General Remarks
For
Gov. Godwin Emefiele, *CON*
During the Annual Bankers' Dinner
Lagos, 5th December 2014

Opening Pleasantries — Good evening ladies and gentlemen. First, I would like to thank the Chartered Institute of Bankers of Nigeria (CIBN) for organizing this event. I am particularly delighted that I am present at today's occasion because of the multiple times that the Institute had to postpone it in order to accommodate my schedules, which kept changing unavoidably. So I am truly happy that it all worked out and I am here today.

Let me appreciate the presence of Managing Directors/Chief Executive Officers of our banks and other financial institutions who have all made time to be here today. Given that we are approaching the end of the year, and having once been in your position, I know many of you must be under pressure to put your books in order and ensure that you have resounding results for your shareholders. Therefore, your presence here is testament to your commitment to a continuation of a tradition that has long been with us. I thank you for coming.

I would also like to appreciate my colleagues from the Central Bank of Nigeria—Deputy Governors, Directors, Special Advisers, Special Assistants, and everyone else from the Bank. I thank you for finding time to be here today despite the difficulties and headwinds we are dealing with at the moment.

And to everyone else present at this gathering, I thank you for coming and enjoin you to savor the rest of the evening.

Normally, a night such as this should really not be for jargonic, technical, or policy-related speeches. But these are not normal times by any stretch of imagination. While very few may have envisaged the economic and geopolitical environment that the world is grappling with today, I have always maintained that the Central Bank of Nigeria would act in good faith, with the best available information and in cognizance of current economic conditions, to pursue the goals of price and financial system stability, as well as catalyzing job creation and inclusive growth in the country. And this is what we have tried to do over the last couple of weeks.

I am fully cognizant of the seeming unpopularity of some of our decisions but this room is full of leaders and I am sure most of you would agree that leadership is not a popularity contest. I have watched so-called economic and financial experts analyze our situation and reach different conclusions than the ones we have made in recent times but I am not surprised because most have done so with shockingly limited or out-rightly incorrect information. I also understand why some may reach a different set of conclusions even when they have substantially correct information. Yes, reasonable people with the same set of facts can reach different opinions and conclusions because therein lies the dilemma of policy making.

In deed, this dilemma is crystalized in the story of a young man who was alone in a two-seater car and driving down a lonely, snow-filled, and slippery road in order to escape the growling thunderstorm. About halfway between one town and the next, he suddenly saw another car that had accidentally skid off the road and irreparably struck a nearby tree. There were three persons in that car—an old friend who had once saved his life, a beautiful lady he had been asking out but refused, and an old sickly grandma who was being severely battered by the prevailing weather conditions.

The young man, having recognized these persons, decided to help and quickly stopped. But soon after, he realized that his car could actually only take one more person since it was a two-seater car. If you were in this young man’s situation, what would you do? Who amongst these persons would you give a ride—your dear friend who once saved your life, the prospective love you have been asking out, or the old sickly woman?

As you wrestle with finding an optimal solution to this problem, let me briefly explain the macroeconomic and geopolitical contexts in which the Bank and the country have been operating.

In recent times, the global economy has been dominated by strong downside risks to growth, in view of softening commodity prices, rising geo-political tensions, and heightening threats to financial markets in the aftermath of the termination of the Quantitative

Easing Programme by the US Federal Reserve at the end of October 2014. Developments in the international oil market have intensified these risks particularly for oil exporting countries like ours, in the wake of recent episode of falling oil prices. While the impact of falling oil prices has been expectedly unfavorable on oil exporting countries, it seems to have been largely positive on oil importing countries led by the United States, which has also emerged as a major oil exporter.

With considerable divergence across regions, global growth picked up in the second half of 2014 at a lower than predicted pace. In view of the perceived vulnerabilities and associated risks, the International Monetary Fund (IMF) recently downgraded its global growth forecast for 2015 to 3.3 percent from an earlier projection of 3.7 percent. The expected tepid performance in 2015 reflects the impact of the strong headwinds arising from the negative spillover effects of the unwinding of the US monetary stimulus, deteriorating geo-political tensions in many regions, and uncertainty about the duration of the US-led economic sanctions on Russia; a development which in combination with the shale oil revolution has created a supply glut in the world oil market forcing prices to remain at far below long run trends.

