CENTRAL BANK OF NIGERIA

MONETARY POLICY REVIEW

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Central Bank of Nigeria

Mandate

▪Ensure monetary and price stability

▪Issue legal tender currency in Nigeria

▪Promote a sound financial system in Nigeria

▪Maintain external reserves to safeguard the international value of the legal tender currency

▪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

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STATEMENT BY THE GOVERNOR

Monetary policy environment in the review period was characterized by the complex challenge of managing the threat of inflationary pressure in the face of slowdown in output. It had been anticipated that movements in prices would show reasonable deceleration towards the end of the second half of 2012 as the effects of the partial removal of fuel subsidy in January 2012 waned. Against expectations, there was renewed threat to price stability as the economy was confronted with additional shocks in form of unprecedented and highly devastating flood, reinforced by other upside risks including upward adjustment in electricity and import tariffs in the second half 2012.

Liquidity surfeit in the banking system resulting from fiscal expansion and general improvements in DMB balance sheets found outlet in the foreign exchange market exerting pressure on the naira. At the same time, dark clouds continued to dot the global economy creating uncertainty over the fiscal cliff in the US and the euro zone, which was declared officially to be in recession. The domestic financial market, however, benefited from the third round quantitative easing in the US and the monetary easing of some major central banks through portfolio flows although with heightened apprehension about the risk of capital reversal.

In the light of these developments, therefore, the use of monetary policy as a stabilization instrument almost reached its limit, requiring strong complimentary measures including broad structural reforms that could address the various bottlenecks in the production and distribution process. Given the preference for financial stability in relation to growth, the monetary authority strengthened the tightening stance which commenced in the third quarter of 2010 by raising the Cash Ratio Requirement (CRR) by 400 basis points while the Net Open Position (NOP) for authorized dealers was reduced by 200 basis points.

There could be some grounds to express skepticism about the gains of the various measures relative to the cost in terms of persistent elevated lending rates but the success story in the period could better be appreciated through a counterfactual analysis. Despite the rising global food and energy prices, core inflation was largely subdued by end-December 2012 due mainly to the low pass-through on imported foods resulting from the relative stability in the exchange rate. Furthermore, the confidence of the global community in Nigeria's macroeconomic environment led to the inclusion of the FGN bond in the JP Morgan bond Index for emerging economies with the attendant decline in yield.

On the whole, the entire process of monetary policy process was fraught with difficult choices in the review period but it is heartwarming that the outcomes considerably justified the enormous resources invested thereon. Evolving signals from both the international and domestic environments do not suggest much optimism in the near to medium term but the monetary authority would continue to proactively respond to the various challenges with a view to fostering a stable and robust macroeconomic environment.

Sanusi Lamido Sanusi, CON
Governor,
Central Bank of Nigeria.

CHAPTER 1
OVERVIEW

…monetary policy environment in the second half of 2012 was characterized by the need to strike a delicate balance between halting the declining trend in output growth and rising inflationary pressures.

The monetary policy environment in the second half of 2012 was characterized by continuing threat of inflationary pressures against the backdrop of declining trend in output growth. Other key concerns included sustaining a stable exchange rate for the naira, creating a buffer for the external reserves, sustaining stability in money market rates, narrowing the spread between the lending and deposit rates and mitigating the impact of the continued slowdown in global economic activities on the domestic economy. In view of these multi-dimensional challenges, monetary policy during the period focused on deploying the mix of appropriate instruments to deliver on price stability. In addition, the slow pace of recovery in the advanced economies, the reduced growth momentum in the emerging economies and the prolonged financial fragilities in the Euro Area were some of the key considerations that defined the thrust of monetary policy in the period

The Bank continued with tight monetary policy stance, which commenced in the fourth quarter of 2011…

Accordingly, the Bank continued with its tight monetary policy stance, which commenced in the third quarter of 2010, using the Monetary Policy Rate (MPR) as the signaling interest rate to affect money supply and rein-in inflation expectations. Open Market Operations (OMO) continued to be used as the main instrument of monetary policy, supplemented by Repurchase Agreements and Discount Window Operations to ensure optimal liquidity management. These tools were complemented with prudential requirements such as cash reserve requirement (CRR), liquidity ratio (LR) and foreign exchange Net Open Position (NOP) limit for Deposit Money Banks. Primary market transactions in government securities and foreign exchange market interventions were also used for monetary management. The Bank sustained efforts towards improving communication with market operators and other stakeholders.

The Monetary Policy Committee (MPC) held three regular meetings in the review period, during which it maintained the

MPR at 12.0 per cent with a symmetric corridor of +/- 200 basis points. To further sustain the tightening stance, CRR was raised from 8.0 to 12.0 per cent and NOP limit reduced from 3.0 to 1.0 per cent at the July 2012 meeting. The LR was retained at 30.0 per cent with the mid-point of exchange rate maintained at N155/US$ within a band of +/-3.0 per cent.

Growth in the monetary aggregates was generally below the benchmark during the period.

Growth in the monetary aggregates was generally below the benchmark during the period. Broad money (M2) grew by 13.72 per cent as at end-December 2012 which was lower than the target of 24.64 per cent and 15.43 per cent at end-December 2011. This development reflected the contraction in net domestic assets, particularly credit to government, which declined substantially in the review period relative to the end-December 2011 level. The phenomenon was as a result of the persistence of government as a net creditor to the banking system due to more prudent fiscal measures and the introduction of the Treasury Single Account (TSA). The sluggish growth in the overall monetary aggregates notwithstanding, the net foreign asset (NFA) recorded a significant growth of 27.46 per cent which was higher than the benchmark of 6.6 per cent. The impressive growth rate in the NFA was as a result of the high price of crude oil throughout the year, relaxation of regulation on capital flows and the relatively high rate of returns on domestic fixed income financial assets.

Inflation environment remained uncertain and unlike in the past trend, the pressures emanated mostly from the core component.

Headline inflation moderated slightly during the review period relative to the first half of the year. Headline inflation, however, remained generally high with the pressure originating mostly from its core component. Both pull and push factors were at play in driving up domestic prices during the period. The demand pull factors were mainly from fiscal operations of the Federal Government and monetized capital inflows following the third quantitative easing in the US and ECB which resulted in substantial increase in domestic liquidity. The cost-push factors included the lagged effects of the partial removal of petroleum subsidy in the first half of the year, upward review of electricity tariff and import duty on wheat and rice. Added to these was the supply shock due to the highly devastating flood that ravaged most parts of the country especially the food producing belt during the review period.

Headline inflation (year-on-year) stood at 12.0 per cent at end-December 2012, slightly lower than 12.9 per cent at the end of first half of the year, but higher than the level recorded in the corresponding period of 2011 by 1.7 percentage points. Similarly, core Inflation which stood at 13.7 per cent was lower than the 15.2 per cent recorded at the end of first half of the year, but higher than the level recorded in the corresponding period of 2011 by 2.9 percentage points. Unlike headline and core inflation, food Inflation at 10.2 per cent was 1.8 and 0.8 percentage points lower than the levels at the end of first half and the corresponding period of 2011, respectively. Nonetheless, the relatively stable naira exchange rate, the lower-than-programmed expansion in the monetary aggregates and the generally tight monetary policy stance had moderating effects on consumer prices during the period.

Demand pressure moderated considerably at the wholesale Dutch Auction System (wDAS) segment... exchange rate experienced appreciation at the wDAS, Interbank and BDC's segments...

Following the success of the resolution of the banking system crisis, the domestic financial markets stabilized to play key roles in the transmission of monetary policy impulses to the real economy. Thus, improved banking system stability helped to promote the effectiveness of monetary policy during the review period. As a direct consequence of the tight monetary policy, short-term interest rates were largely within the MPR corridor. With the standing lending facility at 14.0 per cent (MPR+200 basis points), interbank interest rates were relatively less volatile. In addition, the implementation of administrative measures such as the prohibition of concurrent dealings in wDAS and the Bank's lending window had quite salutary impact on market activities in the review period. The average interbank call and open buy back (OBB) rates declined by 304 and 299 basis points to 11.88 and 11.73 per cent in December 2012 from 14.92 and 14.72 per cent in June 2012, respectively.

.. major challenge, however, was the sustained elevated lending rate as well as the persistence of asymmetry in deposit and lending rates.

There was an upward movement in interest rates in the credit market reflecting the tight stance of monetary policy. A major challenge, however, was the sustained elevated lending rate as well as the persistence of asymmetric response to policy rate between deposit and lending rates. The prime lending rate decreased marginally to 16.54 per cent at end-December 2012 from 16.75 per cent at end-December 2011. The average maximum lending rate rose to 24.61 per cent in December

2012 from 23.21 per cent in December 2011. The average consolidated deposit rate rose to 3.77 per cent in December 2012 from 3.09 per cent in December 2011; thus widening the spread between the maximum lending and consolidated deposit rates to 20.84 from 20.12 per cent in the review period.

Demand pressure moderated considerably at the wholesale Dutch Auction System (wDAS) segment of the foreign exchange market. In the review period, total demand at the wDAS segment reduced by 25.9 per cent compared with the first half of 2012 and by 56.5 per cent compared with the corresponding period of 2011. The development was due to the effectiveness of monetary policy instruments deployed during the period. In particular, the reduction in the NOP from 3.0 to 1.0 per cent and increase in CRR from 8.0 to 12.0 per cent succeeded in reducing speculative demand. In addition, the restriction of authorised dealers from accessing the standing lending facility and the wDAS concurrently had moderating effect on the demand for foreign exchange. As a result, the exchange rate appreciated by 0.11, 3.56 and 3.14 per cent at the wDAS, Interbank and Bureau de Change (BDC) segments, respectively.

During the second half of 2012, the Federal Government of Nigeria (FGN) bonds and Nigerian Treasury Bills (NTBs) auctions were over-subscribed due to the attractive yields on the instruments and the increased appetite of local and foreign investors in the Nigerian government-issued fixed income securities. This positive development was due to improvements in macroeconomic management. In addition, the inclusion of FGN bonds in the JP Morgan Government Bonds Index of Emerging Markets (GBI-EM) and other international rating agencies substantially improved investor confidence in the sovereign securities.

There was significant improvement in stock market activities during the review period. The Nigerian Stock Exchange All-Share Index (ASI) increased by 30.0 per cent compared with the end-June 2012 level and by 35.45 per cent compared with the end-December 2011 level. Similarly, Market Capitalisation (MC) for equities increased by 30.0 per cent compared with the end-June 2012 level and by 37.37 per cent compared with the end-December 2011 level. The development resulted from the salutary impact of the regulatory reforms and the accompanying significant capital inflows traced to the favourable macroeconomic environment.

Domestic output growth remained resilient despite the severe weaknesses in the global economy. However, real sector performance showed a slight decline in the review period as data from the National Bureau of Statistics (NBS) indicated that GDP growth rate slowed to 6.99 per cent in second half of 2012 from 7.76 per cent in the second half of 2011. Although, the non-oil sector remained the major driver of growth during the period, it exhibited a declining trend in its contribution to overall GDP. In particular, the agricultural; and wholesale and retail trade sectors experienced declining growth due to flood and security challenges which affected economic activities in most parts of the country. In view of the limitations of monetary policy in inducing long-term growth in the face of structural deficiencies, the Monetary Policy Committee (MPC) reiterated the need for supportive fiscal and structural reform and policies in key areas of power and other infrastructure.

