23, 2015. Average inter-bank call and OBB rates for the period were 9.83 and 10.23 per cent, respectively.

The Committee noted a bearish trend in the equities segment of the capital market during the review period. The All-Sh are Index (ASI) declined slightly by 1.66 per cent from 31,744.82 on March 31, 2015 to 31,216.72 on July 23,

2015. Similarly, Market Capitalization (MC) decreased by 0.37 per cent from N10.72 trillion to N10.68 trillion during the same period. Relative to end-December 2014, the market indices decreased by 9.9 and 6.9 per cent, respectively. The slight decline in share prices year-to-date was largely due to subdued sentiments preceding the general elections as well as the lingering effects of falling oil prices.

External Sector Developments

The average naira exchange rate was relatively stable at the inter-bank segment, but significantly volatile in the BDC segment during the review period. The exchange rate at the interbank market opened at N197.00/US$ and closed at N197.00/US$, with a daily average of N197.00/US$ between July 21 and July 23, 2015. The relatively stable exchange rate in the inter-bank segment can be attributed to the effects of some recent demand management measures. Gross official reserves increased from US$28.57 billion at end-May 2015 to $31.53 billion as at July 22, 2015, reflecting the blockage of leakages as well as the bank's management policies.

Committee's Considerations

The Committee was concerned about the trends in key macroeconomic indices in the first half of 2015.

The Committee acknowledged the absence of easy choices in the circumstance but monetary policy alone is limited, and would require urgent complementary fiscal policies to define the path of growth and create the basis for stabilization.

On the external front, the adverse effect of the protracted decline in global crude oil prices on the fiscal position of government is becoming increasingly obvious. The expected policy normalization in the US could accentuate capital flow reversals from emerging and developing economies and further tighten global monetary conditions, thus exerting greater pressure on exchange rates in those countries. Given the choice between controlling either quantity or price, the limitations on choosing quantity were evident necessitating the need to employ some flexibility around price while allowing current demand management measures to fully work their way through the economy. The Committee however noted that financial system stability considerations placed key limitations on the extent of considering price flexibility, creating a compelling need to balance measures to address the current vulnerabilities.

On inflation, the Committee stressed that some of the drivers of the current pressure on consumer prices were transient and outside the direct influence of monetary policy. Pressure

on food prices is expected to gradually wane as the planting season gives way to harvests in the months ahead. Early resolution of fuel scarcity would dampen transportation costs and improve food distribution across the country while improvements in electricity supply could steady output at lower costs.

Overall, the Committee expressed optimism that business confidence would continue to improve as Government continues to unfold its economic plans. In addition, some of the reassuring measures of the administration including efforts aimed at resolving fiscal challenges at the sub-national levels, and the fight against corruption and improving the business environment would unlock the inflow of foreign direct investment. The Committee also underscored the imperative of growing and protecting the country's foreign reserves and building fiscal buffers in the process of strengthening confidence in the economy which is essential for promoting growth and stability.

The Committee's Decision

In consideration of the underlying fundamentals of the economy, the evolving international economic environment, developments in oil prices as well as the need to allow for the unveiling of the economic agenda of the Federal Government, the Committee decided by a vote of 8 to 4 to retain the Monetary Policy Rate at its current level of 13 per cent, by a unanimous vote to retain the CRR at 31 per cent while 4 members voted to remunerate the CRR.

Overall, the MPC voted to hold its position.

In summary, the MPC voted:

(i) To retain the MPR at 13 per cent with a corridor of +/- 200 basis points around the midpoint;

(ii) Retain the CRR at 31 per cent; and

(iii) To retain the symmetric corridor of 200 basis points around the MPR.

Thank you.

Godwin I. Emefiele, *CON*
Governor, Central Bank of Nigeria
21st July, 2015

Central Bank of Nigeria Communiqué' No. 103 of the Monetary Policy Committee Meeting of Monday and Tuesday, September 21 and 22, 2015

The Monetary Policy Committee met on 21st and 22nd September, 2015 against the backdrop of lingering uneven recovery in the global economy and slowing domestic growth. In attendance were 10 out of 12 members. The Committee reviewed developments in global and domestic economic and financial environments in the first eight months of 2015 in order to provide the policy direction for the rest of fiscal 2015.