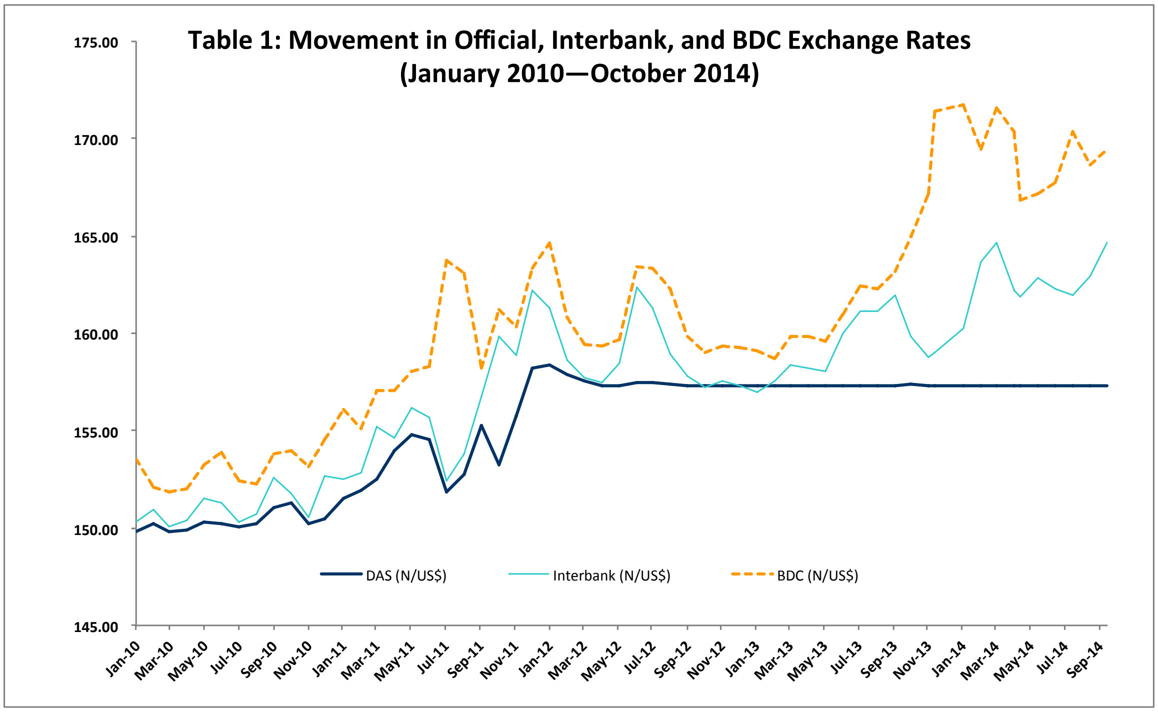
Growth in Sub-Saharan Africa was also revised downwards to 5.1 percent in 2014 from the earlier projection of 5.4 percent to reflect the ongoing sluggish global growth and declining commodity prices. In effect, both oil exporting and other commodity exporting countries have been negatively affected by the slowdown in global growth. In addition, political crisis, infrastructural challenges, and outbreak of Ebola in Guinea, Liberia and Sierra Leone have moderated earlier robust growth outlook for the continent.

In subtle contrast, however, the Nigerian economy has displayed uncommon resilience when compared to its peers as well as when contrasted against the spillover effects of the aforementioned exogenous factors it has been dealing with during the year. For the first three quarters of the year, the economy expanded by an average of about 6.3 percent. The growth rate for the third quarter was recorded to be 6.23 percent, reflecting significant growth from key non-oil sectors. These numbers are impressive particularly considering the fact that after the GDP Rebasing Exercise, the recomputed growth rates for 2012 and 2013 were 4.2 percent and 5.5 percent, respectively.