Economic outlook in the near term suggest that output is expected to remain sluggish in the advanced economies while it would be relatively robust in the emerging and developing economies. Overall, global growth by the IMF is projected at 3.5 per cent in 2013, representing a modest improvement over the 3.2 per cent recorded in 2012. Improvement in global output notwithstanding, unemployment is likely to stay elevated in many parts of the world, especially in the euro area. Output growth in the domestic economy is expected to improve to 6.8 per cent in 2013 due to favourable macroeconomic conditions arising from reform measures. Key risks to output growth in the near term include the aftermath of severe flooding in several parts of the country in 2012. In addition, the lingering security challenges as well as delays in reform of critical sectors could undermine investor-confidence and output growth.

According to the World Bank, global inflation is expected to moderate slightly within the range of 3.5 – 4.0 per cent in 2013 which is close to 3.9 per cent reported for 2012. In the advanced economies consumer price is expected to moderate from 2.0 per cent in 2012 to 1.6 per cent in 2013, while in the emerging economies prices are expected to remain unchanged at 6.1 per cent in 2013 (WEO). Staff forecast indicated that inflation would moderate in the domestic economy to 8.5 per cent in the first half of 2013 based on the sustenance of tight stance of monetary policy.

CHAPTER 2

DOMESTIC PRICE DEVELOPMENTS AND THE REAL ECONOMY

Inflationary pressures moderated following the diminishing effects of the partial removal of subsidy on premium motor spirit (PMS) and higher electricity tariff

In the second half of 2012, inflationary pressures moderated slightly following the diminishing effects of the partial removal of subsidy on premium motor spirit (PMS) in January 2012. The moderation was complemented by the sustained tight monetary policy stance of the Bank and the relative stability in the exchange rate of the naira. While domestic output in 2012 remained strong, compared with 2011, there was a decline partly traced to the impact of widespread flooding which ravaged most farmlands along the major agricultural belt of the country as well as higher electricity tariff and imported food inflation.

2.1 Domestic Economic Activity

Domestic output growth remained resilient despite flooding in most parts of the country, incessant security challenges and the slow pace of recovery in the global economy. Growth in real Gross Domestic Product (GDP) in both oil and non-oil sectors were, however, lower in 2012 relative to 2011. Real GDP stood at 6.99 per cent compared with 6.39 per cent in the first half of 2012 and 7.76 per cent in the corresponding period of 2011. The contribution of the oil sector to real GDP declined to 12.59 per cent in the second half of 2012 from 13.86 per cent in the first half and 13.57 per cent in the corresponding period of 2011. The decline was attributed to disruptions in production due to facility shut downs and pipeline vandalism.

The non-oil sector remained the major driver of growth at 8.22 per cent rate in the second half of 2012 compared with the 0.11 per cent drop in the oil sector. In the non-oil sector, contributions from agriculture; and wholesale and retail trade to overall growth declined to 1.43 and 2.22 percentage points, respectively, compared with 2.31 and 2.26 percentage points recorded in the second half of 2011. The slowdown in the contribution of agriculture to output growth was attributed to the flood and security challenges, which affected farming activities in some parts of the country during the review period.

In addition, the decline in the contribution of the wholesale and retail trade sector was due to the prevailing security challenges in the country, which affected distribution channels for most products thereby exacerbating the structural rigidities and infrastructural deficiencies.

The index of industrial production rose to 137.59 (1990=100) in the second half of 2012, compared with 136.30 in the first half and 135.10 in the corresponding period of 2011. This represented an increase of 0.95 per cent over the first half and 1.84 per cent in the corresponding period of 2011. Similarly, the index of manufacturing production stood at 106.80 (1990=100) in the second half of 2012 compared with 106.10 in the first half and 98.88 in the corresponding period of 2011. This represented an increase of 0.66 per cent over the level in the first half and 8.0 per cent in the corresponding period of 2011. Likewise, the index of mining production at 146.96 (1990=100), was 0.18 per cent higher than the 146.70 recorded during the first half of 2012. The noticeable improvements in some of these indices were attributed largely to the steady power supply, increased production in the cement industry and the value-chain initiatives of the government.

In addition, the slow rate of domestic output growth in 2012 relative to 2011, were traceable to developments in the global economy, which included lingering sovereign debt crisis, financial sector fragilities in the euro zone and the unresolved US fiscal cliff.

2.2 Trends in Inflation

….Headline inflation (year-on-year) moderated in the second half of 2012 to 12.0 per cent by end-December, from 12.9 per cent end-June 2012

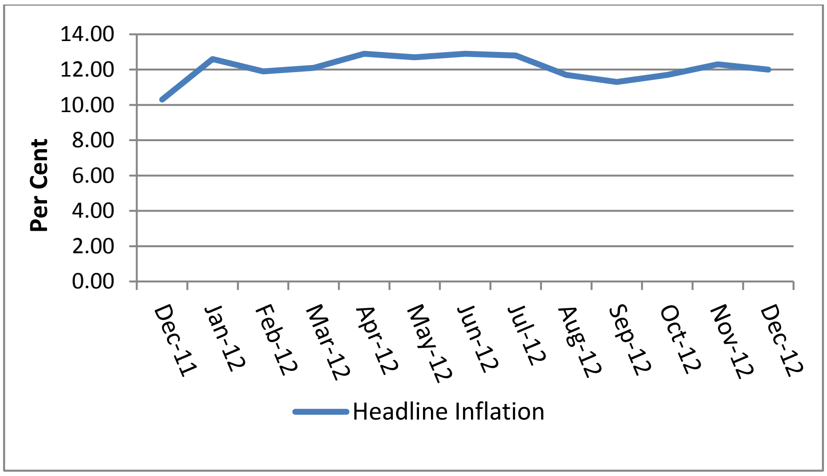
Consumer prices moderated in the second half of 2012 due to the waning effects of the increase in prices of petroleum products in January and the sustained tight monetary policy. Inflationary pressures were, however, heightened by the increased tariffs on electricity, import duty on rice and wheat; implemented in July 2012 and the effects of the flood in some parts of the country, which affected agricultural output and distribution channels.

Headline inflation (year-on-year) moderated in the second half of 2012 to 12.0 per cent at end-December, from 12.8 per cent at end-June 2012, which was however, higher than the 10.3 per cent attained at end-December 2011. The major drivers of headline inflation for end-December 2012 included food and non-alcoholic beverages, housing, water, electricity and transport.

Food inflation (year-on-year) also moderated to 10.2 per cent by end-December 2012, compared with 12.1 and 11.0 per cent at end-June 2012 and December 2011, respectively. The moderation was partially due to farm produce component of food inflation which dropped by 1.9 percentage points as a result of the harvest season.

Core inflation (year-on-year) decelerated to 13.7 per cent by end-December 2012 from 15.0 per cent at end-June 2012, which was, however, higher than the 10.8 per cent achieved at end- December 2011.

Figure 2.1
Headline Inflation (December 2011 – December 2012)



Source: NBS

The core and food components of the consumer price index increased from 138.0 and 134.5, at end-June 2012 to 141.80 and 141.20, respectively (Table 2.1). The index of core inflation increased by 3.8 points, while that of food rose by 6.7 points. In effect, the food components of inflation exerted greater pressure on headline inflation.

Table 2.1
Inflation Rate (December 2011 – December 2012)

	Headline Inflation			Core Inflation			Food Inflation		
Date	CPI	Y-on-Y	12-MMA	CPI	Y-on-Y	12-MMA	CPI	Y-on-Y	12-MMA
Dec-11	126.00	10.30	10.80	124.80	10.80	11.70	128.10	11.00	10.30
Jan-12	130.20	12.60	10.90	129.10	12.70	11.80	129.30	13.10	10.50
Feb-12	130.50	11.90	11.00	129.30	11.90	11.90	129.10	9.70	10.30
Mar-12	132.60	12.10	10.90	135.10	15.00	12.10	132.10	11.80	10.30
Apr-12	132.80	12.90	11.10	135.20	14.70	12.20	132.30	11.20	10.30
May-12	133.80	12.70	11.10	136.70	14.90	12.40	133.90	12.90	10.40
Jun-12	135.30	12.90	11.30	138.00	15.20	12.70	134.50	12.00	10.60
Jul-12	135.70	12.80	11.60	138.10	15.00	13.00	135.00	12.10	11.00
Aug-12	136.60	11.70	11.80	139.00	14.70	13.30	135.90	9.90	11.10
Sep-12	138.00	11.30	11.90	139.70	13.10	13.50	137.50	10.20	11.10
Oct-12	139.20	11.70	11.90	140.30	12.40	13.50	138.80	11.10	11.20
Nov-12	140.00	12.30	12.10	140.90	13.10	13.60	139.80	11.60	11.40
Dec-12	141.10	12.00	12.20	141.80	13.70	13.90	141.20	10.20	11.30

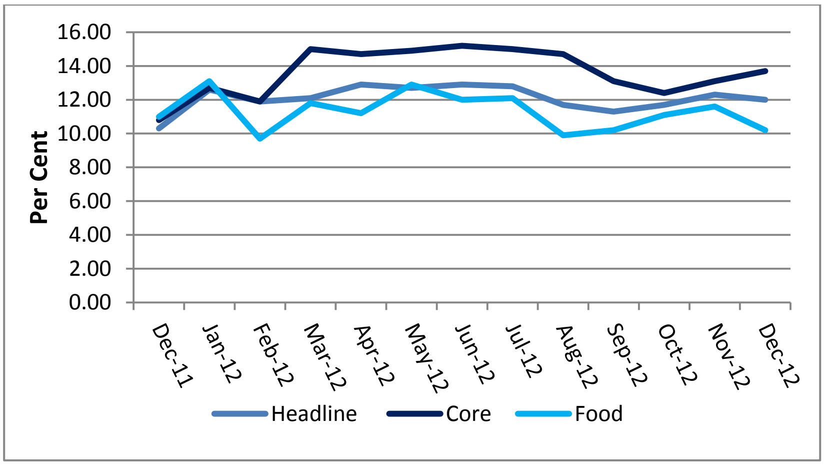
Source: National Bureau of Statistics (NBS)

Table 2.2
Quarterly Consumer Price Development
(November 2009=100)

	12-Mar		12-Jun		12-Sep		12-Dec	
	Y-on-Y	12-MMA	Y-on-Y	12-MMA	Y-on-Y	12-MMA	Y-on-Y	12-MMA
Headline	12.10	10.90	12.90	11.30	11.30	11.90	12.00	12.20
Core	15.00	12.10	15.20	12.70	13.10	13.50	13.70	13.90
Food	11.80	10.30	12.00	10.60	10.20	11.10	10.20	11.30

Source: National Bureau of Statistics (NBS)

Figure 2.2
Headline, Core and Food Inflation (Y – Y)
(December 2011 - December 2012)



Source: NBS

In terms of food inflation, the contribution of processed food increased from 4.3 to 4.4 per cent between July and December, 2012. On the other hand, the contribution of farm produce declined from 7.7 per cent at end-June 2012 to 5.8 per cent at end-December 2012. Further analysis showed that meat; fruits; and yams, potatoes and other tubers declined from 1.3, 0.4, and 1.8 per cent at end-June to 1.14, 0.29, and 1.17 per cent, respectively, in December 2012 (Table 2.3).