International Economic Developments

The Committee observed a divergence in the global economic environment, with a gradual but steady growth in the United States and UK but a slowdown in emerging and developing economies. The underlying drivers of growth in the advanced economies included improving financial conditions and consumer sentiments, suppressed commodity prices and favorable labour market conditions. On the flip side, the slowdown in the emerging and developing economies is mainly attributable to tight external financial conditions, mostly a direct consequence of reduced revenues from weak commodity prices, fragile global demand and other geo-political factors.

Aided by strong consumer spending, continuous improvement in the housing and labour markets and wage growth, the United States continues to benefit from soft energy and other commodity prices evidenced by the country's revised second quarter 2015 GDP growth of 3.7 per cent. Growth outlook in the second half, however, remains moderate as exports could slow on the heels of a strengthening dollar and slowing growth in China.

The Bank of Japan maintained accommodative monetary policy through its asset purchasing program, with monthly injection of ¥6.7 trillion (US$55.48 billion), resulting in stronger than anticipated second quarter growth. Following its September 3, 2015 meeting, the European Central Bank (ECB) retained its key policy rate, even as its asset purchasing program continued, while inflation remained largely subdued.

In the United Kingdom, the Bank of England also continued its asset purchase program as the economy maintained a robust growth path in the second quarter, with a modest uptick in inflation. These developments have started to trigger the debate over when the Bank of England (BoE) would start raising its rates.

Mindful of the potential impact of a rate adjustment, particularly on the emerging markets and considering the

sluggish recovery in the Euro Area and Japan as well as the need to firm up recent growth and employment gains in the domestic economy, the US Federal Reserve voted at its September meeting to maintain its key interest rate, and delay monetary policy normalization. The decision is expected to strengthen stability in global economy and moderate volatility in the financial markets, while also consolidating recovery at home.

In the emerging markets and developing economies, expectations of low growth continued into the third quarter of 2015, with strong likelihood of moderate uptick in 2016. Output growth in China at 7.0 per cent in the second quarter of 2015, is expected to moderate further, due to slower productivity and exports, collapsing assets value and excess capacity in the manufacturing sector.

Global inflation is expected to remain tepid as the recent temporary rebound in oil prices and stronger consumer sentiments have mildly raised consumer prices in the advanced economies. Consumer price developments were mixed in emerging and developing economies. Commodity importing economies have continued to benefit from low global oil and other commodity prices, while others, especially exporters of primary commodities, are contending with increased pressure on their currencies and fiscal position; and in some cases, significant inflation pass-through to domestic prices.

Domestic Economic and Financial Developments

Output

Output growth in the first half of 2015 trended downwards from the level in the fourth quarter of 2014, mainly on account of softening oil prices. According to the National Bureau of Statistics (NBS), real GDP grew by 2.35 per cent in the second quarter of 2015, a significant decrease when compared with the 3.96 and 6.54 per cent in the preceding quarter and corresponding period of 2014, respectively. Real GDP growth is projected by the National Bureau of Statistics (NBS) to stabilize at 2.63 per cent in 2015, compared with the 6.22 per cent recorded in 2014. The non-oil sector remained the main driver of growth in the second quarter of 2015, at 3.46 per cent. The key drivers were services, trade and agriculture, contributing 1.80, 0.95 and 0.82 percentage points, respectively. On the other hand, Oil and Natural Gas sector declined by 0.73 percentage point an improvement of 1.13 percentage points relative to the first quarter of 2015.

The overall outlook for economic activity is expected to improve on account of sustained improvement in

the supply of power and refined petroleum products and progress with counter-insurgency in the North East axis. The Committee reiterated its commitment to efforts in support of the various ongoing Federal Government initiatives to stimulate output growth.

Prices

The Committee noted that the year-on-year headline inflation edged upwards to 9.3 per cent in August, from 9.2 per cent in June and July, 2015. The increase in headline inflation in August reflected marginal increases in both the core and food components of inflation. Core inflation rose to 9.0 per cent in August from 8.8 per cent in July, while food inflation increased to 10.1 per cent from 10.05 per cent over the same period.

The Committee observed that the uptick in inflation was mainly traceable to higher energy prices, delayed harvests and pass through from imports. It however, noted with satisfaction, the continued moderation in all measures of month-on-month inflation across all the measures. In August, on a month-on-month basis, headline inflation rose by 0.59 per cent from 0.69% in July; core inflation rose by 0.61 per cent, same as in July. Month-on-month food inflation also moderated to 0.63 per cent in August, from 0.77 per cent in July. The Committee, while reiterating its commitment to price stability, noted that the rising inflationary trend was a concern given the already tight monetary policy stance of the Bank.