Although inflation edged up during the first and second quarters of the year, these pressures have started to dissipate as inflation has been trending downwards from a peak of 8.5 percent in August to 8.1 percent in October 2014. Interestingly, this outcome is reflected in a reduction in both core and food inflation. While core inflation trended slightly down from 6.28 percent to 6.25 percent, food inflation decreased from 9.68 percent to 9.34 percent in September and October, respectively.

During the third quarter of the year, the economy created almost 350, 000 jobs with the private sector contributing about 60 percent of that number. The country's financial system continues to look good based on fundamental measures of stability, even though there is always room for improvement.

Despite these impressive outcomes, the Naira/Dollar Exchange Rate has been under considerable pressure over the last couple of months. In the days leading up to last month's Meeting of the Monetary Policy Committee, the interbank rate closed at ₦173 to the dollar, the BDC rate closed at ₦176 to the dollar but the CBN managed to keep the official rDas rate at slightly above ₦160 to the dollar.

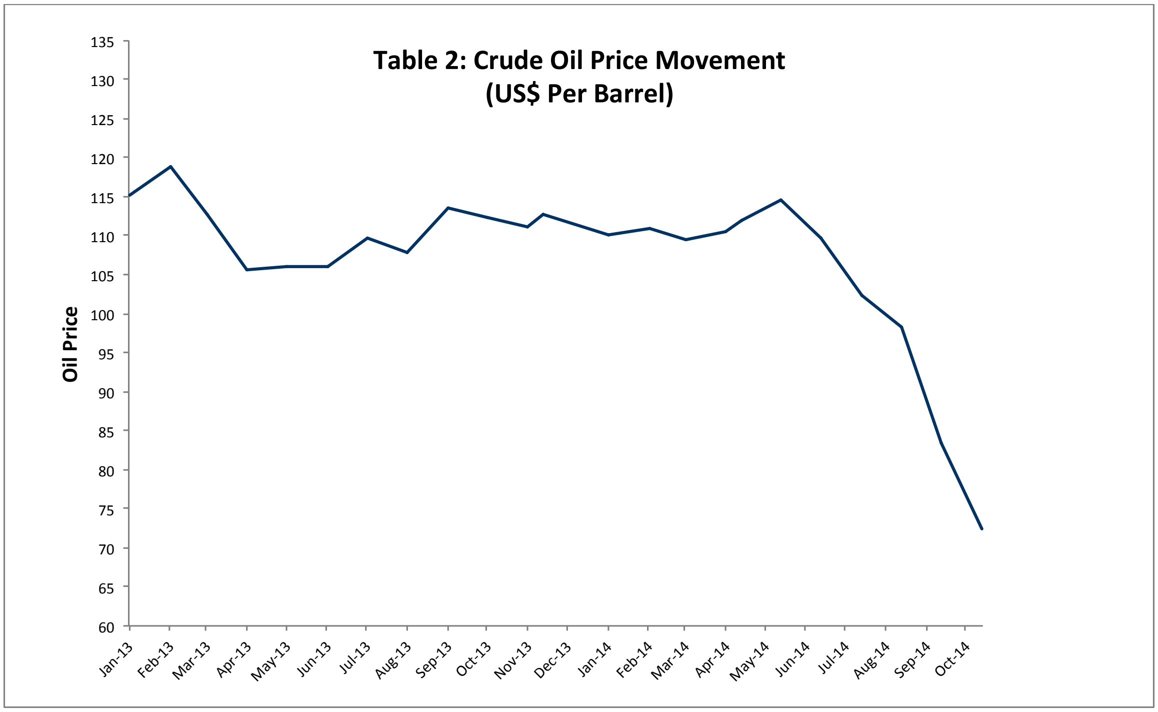


It is important to note that the reason that the official rate only increased marginally over this period is because of the huge outlay of foreign exchange (FX) reserves that the CBN has spent in defending the naira and ensuring that the official rate stayed about the same. In an effort to do so, the CBN has spent substantial amount of its reserves in shoring up the value of the naira. In contrast, inflows into the Bank's FX Reserves during the year have been less than anticipated in view of dwindling oil prices. In sum, therefore, the bank's reserves have had a net outflow for the year.