Table 2.3
Selected CPI Components' Contribution to
Food Inflation (Year-on-Year) (July – December 2012)

Date	12-Jun	12-Jul	12-Aug	12-Sep	12-Oct	12-Nov	12-Dec
Food	12.0	12.1	9.9	10.2	11.1	11.6	10.2
Processed Food	4.3	4.2	3.6	3.1	3.7	4.5	4.4
Farm Produce	7.7	7.9	6.4	7.1	7.3	7.1	5.8
Meat	1.3	1.4	1.3	1.2	1.4	1.4	1.1
Fruits	0.4	0.4	0.3	0.3	0.3	0.4	0.3
Yams, Potatoes & Other Tuber	1.8	1.8	1.4	1.4	1.5	1.5	1.2

Source: NBS

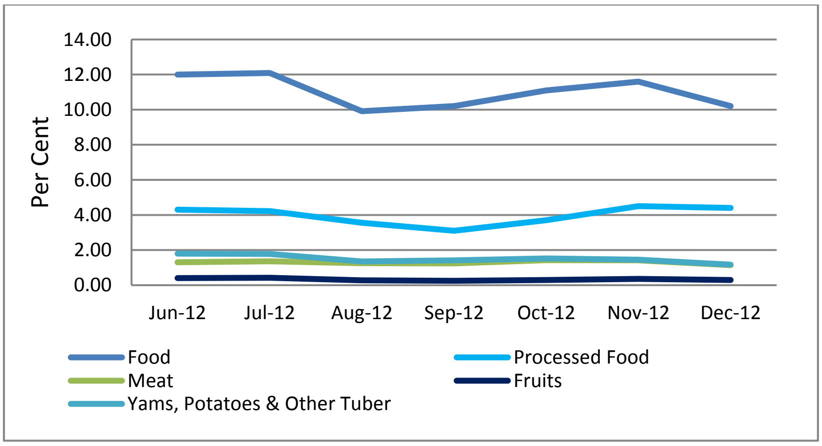
Analysis of core inflation showed that of all the components, housing, water, electricity, gas & other fuels contributed less to inflation during the second half of 2012, as it declined from 4.9 per cent in June to 4.0 per cent in December, 2012. Also, the contributions of transport; and furnishings, household (HH) equipment & HH maintenance, decreased from 1.4 and 1.0 to 1.3 and 0.9 per cent in June and December 2012, respectively. However, the contribution of education to core inflation stabilised at 0.7 per cent during the period (Table 2.4).

Table 2.4
Selected CPI Components' Contribution to Core Inflation
(Year-on-Year) (July – December 2012)

Date	12-Jun	12-Jul	12-Aug	12-Sep	12-Oct	12-Nov	12-Dec
Core	**15.2**	**15.0**	**14.7**	**13.1**	**12.4**	**13.1**	**13.7**
Housing, Water, Electricity, Gas & Other fuel	4.9	4.7	4.5	4.5	4.2	4.4	4.0
Transport	1.4	1.2	1.2	1.1	1.1	1.1	1.3
Furnishings, Household Equip. & HH Maint.	1.0	0.8	0.8	0.8	0.7	0.7	0.9
Education	0.7	0.7	0.7	0.6	0.6	0.6	0.7

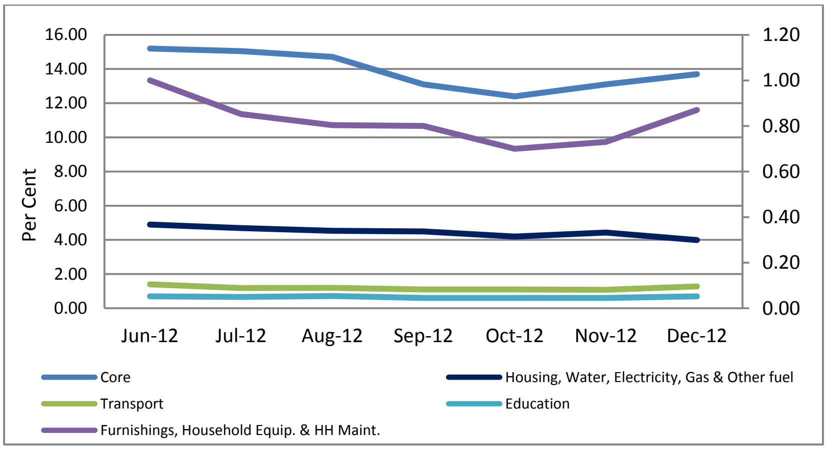
Source: NBS

Figure 2.3
Selected CPI Components' Contribution to Food Inflation (Year-on-Year) (June – December 2012)



Source: NBS

Figure 2.4
Selected CPI Components' Contribution to Core Inflation (Year-on-Year) (July – December 2012)

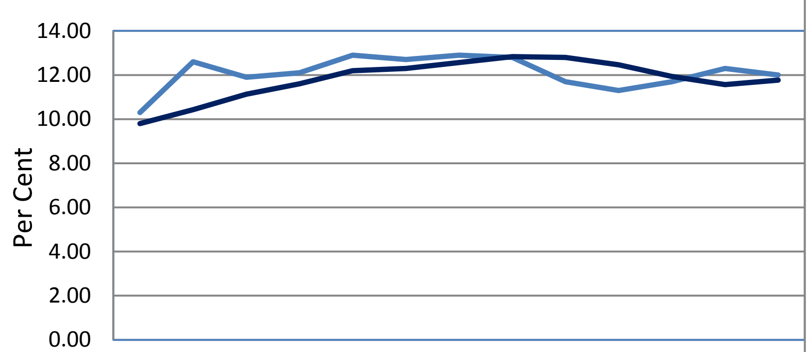


Source: NBS

2.3 Actual and Seasonally Adjusted Headline Inflation

During the period under review, the seasonally adjusted inflation rate was higher than the actual inflation between July and October 2012. The development was attributed to the commencement of the harvesting season which increased food availability and exerted downward pressure on domestic food prices. In November and December, however, actual inflation rose above the seasonally adjusted inflation due to the effects of the nationwide flooding that ravaged most states in the country (which affected the harvest of late maturing crops) as well as increase in expenditure associated with the year-end festivities.

Figure 2.5
Actual and Seasonally Adjusted Headline Inflation
(December 2011 – December 2012)



	Dec-11	Jan-12	Feb-12	Mar-12	Apr-12	May-12	Jun-12	Jul-12	Aug-12	Sep-12	Oct-12	Nov-12	Dec-12
Inflation	10.30	12.60	11.90	12.10	12.90	12.70	12.90	12.80	11.70	11.30	11.70	12.30	12.00
Inflation SA	9.80	10.43	11.13	11.60	12.20	12.30	12.57	12.83	12.80	12.47	11.93	11.57	11.77

Source: NBS

2.4 Key Factors that Influenced the Domestic Price Level

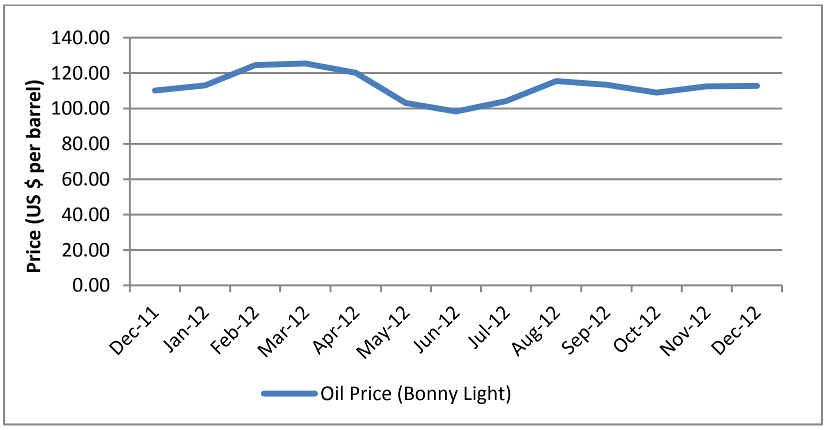
During the second half of 2012, both demand-pull and cost-push factors influenced price developments. There were also other factors which helped to mitigate inflationary pressures during the period under review.

2.4.1 Demand-Pull Factors

The late implementation of the capital budget for the second quarter of 2012 and the implementation of the third and fourth quarter capital budgets during the second half, led to substantial injection of funds beyond what was earlier earmarked for the period. The substantial injection of funds created additional liquidity which mounted pressure on domestic prices during the review period.

In addition, high oil prices experienced during the review period boosted overall federation revenues and supported higher levels of public expenditure across the three tiers of government. These factors contributed to increased demand, which helped to fuel inflation.

Figure 2.6
Bonny Light Crude Oil Price
(December 2011 – December 2012)



Source: Bloomberg

2.4.2. Cost-Push Factors

In the second half of the year, the displacement of farmers in some parts of the country due to flood and insecurity accounted substantially for the drop in agricultural output as a percentage of GDP in the review period. The decline in agricultural output and incessant security challenges hampered effective distribution of agricultural products, accentuating higher food prices.

Although the partial withdrawal of petroleum subsidy took place in the first half of 2012, the spiral and lag effects were still noticeable during the second half of 2012, especially through its primary effect on energy and transport costs and secondary effects on other prices.

The upward review of tariffs on electricity, imported rice and wheat which took effect from July 1, 2012 further exerted pressure on domestic prices, especially core inflation. The increase in imported food prices, which rose from 132.4 per cent in July 2012 to 134.5 in October and further to 136.7 at end-December 2012, was due to rising global food inflation traced to severe drought in the US, Europe and Central Asia;

and flooding in Thailand and India, which negatively impacted food production.

2.4.3 Moderating Factors

The Bank continued the tight monetary policy stance, which commenced in the fourth quarter of 2010. The policy was aimed at moderating inflationary pressures to achieve its price stability mandate.

Against the background of high liquidity in the banking system and the resulting demand pressure in the foreign exchange market, the MPC at its July 2012 meeting raised the CRR from 8.0 to 12.0 per cent and reduced the Net Open Position (NOP) of the DMBs from 3.0 to 1.0 per cent. In addition, the Committee also retained the Monetary Policy Rate at 12.0 per cent with symmetric corridors of +/- 200 basis points. Apart from controlling inflation, these policy measures were meant to sustain the stability of the naira exchange rate and help in building-up external reserves.

Other measures taken to moderate inflation during the review period were the reduction in multiple accounts by the Federal Government through the implementation of the Treasury Single Account, increased recourse to bond financing of government deficits and the substantial sale of CBN bills.

In summary, despite the impact of floods on agricultural output and structural and infrastructural deficiencies in the economy, the sustained tight monetary policy posture of the CBN during the second half of 2012 contributed in moderating the threat of inflationary pressures

Box 1

The Nigeria 2012 Flood Disaster and Monetary Policy

The 2012 flood disaster in Nigeria has been described as the worst in a century given its coverage and magnitude of devastation. The flood, which ravaged twelve states comprising Rivers, Niger, Benue, Sokoto, Katsina, Lagos, Ondo, Delta, Rivers, AkwaIbom, Bayelsa and Cross River states resulted in the loss of 363 lives, injured 5,851 others, while 3,891,314 people were displaced and 59 communities completely sacked.

The National Emergency Management Authority (NEMA) reports that the flooding was caused by persistent heavy rains between July and October 2012, and the rising water level resulting in runoffs of major local dams such as the Kainji, Shiroro and Jebba on the Niger River, Lagdo Dam in the neighboring Cameroun on the Benue River, Kiri Dam on the Gongola River and several other irrigation dams and tributaries of the Rivers Niger and Benue. Consequently, apart from submerging homes and farmlands, there was an invasion of reptiles such as crocodiles, snakes and other dangerous aquatic animals that were thrown into the hinterland, which hastened the abandonment of homes and villages by coastal inhabitants.