Monetary, Credit and Financial Markets Developments

Broad money supply (M2) contracted by 2.23 per cent in August 2015, below the level at end-December 2014. When annualized, M2 contracted by 3.34 per cent, which was significantly below the growth benchmark of 15.24 per cent for 2015. Net domestic credit (NDC) rose by 11.00 per cent, which annualizes to 16.49 per cent in the same period. At that level, NDC was within the provisional benchmark of 29.30 per cent for 2015. The growth in aggregate credit was attributable mainly to growth in Federal Government borrowing which reached 140.13 per cent in August 2015 or 210.19 per cent when annualized.

During the period under review, rates in all segments of the money market were largely influenced by the level of liquidity in the banking system. Money market interest rates were relatively volatile, reflecting fluctuations in banking system liquidity during the period. Average inter-bank call and OBB rates, which opened at 10.85 and 10.65 per cent in June, 2015, closed at 31.07 and 28.10 per cent, respectively, in August, 2015. Average inter-bank call and OBB rates for the period were 14.95 and 17.17 per cent, respectively.

The Committee noted the bearish trend in the equities segment of the capital market during the review period. The All-Share Index (ASI)decreased by 9.3 per cent from 33,456.83 on June 01, 2015 to 30,332.68 on September 18, 2015. Similarly, Market Capitalization (MC) fell by 8.8 per cent from N11.42 trillion to N10.42 trillion during the same period. However, relative to end-December 2014, the indices decreased by 12.5 and 9.3 per cent, respectively. The decline in share prices (year-to-date) was largely due to subdued sentiments preceding the general elections, which held in March and concerns for the country's foreign reserves position due to declining global oil prices.

External Sector Developments

The average naira exchange rate remained relatively stable at the inter-bank segment, but significantly volatile in the BDC segment of the foreign exchange market during the review period. The interbank exchange rate opened at N196.95/US$ and closed at N197.00, at a daily average of N196.98/US$ between June 29 and September 18, 2015 representing a depreciation of N0.5K for the period. At the bureau-de-change segment, the exchange rate opened at N224.50/US$ and closed at N211.50. This represented an appreciation of N13.00k for the period. The relative stability in the inter-bank market and improvement in the BDC segment were attributed to the effects of various administrative and policy measures. Consequently, gross official reserves decreased modestly from US$31.20 billion at end-July 2015 to $30.63 billion on September 17, 2015.

Committee's Considerations

The Committee noted that the overall macroeconomic environment remained fragile. The economy further slowed in the second quarter of the year, making it the second consecutive quarterly less-than expected performance. The Committee noted that growth had come under severe strains arising from declining private and public expenditures. In particular, it noted the impact of non-payment of salaries at the state and local government levels as a key dampening factor on consumer demand. Year-on-year headline inflation continued to trend upwards, although the month-on-month measure moderated. Demand pressure in the foreign exchange market remained significant as oil prices continued to decline. Arising from these developments, there were indications that some of the banking sector performance indicators could be stressed if conditions worsen further. Specifically, the Committee noted that liquidity withdrawals following the implementation of the TSA, elongation of the tenure of state government loans as well as loans to the oil and gas sectors could aggravate liquidity

conditions in banks and impair their financial intermediation role, thus affecting economic growth, unless some actions were immediately taken to ease liquidity conditions in the markets.

Having seen two consecutive quarters of slow growth, the Committee recognized that the economy could slip into recession in 2016 if proactive steps were not taken to revive growth in key sectors of the economy.

In the face of prevailing circumstances, the Committee acknowledged that synergy between monetary and fiscal policies remained the most potent option to sustainable growth. The Committee further observed that the impact of the persistent decline in global crude oil prices on the fiscal position of Government continues to reflect in rising credit to government. The Committee also noted that the initial market reaction to the decision by JP Morgan to exclude the country from its Government Bond Index for Emerging Economies (GBI-EM) had largely dissipated as yields soon adjusted to their pre-announcement levels' adding that there may be second round effects over the next two months as the economy adjusts to that decision. The Committee reiterated its unwavering commitment to naira exchange rate stability despite the pressures. Mindful of the possibility of diversion of any extra liquidity to the foreign exchange market, the Committee urged the Bank to closely monitor the nature and sources of demand pressure in the foreign exchange market to ensure that funds were not diverted to demand for foreign exchange but applied to specific growth enhancing asset creation lending by banks. It further noted that sectors such as agriculture and MSMEs were sectors for rapid generation of productive employment and wealth creation, and must therefore, be painstakingly encouraged.