What then can a Central Bank do to react to such a situation of falling reserves and pressurized exchange rates? One course of action would be to continue to deplete the FX Reserves in trying to keep the official rate at a stable level. But there are several difficulties with this option.

First, we must remember that regardless of its critical nature in an import-dependent country like ours, the exchange rate operates like any other "price" in the market. The Dollar/Naira Exchange Rate is simply the "price" of US Dollars in Naira. The forces of demand and supply basically determine its movement. When demand rises, the price rises. When supply falls, the price also rises as well. In recent times, Nigeria has faced a perfect storm of simultaneous dwindling supply of US Dollars and rise in demand. Both forces have led to a rise in the price of US Dollars, that is, depreciation, in both the Interbank and BDC segments of the market.

Secondly, the underlying factors that led to dwindling supply of US Dollars are mainly global and not country-specific. As we all know, the main source of supply to our foreign reserves is sale of crude oil. However, during the course of the year, we have seen oil prices fall by nearly 40 percent (See Table 2). From a peak of US$116 per barrel in January 2014, oil prices have fallen to as low as US$70 per barrel in November 2014. The direct implication of this is a



significant reduction in supply of US Dollars to the market, even with constant output of crude oil production. The other global factor, which has significantly reduced the supply of US Dollars in the market, is related to the end of Quantitative Easing by the US Federal Reserve. At the height of the programme, the Federal Reserve was supplying a total of about US$85 billion into the US economy on a monthly basis, through asset purchases. This programme came to an end in October 2014, thereby significantly reducing the supply of US Dollars in the global economy.

The third difficulty which has contributed to the continuing depletion of our FX Reserves, and our capacity to defend the naira is that the combination of a fall in oil prices and the end of the Quantitative Easing programme by the US Federal Reserve have led to a depreciation of most currencies in the world against the US Dollar. An analysis of the year-on-year change in the exchange rate of 26 Emerging Market countries (including Brazil, China, India, South Africa, Turkey, Mexico, and Nigeria) indicates that their currencies have depreciated by about 8.1 percent on average against the US Dollar.

Finally, most market watchers and economic analysts now believe that the current episode in oil price decline may not be transitory but seemingly permanent. This is because technological advances have made shale oil production profitable, to the extent that the United States which used to be Nigeria's major oil consumer now meets a lot of its demand from local shale oil production, and in fact, exports over 8 million barrels of crude oil daily. The current US-led sanctions against Russia for its alleged role in the ongoing Ukrainian crisis do not appear to be abating anytime soon. More also, current negotiations between Western powers and Iran could end in a deal that may open up Iranian oil supply lines to more parts of the global economy, a development that is likely to depress prices even further.

On the basis of these analyses and realities, the CBN reached the decision that it would be sub-optimal to indefinitely continue to deplete the country's FX Reserves in defending the naira. This decision was particularly appropriate in light of the fact that neither the Bank nor the Federal Government was in control of the major factors forcing the depreciation of the currency. And there are examples of countries that tried hard but failed abysmally in efforts to defend a currency indefinitely. In fact, the Russian Central Bank abandoned its staunch defense of the national currency and allowed some depreciation in its value but only after it had painfully spent over US$90 billion over a couple of months.

In addition to our decision to allow some flexibility in the Dollar/Naira Exchange Rate, the Bank has also taken other associated policy actions that are in line with its mandate for price and financial system stability. As we know, one of the Bank's major mandates is to ensure price stability and we believe that without complementary policy actions, developments in the FX Market would reverse the fragile gains we have recorded recently in our fight against inflation. Therefore:

- The decision to tighten monetary policy is expected to moderate the expected inflationary pressures that may result from exchange rate pass through to domestic prices, and ensure that inflation expectations are well anchored;