The World Bank estimates the total social and economic costs of the flooding to be around N1.48 trillion or equivalent of $9.5 billion. The major sectors negatively impacted include Social (education, health and housing), production (Agriculture, manufacturing, commerce and Oil industry), infrastructure (water, sanitation, electricity and transport) and the cross-sectoral (environment). From the estimates, the shares of physical and durable assets were 57.0 per cent of the total flood effects, while production accounted for the remaining 43.0 per cent.

To mitigate the socio-economic impact of the flooding, the Federal Government released the sum of N17.6 billion as direct financial assistance to the affected states and government agencies responsible for disaster management. In addition, a disaster relief fund committee was inaugurated to raise financial resources to complement governments' financial and logistic intervention.

The Monetary Policy Committee (MPC) meetings of September and November 2012 considered two issues arising from the flood disaster that has implications for monetary policy. First, the inflationary impact of increased government expenditure as a result of the flood disaster intervention and relief fund. The second is the likely uptick in food inflation in the near-to-medium-term arising from the devastation of agricultural production and infrastructure. The Committee, in response to the anticipated downside risks to inflation objectives by the foregoing retained the tight stance of monetary policy to insulate the domestic economy from the adverse consequences of liquidity surfeit arising from increased government expenditure and likely rise in food prices as a result of the shortfall in domestic food production.

CHAPTER 3
MONETARY POLICY

Monetary policy in the second half of 2012 was mainly driven by the need to contain inflationary pressures……

The monetary policy environment in the second half of 2012 was characterized by inflationary pressures from the lag effect of the partial removal of subsidy on premium motor spirit (PMS), upward adjustment of tariffs on electricity and imported rice/wheat and flooding in the food producing belt of the country. In response, the Monetary Policy Committee (MPC) continued with the tight policy stance by raising the Cash Reserve Ratio (CRR) from 8.0 per cent to 12.0 per cent and lowering the Net Open Position (NOP) from 3.0 per cent to 1.0 per cent in July, 2012. The MPR was raised to and retained at 12.0 per cent at the three meetings of the MPC during the review period.

3.1 Highlights of Monetary Policy Measures

The MPR was unchanged at 12.0 percent in the three meetingsheld during the period.

The monetary policy stance of the Bank remained restrictive during the second half of 2012. The CRR was increased from 8.0 per cent to 12.0 per cent at the July 2012 MPC meeting and remained at that level throughout the review period. The foreign exchange NOP, which was reduced to 1.0 per cent from 3.0 per cent at the July 2012 MPC meeting, was also retained in subsequent meetings. In addition, the mid-point of the exchange rate remained at N155.00/US$1.00 with the band of +/- 3.0 per cent in order to sustain the stability of the exchange rate of the domestic currency, attract foreign investment and build-up external reserves.

Key considerations that informed the continuation of the tight monetary policy stance included the need to stabilise the exchange rate; the increase in import tariff on rice and wheat effective from July 2012; increase in electricity tariff effective from June 2012 and the impact of the flood on food production.

3.2 Decisions of the Monetary Policy Committee

Uncertain developments in the international and domestic economic environment shaped Monetary Policy Committee (MPC) decisions in the second half of 2012. Some of the challenges included the continued fragility in the global economy, weak domestic growth performance and outlook, threats of high inflation, unemployment and possible exchange rate depreciation.

In its July 2012 meeting, the MPC considered three options. The first was an expansionary stance by lowering MPR in view of the weakening domestic growth and the need to boost credit to the economy and stimulate growth. However, the Committee noted the slow pace of structural reforms and the limitations of monetary policy to ensure sustained growth in an economy with weak infrastructure base and poor implementation of capital budgets. The second was to pursue a contractionary policy by increasing the MPR specifically to moderate inflation and stabilize domestic price movements. The Committee acknowledged the threat of inflation but noted the negative impact of high interest rates on small and medium scale businesses. Second, high interest rates impact negatively on the performance of risk assets in DMBs balance sheets and the growth consequences for declining domestic credit to the economy. The third option was to adopt a neutral policy stance by leaving MPR unchanged in spite of inflationary pressures from both domestic and international developments. Given the mixed signals from price movements, the likely speculative run on the naira as a result of growing banking system liquidity, and the uncertainty in global economic developments, the Committee opted to retain the MPR at 12.0 per cent with symmetric corridor of +/- 200 basis points. However, the CRR was increased from 8.0 to 12.0 per cent to contain liquidity surfeit in the banking system, while the foreign exchange Net Open Position was reduced from 3 percent to 1.0 per cent to avert speculative attacks on the Naira.

At the September 2012 meeting, the Committee noted that the continued fragility in the global economic conditions manifested in weak macroeconomic performance in some industrialized and emerging market economies. Specifically, the Committee was concerned about the weak global demand, elevated inflationary pressures, slow pace of growth in global trade, contracting fiscal space, especially in Europe and the US and declining investments. In contrast, the Committee noted with satisfaction some positive developments in domestic growth performance, which was mainly driven by improvements in agricultural production, declining insecurity and relative improvement in power supply and distribution. In addition, the period witnessed high oil prices and increased foreign portfolio inflows which sustained accretion to foreign reserves. The moderation in domestic inflation and sustained efforts by the government in structural reforms and fiscal consolidation pointed to recovery in the domestic economy and presented prospects for macroeconomic stability. Notwithstanding, the Committee cautioned against fiscal expansion predicated on favourable crude oil prices as this would threaten the inflation objective of the Bank. Against this backdrop, the Committee unanimously voted to maintain the tight policy stance by retaining the MPR at 12.0 per cent with +/- 200 basis points corridor, the CRR at 12.0 per cent and foreign exchange NOP at 1.0 per cent.

At the November 2012 meeting, the Committee observed that the global economy showed little signs of recovery as output continued to decline, caused mainly by weak growth performance in the euro area, Asia and other emerging market economies. Also, there was speculation that global recovery would be further challenged if the fiscal cliff in the US was not resolved. Weak global recovery manifested in rising unemployment rates, fragile financial conditions and housing markets as well as deterioration in public and private balance sheets, which negatively impacted on oil export and foreign capital inflow to developing and emerging markets, including Nigeria. On the domestic front, the real GDP growth rate was revised downward to 6.61 from 6.85 per cent by the National Bureau of Statistics (NBS). Furthermore, inflationary pressures re-emerged in October 2012, in spite of the moderation in core inflation to 12.40 from 13.10 per cent. The Committee noted with concern some structural elements in the inflation threat, which was beyond the scope of monetary policy. However, there was improvement in reserve accretion of $10.27 billion or 29.0 percent to US$45.68 billion as at November 15, 2012 from US$ 35.41 billion at end-June 2012.

The Committee, in considering the options available for monetary policy, noted that the uncertainty in the global economy posed downside risks to the sustenance of growth prospects in the domestic economy. In addition, the domestic economy, in its opinion, had not achieved sufficient stability to warrant a reversal of the tight stance of monetary policy. The committee, therefore, unanimously voted to retain the MPR at 12.0 per cent with a corridor of +/- 200 basis points; retain the CRR at 12.0 per cent and the Liquidity Ratio at 30.0 per cent.

Table 3.1
MPC Decisions, July – November, 2012

Items	July	September	November
MPR	Retain the MPR at 12%	Retain the MPR at 12%	Retain the MPR at 12%
MPR Corridor	Maintain +/- 200 basis points	Maintain +/- 200 basis points	Maintain +/- 200 basis points
SDF Rate	Maintain at 10%	Maintain at 10%	Maintain at 10%
SLF Rate	Maintain at 14%	Maintain at 14%	Maintain at 14%
CRR	Raise to 12% from 8%	Retain at 12%	Retain at 12%
LR	Retain at 30%	Retain at 30%	Retain at 30%
NOP	Reduce to 1% from 3%	Retain at 1%	Retain at 1%
FX Rate Mid – Point	Retain at N155/US$1	Retain at N155/US$1	Retain at N155/US$1
FX Band	Maintain +/-3 per cent band	Maintain +/-3 per cent band	Maintain +/-3 per cent band

3.3 Monetary Policy Instruments

In consideration of the overriding goal of price stability and the need to create an environment conducive to local and international investments, the MPC deployed a number of instruments, notably MPR complemented by CRR, Open Market Operations (OMO) and Discount Window Operations. The choice of these instruments was guided by the need for stability in the domestic macroeconomic environment.

3.3.1 Monetary Policy Rate (MPR)

The MPR, the Bank's benchmark policy rate, remained the major signaling instrument accompanied by interest rate corridor (standing lending/deposit facility rates). The Committee kept the MPR unchanged at 12.0 per cent during the three regular meetings held in the second half of 2012.

3.3.2 Reserve Requirements

The Bank retained the use of reserve requirements (Cash Reserve and Liquidity Ratios) in the review period to complement OMO and other instruments of liquidity management. The Cash Reserve Ratio was increased from 8.0 to 12.0 per cent, while the Liquidity Ratio was unchanged at 30.0 per cent in the second half of 2012. The increase in CRR was to address excess liquidity and demand pressure on the Naira.

3.3.3 Open Market Operations (OMO)

Actual sales, however, amounted to N2,795.58 billion in the second half of 2012,compared with N1,717.35 billion in the first half of2012….

The Bank continued to use OMO as the major medium for liquidity and monetary management. The CBN Bills were the main securities for OMO during the period. Total OMO securities offered was ₦4,061.00 billion, while subscription was ₦4,678.23 billion. Actual sales amounted to ₦2,795.58 billion in the second half of 2012, compared with ₦1,717.35 billion in the first half of 2012 and ₦1,582.02 billion in the corresponding period of 2011. This represented an increase of 62.8 and 17.1 per cent, respectively. The increase in OMO sales was attributed to the impact of monetization of AMCON bonds, attractive long dated bills and augmentation from excess crude account. Public subscription and sales in the review period were remarkably higher than the preceding period due to huge liquidity that prevailed, the greater frequency of auctions and attractive yields.

Table 3.2
CBN OMO Bills Auction (N'million) January 2009 – December 2012

Date	2009	2010	2011	2012	% Change over the Previous Period
Jan	115.47	149.83	205.59	246.64	
Feb	80.11	100.22	216.92	297.70	
Mar	80.00	65.00	284.06	491.59	
Apr	101.36	160.49	215.07	304.18	
May	120.22	100.22	204.60	363.13	
Jun	120.00	158.70	340.24	14.12	
1st Half	**617.16**	**734.46**	**1466.48**	**1717.35**	**8.60**
Jul	125.36	250.91	209.74	0.05	
Aug	105.22	141.16	218.92	4.50	
Sep	91.76	206.57	280.57	318.42	
Oct	170.26	167.01	309.95	882.80	
Nov	120.22	205.93	242.93	939.54	
Dec	162.56	297.91	319.91	650.27	
2nd Half	**775.38**	**1269.49**	**1582.02**	**2795.58**	**62.70**
Cumulative Figure	**1392.54**	**,2003.95**	**3048.50**	**4518.18**	

3.4 Standing Facilities

The Bank's In the second half of 2012, DMBs and Discount Houses (DH) actively accessedthe Standing facilities (lending/deposit) to meet their daily liquidityneeds

In the second half of 2012, DMBs and Discount Houses (DHs) accessed the standing facilities (lending/deposit) to meet their daily liquidity requirements. However, there was a reduction in the cumulative volume of transactions at the CBN standing lending facility (SLF). SLF stood at ₦7,733.53 billion compared with ₦10,721.44 billion in the first half of 2012 and ₦25,047.27 billion in the corresponding period of 2011. The cumulative volume of SLF at end-December 2012 represented a decrease of 27.9 and 69.1 per cent, compared with the level in the first half of 2012 and the corresponding period of 2011, respectively (Table 3.3). The significant decrease in the volume of SLF transactions in the second half of 2012 was attributed to improvement in liquidity conditions in the banking system driven mainly by AMCON injections, huge repayments of matured FGN Bonds and CBN securities.