On inflation, the Committee was optimistic that as harvests progress in the coming months, pressure on food prices would gradually recede, while growth enhancing measures would over the medium term have some moderating effect on food prices.

Overall, the Committee expressed optimism that business confidence would continue to improve as the Government continues to unfold its economic plans. In addition, some of the reassuring measures of the administration including efforts aimed at resolving fiscal challenges at the sub-national levels, and the fight against corruption and improving the business environment would unlock the inflow of foreign direct investment. The Committee also underscored the imperative of growing and protecting

the country's foreign reserves and building fiscal buffers in the process of strengthening confidence in the economy, which is essential for promoting growth and stability. The MPC also observed that despite the TSA, banking system liquidity ratio remained moderate. Consequently, the Committee advised on the urgent imperative of banks to aggressively support the efforts of government at job creation by channeling available liquidity into target growth enhancing sectors of the economy such as agriculture and manufacturing. This is with a view to promoting employment creation through conscious efforts aimed at directing lending to the growth enhancing sectors of the economy. The Committee considered that the Bank and deposit money banks, must strive to reverse the slowing GDP trajectory by actively stepping up their efforts in catalyzing the economy with substantial new loans to the target sectors earlier highlighted.

The Committee's Decisions

In consideration of the underlying fundamentals of the economy, particularly the declining output growth, rising unemployment, evolving international economic environment as well as the need to properly position the economy on a sustainable growth path, the MPC decided by a vote of 7 to reduce the Cash Reserve Requirement (CRR) from 31 per cent to 25 per cent while 3 voted to hold. By a unanimous vote, the MPC voted to retain the MPR at 13 per cent.

In summary, the MPC voted to:

(i) Reduce the CRR from 31 to 25 per cent;

(ii) Retain the MPR at 13 per cent;

(iii) Retain the symmetric corridor of 200 basis points around the MPR; and

(iv) Retain the Liquidity Ratio at 30 per cent.

Thank you.

Godwin I. Emefiele
Governor, Central Bank of Nigeria
22nd September 2015

Central Bank of Nigeria Communiqué No. 104 of the Monetary Policy Committee Meeting of Monday and Tuesday, November 23 and 24, 2015

The Monetary Policy Committee met on 23rd and 24th November, 2015 against the backdrop of slowing global growth and a weakening domestic economic environment, attributable largely to the down turn in oil prices. In attendance were 10 out of 12 members. The Committee appraised the global and domestic economic and financial environments up to October 2015 as well as the economic outlook for the first half of 2016.

International Economic Developments

The Committee noted the moderation in global output recovery evidenced by the less-than-expected growth of 2.9 per cent in the first half of 2015. The development was underpinned largely by deteriorating global trade, reversal in output growth in the advanced economies and a significant slowdown in growth in the emerging and developing economies. The key drag on growth in the advanced economies included unfavorable labour market conditions, suppressed foreign demand and weaker than anticipated domestic aggregate demand. Consequently, growth in the U.S. slowed to 1.5 per cent in the third quarter of 2015 as a result of a drawdown in inventories; deceleration in exports; drag in private consumption, government spending and residential fixed investment. The outlook for the fourth quarter, however, remains optimistic as consumption spending is expected to drive growth, supported by low inflation.

The Bank of Japan continued with monetary easing, through its asset purchase program, with a monthly injection of ¥6.7 trillion ($54.27 billion); but this was insufficient to restart output as third quarter growth is projected to be weaker than the second quarter, thereby increasing the likelihood of dampening growth and pressure for higher stimulus. The European Central Bank (ECB) in October 2015; reaffirmed commitment to its monthly asset purchase of €60 billion ($64.2 billion) until September, 2016; although the package may fall short of what is required for meaningful impact on growth. Similarly, the Bank of England continued its ₤375 billion ($570 billion) monthly asset purchase program, as the economy is expected to retreat from its performance of 0.7 per cent in the second quarter to about 0.5 per cent in Q3 with the decline in foreign demand, potentially dampening the prospects for an interest rate hike.

Growth in the emerging markets and developing economies (EMDEs) continued to sag; reflecting the protracted slowdown in China as well as recession in Russia and Brazil. The slowdown among EMDEs has been

mainly due to weak import growth in China, low commodity prices, capital flow reversals, rising debt levels and other geopolitical factors. In effect, the poor growth expectations could continue into the fourth quarter with the likelihood of further dampening in 2016.