- The decision to raise the Monetary Policy Rate (MPR) is expected to increase capital inflows into the country, which should improve accretion to reserves;
- The increase in Cash Reserve Requirement (CRR) will reduce the amount of excess liquidity available for speculative and arbitrage activities and moderate the pressure in the foreign exchange market;
- Shifting the mid-point of the official exchange rate from ₦155/US$ to ₦168/US$ realigns it with the already depreciated rates in the Interbank and BDC segments, reduces the extant premium and discourages arbitrage tendencies in the market;
- The new value of the naira naturally provides a critical opportunity for entrepreneurs to take steps toward replacing costly imports with cheaper locally made goods and services. Let me

reiterate that the current situation we find ourselves affords us an opportunity to embrace import substitution in Nigeria, thereby reducing the demand for foreign exchange by importers and ultimately conserve our hard-earned FX Reserves.

With respect to this last point, the CBN is already collaborating with the Ministry of Industry, Trade, and Investment, the Ministry of Agriculture and Rural Development, as well as the Directorate of the National Youth Service Programme (NYSC) to aggressively begin the first phase of a Strategic Import Substitution Programme that will take advantage of the current situation. As financial intermediaries and catalysts, let me seize this opportunity to call on our deposit money banks as well as development finance institutions to join hands with the CBN, Ministries of Agriculture, Industry, Trade and Investment and other MDAs in their attempts to encourage our local industries in their drive to boost local production of goods presently being imported.

This strategy has become necessary in light of the fact that records show that as of the beginning of the Jonathan Administration in 2011, the country was spending about N1.3 trillion importing 4 products, namely, rice, sugar, wheat, and fish. It beats my imagination to understand why on earth we cannot produce these items here at home. I do not think it requires rocket science to produce these things. While the said amount is alarming, it also signifies the opportunity for big business that these items provides for those who are willing to go into their local production.

And the CBN will continue to commit resources toward supporting these entrepreneurs through its Commercial Agricultural Credit Scheme (CACS). Similarly, our recently launched N220 billion Micro, Small, and Medium Enterprises Development Fund is meant to support our micro and small businesses, including women and physically challenged persons cutting across all sectors of our economy to grow their entrepreneurial skills and ultimately contribute to job creation and inclusive growth in the country.

In sum therefore, the actions of the CBN suggests that there is cause for concern but no need for panic. This firm conviction stems from:

a) The resilience of the Nigerian economy as described above;

b) The key causal factors of the FX pressure we are facing are global; and

c) The CBN has enough reserves to meet legitimate, transactions-based FX obligations.

In line with the excellent approach adopted by the fiscal authorities, the Central bank is monitoring the situation closely and is prepared with policy options that would match a range of oil price scenarios. This has become necessary to reflect the fluidity of current global economic and geopolitical conditions.

Ladies and Gentlemen, while I have taken time to explain the potential benefits from our recent decisions, I am not unaware of the short-term pains that may be associated with these decisions. But I urge you all to understand that the hallmarks of a credible and effective central bank is to be nimble and responsive to both global and domestic economic realities as they unfold. Central banks must act swiftly, decisively, and sometimes proactively, to respond to the cards that they are dealt in the domestic and global economic environment. Once we have independently analyzed the situation, we must make a decision in good faith that is in the best interest of the country. And given the emergence of 24-hour news television and online media, central banks must now learn to live in a world where every decision it makes is analyzed, second-guessed, and often criticized.

Yet, in light of the narrative I have presented above, I am sure you would agree with me that making an optimal decision is not an easy task. We recall the question I posed at the start of my remarks about the young man in a two-seater car on a lonely snowy road, and yet have to make a decision to save one of three persons—a dear friend who once saved his life, a prospective love he has been seeking for a long time, or an old sickly woman who needs urgent care. What would you do that will satisfy everyone?

Well, ladies and gentlemen, you would agree with me that whatever you do, even in good faith, someone else would have a different idea. As for me, ladies and gentlemen, I would probably ask my dear friend to take the old woman in my car to the next town while I stay back and continue to chat with my prospective love until my friend returns with a bigger car.

Thank you for your attention. And thank you once again, for being here today.

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5th December 2014