Table 3.3
CBN Standing Lending Facility (N'billion)
(January 2009- December 2012)

Date	2009	2010	2011	2012	% change over the preceding/corresponding period
Jan	846.18	135.50	565.51	939.16	66.07
Feb	3457.57	-	1369.60	1060.90	12.96
Mar	4592.69	-	3425.47	2053.62	93.57
Apr	3875.48	-	3328.35	1875.31	-8.68
May	2581.43	270.97	3722.41	1472.21	-21.50
Jun	3691.75	21.70	5217.30	3320.24	125.53
1st Half	**19045.11**	**428.17**	**17628.64**	**10721.44**	**-39.18**
Jul	4675.02	55.76	3334.91	3322.49	0.07
Aug	3733.78	-	2714.70	2235.59	-32.71
Sep	2287.90	73.10	7698.83	979.61	-56.18
Oct	1231.61	983.44	6675.79	319.72	-67.36
Nov	537.58	1374.80	2592.94	355.79	11.28
Dec	1022.60	853.50	2057.10	520.33	46.25
2nd Half	**13488.49**	**3340.60**	**25047.27**	**7733.53**	**-69.12**
Total	**32533.60**	**3768.77**	**42702.91**	**18454.97**	

There was a significant increase in the cumulative volume of transactions in the CBN Standing Deposit Facility (SDF) window in the review period. Cumulative volume of SDF stood at ₦9,885.25 billion in the second half of 2012, compared with ₦3,727.96 billion in the first half of 2012 and ₦1,435.82 billion in the corresponding period of 2011. The level of SDF as at end-December 2012 represented 165.2 and 588.5 per cent increases over the levels in the first half of 2011 and the corresponding period in 2011, respectively (Table 3.4). The observed increase in the use of SDF window reflected increased system-wide liquidity in the review period, compared with the corresponding period of 2011. Also, the increased cumulative volume of transactions on the SDF window resulted from the remuneration under the facility after October 2011 when reserve averaging scheme was suspended in favour of daily maintenance of CRR.

Table 3.4
CBN Standing Deposit Facility (N'billion)
(January 2009- December 2012)

Date	2009	2010	2011	2012	% change over the preceding/corresponding period
Jan	-	5,622.63	1,864.84	868.10	-53.45
Feb	-	6,101.90	721.62	788.26	-9.20
Mar	-	9,413.45	325.75	352.85	-55.24
Apr	-	6,853.06	49.65	201.00	-43.04
May	-	1,735.45	73.00	1242.50	518.20
Jun	-	5,563.64	97.18	275.25	-77.85
1st Half	-	**35,290.13**	**3,132.04**	**3727.96**	**19.03**
Jul	162.00	4,055.52	-	294.95	-
Aug	1453.38	6,849.71	-	980.55	-
Sep	1058.75	4,224.80	-	2130.35	-
Oct	3106.30	1,117.30	422.50	2408.70	13.07
Nov	1050.59	443.78	436.47	2363.53	-1.88
Dec	1797.92	1,191.78	576.85	1707.17	-27.77
2nd Half	**8628.94**	**17,882.89**	**1,435.82**	**9885.25**	**588.47**
Total	**8628.94**	**53,173.02**	**4,567.86**	**13613.21**	

3.5 Foreign Exchange Intervention

The Bank continued its intervention in the foreign exchange marketaimed at sustaining the stability of the naira.

The Bank continued its intervention in the foreign exchange market aimed at sustaining the stability of the Naira. Total supply of foreign exchange by the Bank in the review period stood at US$10,756.78 million, compared with US$13,861.67 million and US$23,458.70 million in the first half of 2012 and the corresponding period of 2011, respectively (Table 3.5). There was a significant decrease in total supply by 22.4 and 54.2per centfrom the levels in the first half and the corresponding period of 2011, respectively. The sharp decline in demand reflected the efficacy of measures to stop simultaneous access to the wDAS and SLF windows by the DMBs and close monitoring of the foreign exchange market. These measures were complemented by increased autonomous foreign exchange inflows due to high year round crude oil price; relaxation of regulations on capital flows as well as increased private capital inflow attracted by the relatively high rate of returns on the domestic financial assets.

Table 3.5
Foreign Exchange Supply by the CBN US$ million
(January 2010 – December 2012)

YEAR	2010			2011			2012		
	Sales to wDAS	Sales to BDC	Total Supply (wDAS + BDC)	Total wDAS sales	Sales to BDC	Total Supply (wDAS + BDC)	Sales to wDAS	Sales to BDC	Total Supply (wDAS + BDC)
Jan	1,461.8	429.2	1,890.9	2,000.0	135.5	2,135.5	1,640.7	365.7	2,006.4
Feb	1,838.9	279.0	2,117.9	1,794.9	300.0	2,094.9	1,942.2	720.6	2,662.8
Mar	1,582.0	482.2	2,064.2	3,274.4	330.5	3,604.9	1,452.8	698.2	2,150.9
Apr	1,841.1	306.1	2,147.1	2,385.6	322.3	2,707.8	891.5	492.8	1,384.3
May	2,707.5	277.3	2,984.8	2,825.2	392.0	3,217.2	1,487.0	625.5	2,112.5
Jun	2,284.0	657.5	2,941.4	2,895.0	347.3	3,242.3	3,000.0	544.8	3,544.8
1st Half	**11,715.1**	**2,431.2**	**14,146.4**	**15,175.0**	**1,827.7**	**17,002.7**	**10,414.1**	**3,447.6**	**13,861.7**
Jul	1,835.2	741.2	2,576.4	2,895.5	398.2	3,293.7	0.0	0.0	0.0
Aug	1,948.5	450.8	2,399.4	3,172.7	504.3	3,677.0	0.0	0.0	0.0
Sep	3,593.5	613.8	4,207.3	4,161.9	995.7	5,157.6	0.0	0.0	0.0
Oct	2,342.1	478.7	2,820.8	3,406.0	716.8	4,122.8	0.0	0.0	0.0
Nov	1,561.7	280.2	1,841.9	3,260.9	795.4	4,056.3	0.0	0.0	0.0
Dec	**1,839.1**	**341.1**	**2,180.2**	**2,475.8**	**675.7**	**3,151.5**	**0.0**	**0.0**	**0.0**
2nd Half	**13,120.2**	**2,905.8**	**16,026.0**	**19,372.8**	**4,085.9**	**23,458.7**	**0.0**	**0.0**	**0.0**
Total	**24,835.3**	**5,337.0**	**30,172.3**	**34,547.8**	**5,913.6**	**40,461.4**	**10,414.1**	**3,447.6**	**13,861.7**

3.6 Performance of Monetary Aggregates

The end-December level was N1,448.87 billion (8.74 per cent) below the 2012 end-December benchmark…

Broad money stock (M2) grew by 12.9 per cent to ₦15,483.85 billion at end-December 2012 from ₦13,483.06 billion at end-June 2012. The end-December 2012 level was 7.1 per cent below the benchmark of ₦16,577.53 billion. The year-on-year growth at 16.4 per cent was below the benchmark growth of 24.6 per cent.

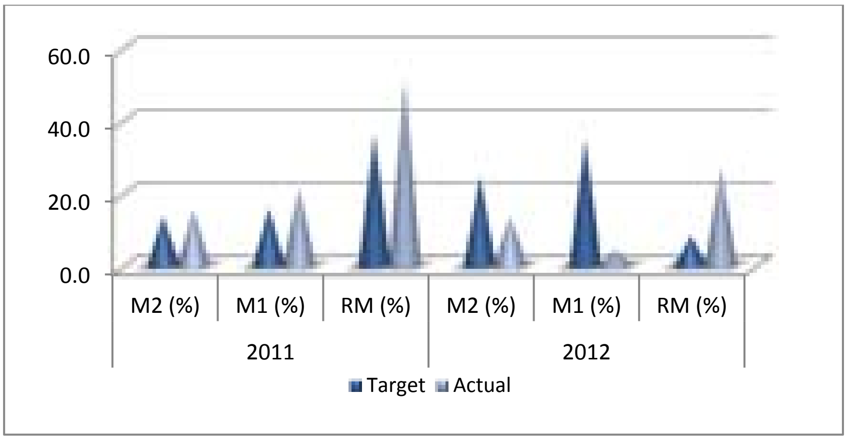
Narrow money (M1) grew by 11.1 per cent to ₦7,420.95 billion at end-December 2012 from ₦6,599.39 billion at end-June 2012. The end-December level was 22.9 per cent below the benchmark of ₦9,117.64 billion. The year-on-year growth in M1 at 9.6 per cent was lower than the benchmark of 34.7 per cent. The performance of the monetary aggregates in the review period reflected the tight monetary policy stance of the Bank and effective management of government liquidity position following the implementation of the Treasury Single

Account (TSA), increased recourse to bond financing of deficit and substantial OMO sales. These developments effectively made the FGN a net creditor of the banking system during the review period.

Table 3.6
Performance of Monetary Aggregates
(December 2011 – December 2012)

	2011	**2012**				**Change in H1 2012**	**Change in H2 2012**
	Actual Dec 2011	Actual June 2012	Target 2012	Actual Dec 2012	Deviation	Actual	Actual
M2 (N'b)	13,303.49	13,483.06	16,577.53	15,483.85	-1,093.65	179.57	2,000.79
M2 (%)	15.4	10.8	24.6	16.4	-0.1	1.3	12.9
M1(N'b)	6,771.58	6,599.39	9,117.64	7,420.95	-1,696.65	-172.19	821.56
M1 (%)	21.5	17.1	34.7	9.6	-0.2	-2.6	11.1
RM (N'b)	2,784.10	2,511.96	3,013.32	3,704.48	691.18	-272.14	1,192.52
RM (%)	54.8	21.7	8.2	26.9	0.2	-10.8	32.2
NDC (N'b)	13,686.73	13,567.43	18,873.49	12,698.21	-6,175.29	-119.30	-869.22
NDC (%)	57.2	52.6	52.2	-7.2	-0.3	-0.9	-6.9
Cg (N'b)	-496.9	-1,133.69	-204.66	-2,453.56	-2,248.86	-636.79	-1,319.87
Cg (%)	55.7	-6.1	61.5	-393.8	5.5	56.2	53.8
Cp (N'b)	14,183.60	14,701.06	19,078.15	15,151.76	-3,926.44	517.46	450.70
Cp (%)	44.3	47.6	47.5	6.8	-0.2	3.5	3.0
NFA (N'b)	7,138.70	7,522.26	7,654.60	9,043.68	1,389.08	383.56	1,521.42
NFA (%)	9.7	16.6	6.6	26.7	0.2	5.1	16.8

Figure 3.1
The Performance of M2, M1 and RM (2011 and 2012)



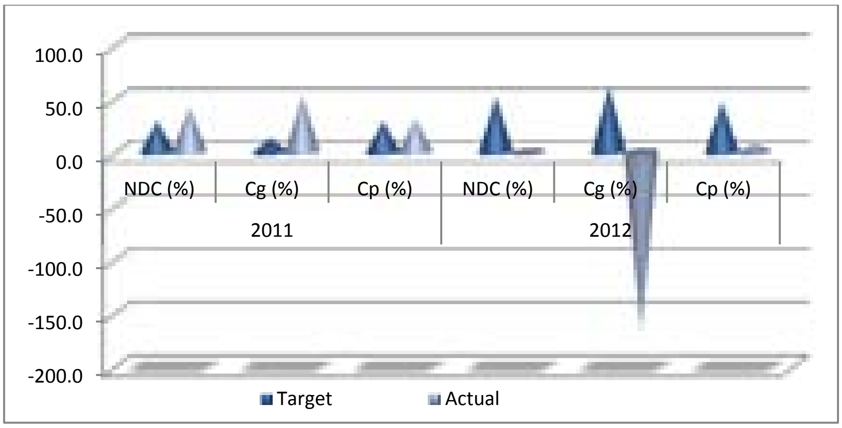
Reserve Money (RM) grew by 32.2 per cent to ₦3,704.48 billion at end-December 2012 from ₦2,511.96 billion at end-June 2012. The end-December level was 18.7 per cent above the benchmark of ₦3,013.32 billion. The year-on-year growth in RM at 26.9 per cent was higher than the benchmark of 8.2 per cent. The significant increase was due largely to an increase in the CRR from 8.0 to 12.0 per cent in July 2012.