Overall, monetary policy in most advanced and emerging market economies appears oriented towards easing to revive output and strengthen employment. No substantial upswing is expected around the current tepid global inflation, projected to remain moderate through 2016. The continuously bearish commodity prices and stronger consumer sentiments have dampened consumer prices in the advanced economies. In the emerging and developing markets, the major risk to domestic prices is mainly the increased pressure on domestic currencies. However, in most emerging markets, the low prices of oil and other commodities continue to cushion consumer inflation pressures.

Domestic Economic and Financial Developments

Output

Data from the National Bureau of Statistics (NBS) indicated that real GDP grew by 2.84 per cent in the third quarter of 2015, compared with 2.35 per cent in the second quarter. However, economic growth in Q3 was lower than the 3.96 and 6.23 per cent in the first quarter of 2015 and the corresponding period of 2014, respectively. Both the oil and non-oil sectors contributed to growth in the third quarter of 2015. In the non-oil sector, the key drivers of output growth were Crop Production, Trade and Telecommunications and Information Services, contributing 0.91, 0.79 and 0.40 percentage points, respectively.

The overall outlook for economic activity is expected to improve on account of sustained improvement in the supply of power and refined petroleum products, progress with counter-insurgency in the North-East and targeted interventions in the real sector. In addition, the inauguration of the Federal Executive Council and the assumption of office of the Ministers, earlier this month, are expected to add impetus to the growth momentum. The Committee reiterated its commitment to support the various ongoing initiatives of the Federal Government to stimulate output growth.

Prices

The Committee noted with delight the slight decline in year-on-year headline inflation to 9.3 per cent in October, from 9.4 per cent in September, 2015. The decline in headline inflation in October 2015, reflected decreases in both the core and food components. Core inflation declined for the second consecutive month to 8.7 per cent in

October from 8.9 per cent in September, while food inflation slowed to 10.1 per cent from 10.2 per cent over the same period. The Committee further noted the continued moderation in month-on-month inflation and reaffirmed its commitment to price stability, stressing the need for complementary supply side policies as part of an overall strategy to lock-in inflation expectations.

Monetary, Credit and Financial Markets Developments

Broad money supply (M2) contracted by 3.75 per cent in October, 2015, over the level at end-December, 2014. Annualized, M2 declined by 4.5 per cent, which is significantly below the growth benchmark of 15.24 per cent for 2015. Net domestic credit (NDC) grew by 10.8 per cent, which annualizes to 12.96 per cent in the same period. At this level, NDC fell below the provisional benchmark of 29.30 per cent for 2015. Growth in aggregate credit reflected mainly growth in net credit to the Federal Government which grew by 96.66 per cent in October, although lower than the 142.38 per cent in September, 2015. The sharp moderation in credit to government may be partly attributable to the effect of implementation of the Treasury Single Account (TSA).

During the period under review, money market interest rates were low but sometimes volatile, reflecting fluctuations in banking system liquidity. Average inter-bank call and Open Buy Back (OBB) rates, which stood at 15.50 and 35.00 per cent on September 21 and 22, 2015, respectively, fell to 9.67 and 9.00 per cent on September 23, 2015. On October 19, 2015, OBB rate closed at 1.00 per cent with no transaction at the interbank call segment. Following the increase in net liquidity level, the interbank call and OBB rates further declined and closed at 3.76 and 0.73 per cent, on October 29 and 30, 2015, respectively. Between the last MPC meeting and end-October 2015, interbank call and OBB rates averaged 6.66 and 6.72 per cent, respectively, and were 0.41 per cent and 1.33 per cent on 19th November, 2015.

The Committee also noted the bearish trend in the equities segment of the capital market during the review period. The All-Share Index (ASI) decreased by 9.9 per cent from 31,217.77 on September 30, 2015 to 28,131.28 on November 20, 2015. Similarly, Market Capitalization (MC) fell by 9.9 per cent from N10.73 trillion to N9.67 trillion during the same period. However, relative to end-December 2014, the indices decreased by 18.9 and 9.5 per cent, respectively. These developments reflected, largely the cautious approach to lending by the deposit money banks.