The year-on-year growth in Aggregate Domestic Credit was 1.98 per cent, which was far below the benchmark of 52.17 per cent…..

Aggregate domestic credit dropped by 6.9 per cent to ₦12.698.21 billion at end-December 2012 from ₦13,567.43 billion at end-June 2012. The end-December level was 48.6 per cent below the benchmark of ₦18,873.49 billion. The year-on-year growth in Aggregate Domestic Credit at 7.2 per cent was far below the benchmark of 52.2 per cent. The sharp decrease was partly due to greater reliance of the FGN on public financing through issuance of bonds and better management of its cash flow under the TSA.

Credit to Government declined by 53.78 per cent to ₦2,453.56 billion at end-December 2012 from ₦1,133.69 billion at end-June 2012. The end-December level was 91.7 per cent below the benchmark of ₦204.66 billion. Credit to Government year-on-year declined by 393.81 per cent, which was lower than the benchmark of 61.5 per cent. In effect, the public sector was a net creditor to the banking system throughout 2012.

Figure 3.2
The Performance of NDC, Cg and Cp (2011 and 2012)



Credit to Private Sector increased by N591.68bn (4.03 per cent) in the second half of 2012…..

Credit to the private sector increased by 2.97 per cent to ₦15,151.76 billion at end-December 2012 from ₦14,701.06 billion at end-June 2012. The end-December level was 25.9 per cent below the benchmark of ₦19,078.15 billion. The year-on-year growth in credit to private sector, at 6.8 per cent, was lower than the benchmark of 47.5 per cent. The moderation in growth was due to flight to safety by DMBs into low-risk Treasury Bills.

Net foreign assets (NFA) increased by 16.8 per cent to ₦9,043.68 billion at end-December 2012 from ₦7,522.26 billion at end-June 2012. The end-December level was 15.4 per cent above the benchmark of ₦7,654.56 billion. The year-on-year growth in NFA, at 26.7 per cent, was higher than the benchmark of 6.6 per cent. The growth was due to increased private capital inflow attracted by the relatively high rate of returns on financial market securities as well as the high price of crude oil throughout the year.

CHAPTER 4
DOMESTIC FINANCIAL MARKETS

4.1 Money Market

Money market activities in the second half of 2012 were largely influenced administrative actions and liquidity conditions

The money market remained active in the second half of 2012 with Government securities and CBN OMO bills dominating the primary market segment. Market activities were influenced largely by liquidity conditions. The implementation of administrative measures like prohibition of concurrent dealings in wDAS and the Bank's lending windows had significant impact on market activities in the review period. As the liquidity situation in the market improved owing to both administrative actions and autonomous inflows, short-term interest rates moderated. Fiscal operations continued to weigh in on liquidity conditions in the market.

4.1.1 Developments in Short-Term Interest Rates

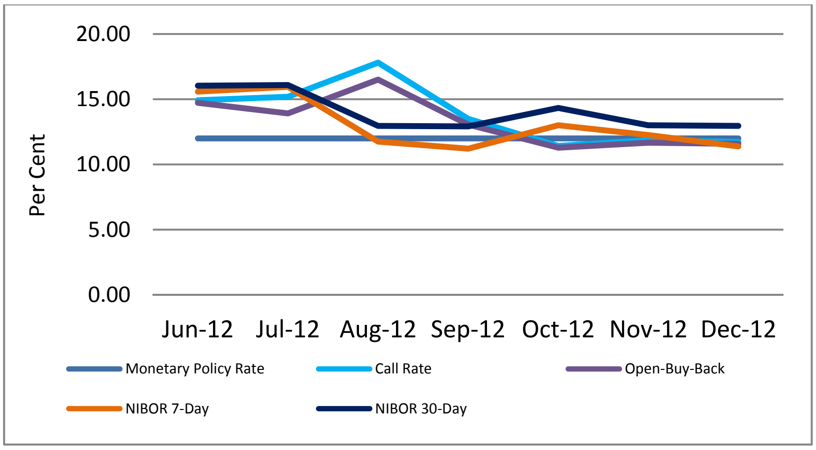
Short-term interest rates moderated but remained largely within the MPR corridor

Stabilizing short-term interest rates around the policy rate remained a challenge for monetary management in the review period. This was because the sharing of revenue proceeds in the Federation Account by the three tiers of government created system-wide liquidity swings and volatility in short-term interest rates (figure 4.1). The average interbank call rate ranged between 11.73 and 17.81 per cent, while the open buy back (OBB) rate ranged from 11.58 and 16.51 per cent in the second half of 2012.

Table 4.1
Weighted Average Money Market Interest Rates (%)
(June 2012 – December 2012)

Month	Monetary Policy Rate	Overnight Interest Rates		Tenored
		Call Rate	Open-Buy-Back	NIBOR 30-Day
Jun-12	12.00	14.92	14.72	16.04
Jul-12	12.00	15.19	13.91	16.08
Aug-12	12.00	17.81	16.51	12.96
Sep-12	12.00	13.50	13.05	12.92
Oct-12	12.00	11.42	11.29	14.33
Nov-12	12.00	11.86	11.66	13.00
Dec-12	12.00	11.73	11.58	12.96

Figure 4.1
Weighted Average Money Market Interest Rate
(June 2012 – December 2012)

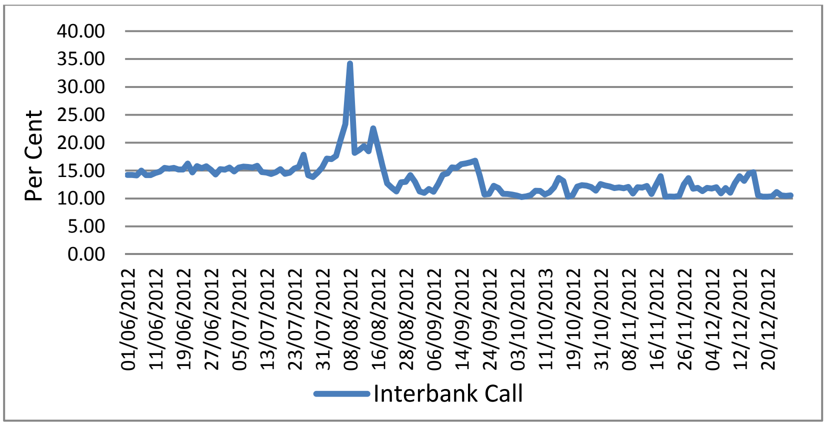


(i) Interbank Call Interest Rate

Interbank call rate eased in response to increased market liquidity

The weighted average interbank call rate rose from 14.92 per cent in June 2012 to peak at 17.81 per cent in August before declining to 11.73 per cent in December 2012. Overall, the interbank call rate decreased by 319 basis points between June and December 2012. On a year-on-year basis, the weighted average interbank call rate declined by 377 basis points to 11.73 per cent in 2012 from 15.50 per cent in December 2011 (Figure 4.1).

Figure 4.2
Daily Interbank Call Rates (June – December 2012)

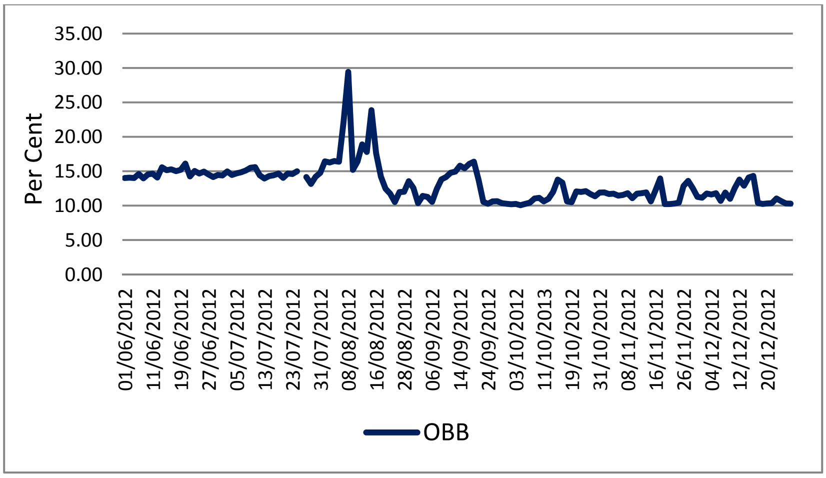


(ii) Open Buy-Back Rate

OBB rate declines as system liquidity conditions eased

The weighted average OBB rate which was 14.72 per cent in June 2012 rose to 16.51 per cent in August but declined to 11.58 per cent in December.. Thus, the OBB rate fell by 314 basis points between June and December 2012. On a year-on-year basis, the weighted average OBB rate fell by 248 basis points to 11.58 per cent in December 2012 from 14.06 per cent in December 2011 (Figure 4.1).

Figure 4.3
Daily Open Buy Back (OBB) Rates
(June – December 2012)



(iii) Nigeria Interbank Offered Rate (NIBOR)

The 30-day NIBOR rate moved against the interbank rates initially but corrected toward the end of the review period.

The NIBOR remained the traditional reference rate for tenured transactions. The 30-day NIBOR moved in opposite direction initially to the interbank call and OBB interest rates in the second half of 2012. The weighted average 30-day NIBOR which was 16.04 per cent in June 2012 moderated to 12.96 per cent in August but rose to 14.33 per cent in October. It nonetheless fell to 12.96 per cent in December 2012 (Figure 4.1).

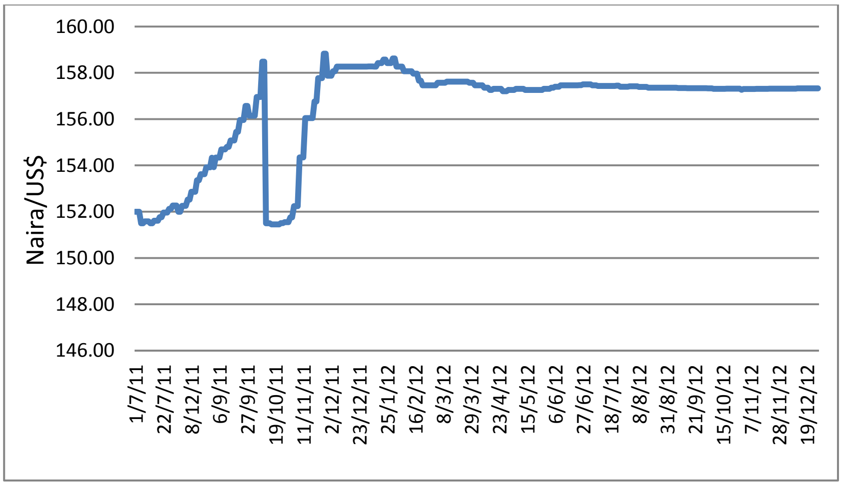
The general decline in short-term rates in the period under review was primarily due to liquidity surfeit traced to payment of maturing OMO bills, fiscal operations as well as AMCON injections. The effect of the injections lasted through the fourth quarter, thereby, moderating rates through year-end. This development was notwithstanding the restrictive stance of monetary policy.

4.2 The Foreign Exchange Market

Exchange rate policy predicated on need to maintain stability.

The thrust of exchange rate policy remained the maintenance of a stable exchange rate of the naira around ₦155/US$ with a band of +/- 3 per cent. The Bank continued to respond to demand pressures to keep the exchange rate within the band. This largely accounted for the stability witnessed in the market in the review period.

Figure 4.4
Daily Exchange Rate (July 2011 – December 2012)



4.2.1 Spot Rate

Appreciation in rates across all segments of the market due to reduced demand pressure

The wDAS spot rate appreciated by 0.19 per cent to average ₦157.35/US$ in the second half of 2012 compared with the average of ₦157.65/US$ in the first half of 2012, and ₦154.51/US$ in the corresponding period of 2011, representing a depreciation of 1.80 per cent.

In the interbank foreign exchange market (IFEM), the spot rate which averaged ₦158.37/US$, appreciated by 0.59 percent compared with ₦159.31/US$ in the first half of 2012 while it depreciated by 0.69 per cent from ₦157.29/US$ in the corresponding period of 2011. Similarly, spot rates at the BDC segment averaged ₦160.49/US$ in the second half of 2012 compared with ₦161.23/US$ in the first half of 2012 and ₦161.66/US$ in the corresponding period of 2011, representing an appreciation of 0.46 and 0.73 per cent, respectively.

The appreciation in the spot rates across most segments of the foreign exchange market was attributed to reduced demand pressure following measures to curtail speculative demand as well as positive developments in the international crude oil market (Table 4.2).

Table 4.2
Average Monthly Spot Exchange Rates (N/US$)
July 2011 – December 2012

	CBN	IFEM	BDC
Jul-11	151.86	152.41	163.71
Aug-11	152.72	153.79	163.10
Sep-11	155.26	156.70	158.23
Oct-11	153.26	159.83	161.25
Nov-11	155.77	158.83	160.35
Dec-11	158.21	162.17	163.30
2011: H2 Average	154.51	157.29	161.66
2011 Average	153.54	155.89	159.31
Jan-12	158.39	161.31	164.62
Feb-12	157.87	158.59	160.85
Mar-12	157.59	157.72	159.41
Apr-12	157.33	157.44	159.37
May-12	157.28	158.46	159.67
Jun-12	157.44	162.33	163.43
2012: H1 Average	157.65	159.31	161.23
Jul-12	157.43	161.33	163.32
Aug-12	157.38	158.97	162.24
Sep-12	157.34	157.78	159.80
Oct-12	157.32	157.24	159.00
Nov-12	157.31	157.58	159.32
Dec-12	157.32	157.33	159.26
2012: H2 Average	157.35	158.37	160.49
2012 Average	157.50	158.84	160.86

4.2.3 End-Period Exchange Rate

The naira appreciated in all segments of the foreign exchange market. At the wDAS, the naira appreciated by 0.11 per cent to ₦157.33/US$ at end-December 2012 from ₦157.50/US$ at end-June. It appreciated by 0.60 per cent to ₦157.33/US$ at end-December, 2012 from ₦158.27/US$ at end-December 2011 (Table 4.4).

Similarly, the naira appreciated by 3.14 per cent to ₦159.00/US$ at the BDC segment at end-December 2012 from ₦164.00/US$ at end-June 2012. On a year-on-year basis, it appreciated by 3.77 per cent. At the interbank segment, the naira rose to ₦157.25/US$ at end-December 2012 from ₦162.85/US$ at end-June 2012 and ₦159.70/US$ at end-December 2011, representing appreciations of 3.56 and 1.56 per cent, respectively (Table 4.4 and Figure 4.5).

Figure 4.5
End-Month Exchange Rate (July 2011 – December 2012)

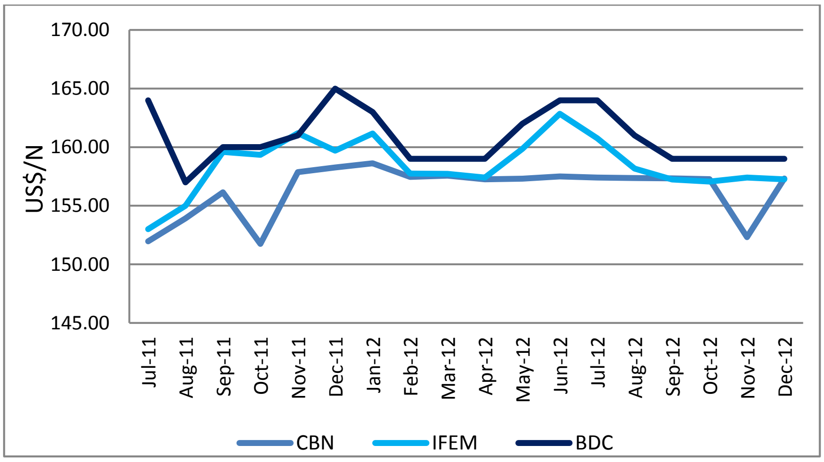


Table 4.3
End-Month Exchange Rates Movements (July 2011 – December 2012) (N/US$)

	CBN	IFEM	BDC
Jul-11	151.96	153.00	164.00
Aug-11	153.92	155.00	157.00
Sep-11	156.15	159.60	160.00
Oct-11	151.75	159.35	160.00
Nov-11	157.87	161.20	161.00
Dec-11	158.27	159.70	165.00
Jan-12	158.62	161.16	163.00
Feb-12	157.46	157.75	159.00
Mar-12	157.57	157.72	159.00
Apr-12	157.26	157.40	159.00
May-12	157.31	159.85	162.00
Jun-12	157.50	162.85	164.00
Jul-12	157.40	160.75	164.00
Aug-12	157.36	158.17	161.00
Sep-12	157.34	157.24	159.00
Oct-12	157.27	157.06	159.00
Nov-12	152.32	157.40	159.00
Dec-12	157.33	157.25	159.00

4.2.4 Nominal and Real Effective Exchange Rate

NEER index increased to N98.04 at end-December 2012

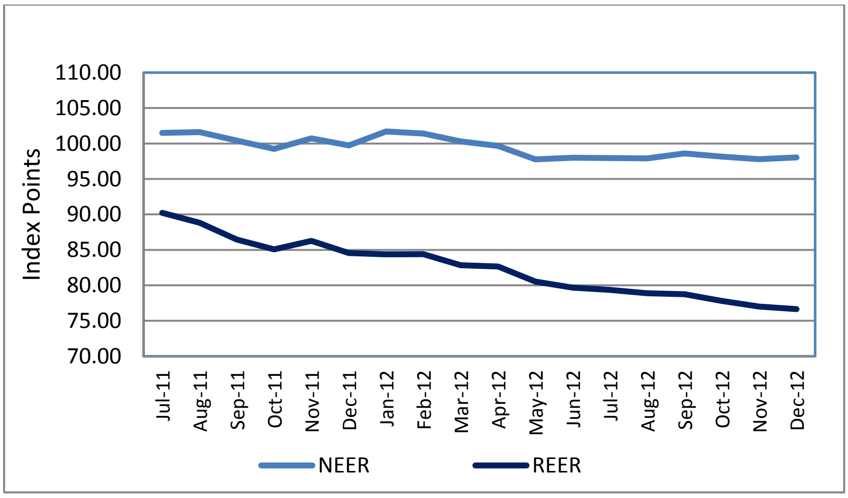
The Nominal Effective Exchange Rate (NEER) index depreciated marginally by 0.04 per cent to 98.04 at end-December 2012 from 98.00 at end-June 2012, while it appreciated by 1.7 per cent relative to 99.73 at end-December 2011. The Real Effective Exchange Rate (REER) index appreciated by 3.8 and 9.4 per cent to 76.65 at end-December 2012 from 79.67 at end-June 2012, and 84.56 at end-December 2011, respectively (Table 4.5 and Figure 4.6).

On the average, both the NEER and REER decreased at end-December 2012, when compared with the level at end-June 2012, reflecting a real exchange rate appreciation relative to the currencies of Nigeria's major trading partners.

Table 4.4
Nominal and Real Effective Exchange Rates Indices
(July 2011 – December 2012)

	NEER	REER
Jul-11	101.49	90.22
Aug-11	101.62	88.82
Sep-11	100.41	86.46
Oct-11	99.24	85.08
Nov-11	100.73	86.26
Dec-11	99.73	84.56
2011: H2 Average	**100.54**	**86.90**
Jan-12	101.69	84.38
Feb-12	101.41	84.40
Mar-12	100.29	82.84
Apr-12	99.66	82.66
May-12	97.78	80.53
Jun-12	98.00	79.67
2011: H1 Average	**99.81**	**82.41**
Jul-12	97.96	79.35
Aug-12	97.90	78.89
Sep-12	98.60	78.75
Oct-12	98.16	77.80
Nov-12	97.79	77.01
Dec-12	98.04	76.65
2012: H2 Average	**98.08**	**78.08**

Figure 4.6
Nominal and Real Effective Exchange Rate Indices
(July 2011 – December 2012)



4.2.5 Demand and Supply of Foreign Exchange

Total demand for foreign exchange at the wDAS in the review period decreased by 20.59 per cent to US$8,705.60 million from US$10,963.16million recorded in the first half of 2012. The demand for foreign exchange fell by 56.52 per cent, when compared with the US$20,020.37 million demanded in the second half of 2011. The total supply of foreign exchange at the wDAS decreased by 14.70 and 39.46 per cent to US$9,170.00 million in the second half of 2012, compared with US$10,750.00 million recorded in the first half of 2012 and US$15,146.87 million in the corresponding period of 2011, respectively (Table 4.6 and Figure 4.7).