External Sector Developments

The average naira exchange rate remained relatively stable at both the inter-bank and Bureau-de-Change (BDC) segments of the foreign exchange market during the review period. The exchange rate at the interbank market opened at N197.00/US$ and closed at N197.00, with a daily average of N196.99/US$ between September 21 and October 30, 2015. At the BDC segment, the exchange rate opened at N223.50/US$ and closed at N225.00, with a daily average of N224.46/US$, representing a depreciation of N1.50k for the period. The relative stability in the foreign exchange market is attributable to the sustained supply of foreign exchange from autonomous sources as well as the effects of various administrative measures taken by the Bank. Gross official reserves increased from US$29.85 billion at end-September, 2015 to $30.31 billion on 20th November, 2015.

Committee's Considerations

The Committee acknowledged the continued fragile global economic environment, including the possibility of monetary policy normalization in the United States; poor outlook for commodity prices and further slowdown in the Emerging Markets and Developing Economies. The MPC also noted the fragility of the domestic macroeconomic environment; reflected partly in low output growth, soft oil prices, low credit to the high employment elastic sectors of the economy and sustained inflationary pressure, which however, softened moderately in October. The MPC was, particularly, concerned that the previous liquidity injections embarked upon through lowering of the Cash Reserve Ratio (CRR), in the last MPC, has not transmitted significantly to improved credit delivery to key growth and employment in sensitive sectors of the economy. Rather, more credit was to sectors with low employment elasticity.

The Committee restated its commitment to evolve and implement measures that would be supportive of consolidating and strengthening in output growth with an eye on price stability. The Committee, however, recognized the limits of monetary policy under conditions of huge infrastructure gap and significant global financial market fragilities. While noting the imperative of complementary fiscal policies to augment monetary policy, under the circumstance, monetary policy must remain bold in charting the desired course that would stimulate sustainable output growth in Nigeria.

Concerned about the state of unemployment in the country, the MPC evaluated various options for ensuring increased credit delivery to the key growth sectors of the

economy, capable of generating employment opportunities, and improving productivity and growth. The Committee underscored the need for banks, to ensure that measures taken by the Bank to inject liquidity and stimulate the economy adequately translate into increased lending to the sectors with sufficient employment capabilities and the potential to generate growth. Accordingly, the MPC agreed that going forward, any attempt by the CBN at easing liquidity into the system shall be directed at targeting real sector, infrastructure, agriculture and solid minerals. The MPC further directed the Bank's Management to put in place necessary measures/regulations to ensure strict compliance by the DMBs. This is aimed at ensuring that employment and productivity is stimulated while also moderating prices.

The Committee noted with satisfaction the stability, soundness and resilience of the banking system even against adverse global financial conditions. Given the situation, the MPC emphasized the necessity of focusing on financial market stability and proactive engagement of policy and administrative levers needed to support the environment in which market institutions operate. On their part, market institutions are encouraged to employ more stringent criteria in evaluating their portfolio and business decisions.

The MPC considered that although, headline inflation had remained at the borderline of single digit, the observed moderation, especially in the month-on-month inflation, provided some room for monetary easing to support output in the short to medium term, while keeping in focus the primacy of price stability. In effect, the Committee will continue to monitor developments around the Naira exchange rate, interest rates, and consumer prices, even as targeted measures are needed to channel liquidity to the key sectors of the economy.

The Committee noted that close coordination between monetary and fiscal policy was imperative for sustainable growth enhancing policies.

The Committee's Decision

In consideration of the weakening fundamentals of the economy, particularly the low output growth, rising unemployment and the uncertainty of the global economic environment, the MPC, by a vote of 8 out of 10, reduced the MPR from 13.0 to 11.0 per cent while 2 members voted for a retention of the rate at 13.0 per cent; 7 members voted to reduce the Cash Reserve Requirement (CRR) from 25.0 per cent to 20.0 per cent while 3 members voted to hold. In addition, 8 members voted for an

asymmetric corridor of +2/-7 per cent while 2 voted to retain the symmetric corridor of +/-2 per cent around the Monetary Policy Rate (MPR).

The MPC emphasized that the liquidity arising from the reduction in the CRR to 20 per cent, will only be released to the banks that are willing to channel it to employment generating activities in the economy such as agriculture, infrastructure and solid minerals.

In summary, the MPC voted to:

(i) Reduce the CRR from 25.0 per cent to 20.0 per cent;

(ii) Reduce the MPR from 13.0 per cent to 11.0 per cent;

(iii) Change the symmetric corridor of 200 basis points around the MPR to an asymmetric corridor of +200 basis points and -700 basis points, around the MPR.

Thank you.

Godwin I. Emefiele
Governor, Central Bank of Nigeria
24th November, 2015