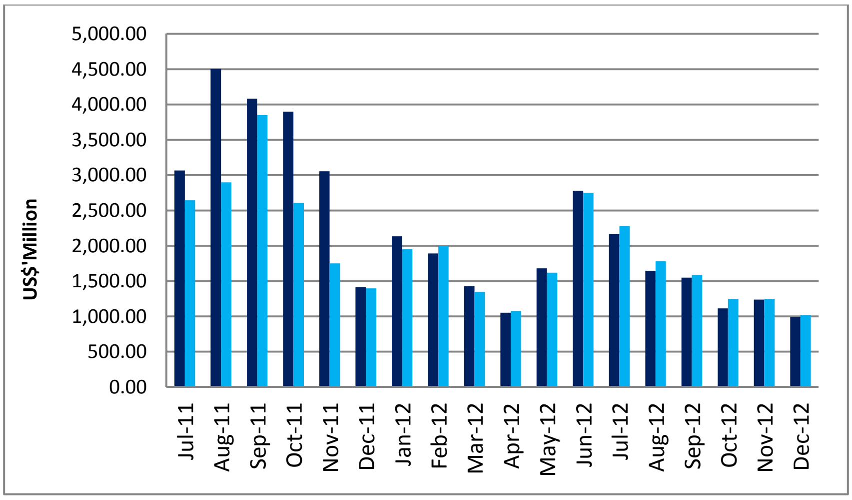
The various policy actions undertaken by the Bank contributed in moderating foreign exchange demand and stabilizing the foreign exchange market in the review period. The decrease in the amount demanded could be traced to the decrease in the demand for foreign exchange by authorised dealers due to the reduction in the Net Open Position limit and increased Cash Reserve Requirement. The restriction of authorised dealers from accessing the CBN Lending Windows (Repo and SLF) and the WDAS windows concurrently also had moderating effects on demand.

The period also experienced an increase in the price of crude oil as well as reduced demand and intervention by the Bank leading to significant accretion to external reserves.

Table 4.5
Foreign Exchange Demand and Supply (US Dollar Million)
(July 2011 – December 2012)

	wDAS Demand	wDAS Supply
Jul 2011	3,065.41	2,643.34
Aug 2011	4,504.49	2,899.05
Sep 2011	4,081.18	3,850.00
Oct 2011	3,899.58	2,607.00
Nov 2011	3,054.43	1,749.62
Dec 2011	1,415.28	1,397.86
2011: H2 Total	**20,020.37**	**15,146.87**
Jan 2012	2,132.99	1,950.00
Feb 2012	1,891.96	2,000.00
Mar 2012	1,426.45	1,350.00
Apr 2012	1,052.88	1,080.00
May 2012	1,681.26	1,620.00
Jun 2012	2,777.62	2,750.00
2012: H1 Total	**10,963.16**	**10,750.00**
Jul 2012	2,166.32	2,280.00
Aug 2012	1,646.41	1,780.00
Sep 2012	1,549.18	1,590.00
Oct 2012	1,112.89	1,250.00
Nov 2012	1,236.98	1,250.00
Dec 2012	993.81	1,020.00
2012: H2 Total	**8,705.60**	**9,170.00**

Figure 4.7
Demand and Supply of Foreign Exchange at wDAS
(July 2011 – December 2012)



4.2.6 Foreign Exchange Flows

4.2.6.1 Foreign Exchange Flows through CBN

A net inflow of US$8,776.36 million recorded in 2nd Half of 2012, reflecting increase in inflows

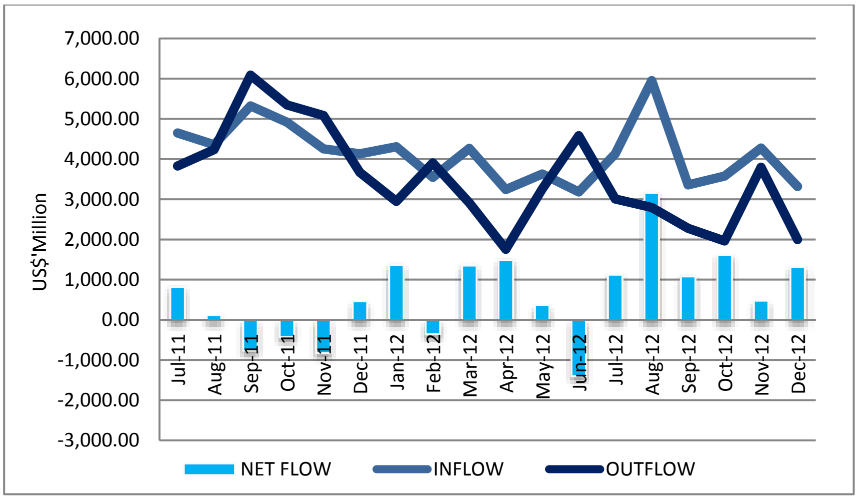
Gross foreign exchange inflow through the CBN was US$24,611.59million in the second half of 2012, compared with US$22,170.75 million in the first half, representing an increase of 11.0 per cent, while it declined by 10.9 per cent from US$27,631.39 million in the corresponding period of 2011 (Figure 4.8 and Table 4.7). Foreign exchange outflow declined by 18.2 and 43.9 per cent to US$15,835.23 million in the second half of 2012 from US$19,355.44 million in the first half of 2012 and US$28,244.16 million in the corresponding period of 2011, respectively.

In the second half of 2012, foreign exchange flows through the CBN resulted in a net inflow of US$8,776.36 million compared with a net inflow of US$2,815.31 million in the first half of 2012 (Table 4.7).

Table 4.6
CBN Monthly Foreign Exchange Flows (US$ million)
(July 2011 – December 2012)

	INFLOW	OUTFLOW	NET FLOW
Jul-11	4,647.69	3,826.89	820.80
Aug-11	4,356.59	4,234.08	122.51
Sep-11	5,323.46	6,087.81	-764.35
Oct-11	4,915.31	5,345.96	-430.65
Nov-11	4,256.05	5,082.29	-826.24
Dec-11	4,132.29	3,667.13	465.16
2011: H2	**27,631.39**	**28,244.16**	**-612.77**
2011 Total	**47,205.72**	**48,774.68**	**-1,568.96**
Jan-12	4,307.02	2,945.79	1,361.23
Feb-12	3,546.16	3,902.26	-356.10
Mar-12	4,266.63	2,912.41	1,354.22
Apr-12	3,242.89	1,754.87	1,488.02
May-12	3,627.10	3,256.98	370.12
Jun-12	3,180.95	4,583.13	-1,402.18
2012: H1	**22,170.75**	**19,355.44**	**2,815.31**
Jul-12	4,132.09	3,006.72	1,125.37
Aug-12	5,953.41	2,796.59	3,156.82
Sep-12	3,358.57	2,277.44	1,081.13
Oct-12	3,576.35	1,960.37	1,615.98
Nov-12	4,272.42	3,794.48	477.94
Dec-12	3,318.75	1,999.63	1,319.12
2012: H2	**24,611.59**	**15,835.23**	**8,776.36**
2012 Total	**46,782.34**	**35,190.67**	**11,591.67**

Figure 4.8
Foreign Exchange Flows through the CBN
(July 2011 – December 2012)



4.2.6.2 Foreign Exchange Flows through the Economy

A net inflow of US$8,776.36 million recorded in 2nd Half of 2012, reflecting increase in inflows

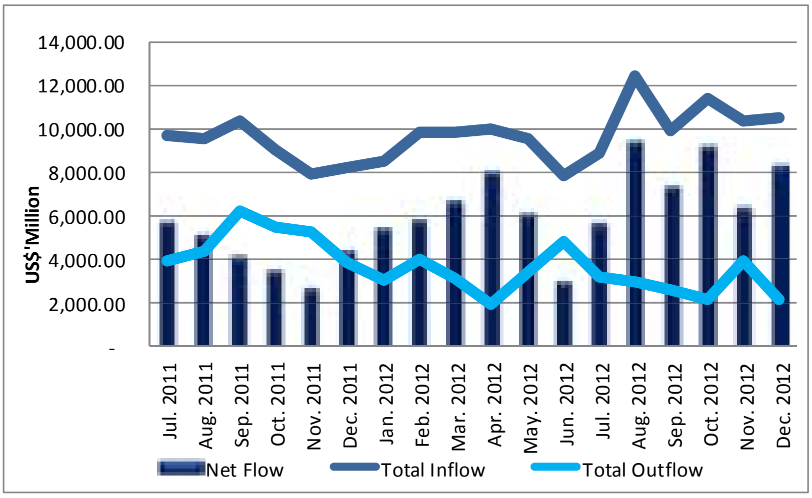
Gross foreign exchange inflow through the entire economy was US$63,466.93million in the second half of 2012, compared with US$55,548.08 million in the first half representing an increase of 14.3 per cent, while it also rose by 15.7 per cent from US$54,849.14 million in the corresponding period of 2011 (Table 4.8). Foreign exchange outflow declined by 16.7 and 42.0 per cent to US$16,822.06 million in the second half of 2012 from US$20,204.63 million in the first half of 2012 and US$29,019.54 million in the corresponding period of 2011, respectively.

In the second half of 2012, foreign exchange flows through the economy resulted in a net inflow of US$46,644.90 million compared with a net inflow of US$35,343.45 million in the first half of 2012 (Table 4.7).

Table 4.7
Monthly Foreign Exchange Flows through the Economy
(US$ million) (July 2011 – December 2012)

Descriptor	Total Inflow	Inflow (CBN)	Inflow (Autonomous)	Total Outflow	Outflow (CBN)	Outflow (Autonomous)	Net Flow	Net Flow (CBN)	Net Flow (Autonomous)
Jul. 2011	9,703.30	4,647.69	5,055.61	3,947.41	3,826.89	120.52	5,755.89	820.8	4,935.09
Aug. 2011	9,563.66	4,356.59	5,207.07	4,351.48	4,234.08	117.4	5,212.18	122.51	5,089.67
Sep. 2011	10,371.26	5,323.46	5,047.80	6,187.00	6,087.81	99.19	4,184.26	-764.35	4,948.61
Oct. 2011	9,035.30	4,915.31	4,119.99	5,469.14	5,345.96	123.18	3,566.15	-430.65	3,996.81
Nov. 2011	7,947.16	4,256.05	3,691.11	5,247.52	5,082.29	165.23	2,699.64	-826.24	3,525.88
Dec. 2011	8,228.46	4,132.29	4,096.17	3,816.99	3,667.13	149.86	4,411.47	465.16	3,946.31
Total H2 2011	54,849.14	27,631.39	27,217.75	29,019.54	28,244.16	775.38	25,829.59	-612.77	26,442.37
Total 2011	105,106.22	47,205.72	57,900.50	50,421.82	48,774.68	1,647.14	54,684.38	-1,568.97	56,253.36
Jan. 2012	8,518.24	4,307.02	4,211.22	3,027.16	2,945.80	81.36	5,491.08	1,361.22	4,129.86
Feb. 2012	9,859.56	3,546.16	6,313.40	3,998.38	3,902.27	96.11	5,861.18	-356.11	6,217.29
Mar. 2012	9,812.73	4,266.63	5,546.10	3,060.67	2,912.43	148.24	6,752.06	1,354.20	5,397.86
Apr. 2012	9,973.15	3,242.89	6,730.26	1,895.22	1,754.89	140.33	8,077.93	1,488.00	6,589.93
May. 2012	9,550.02	3,627.10	5,922.92	3,392.09	3,256.97	135.12	6,157.93	370.13	5,787.80
Jun. 2012	7,834.38	3,180.94	4,653.44	4,831.11	4,583.13	247.98	3,003.27	-1,402.19	4,405.46
Total H1 2012	55,548.08	22,170.74	33,377.34	20,204.63	19,355.49	849.14	35,343.45	2,815.25	32,528.20
Jul. 2012	8,865.39	4,132.10	4,733.29	3,187.15	3,006.74	180.41	5,678.25	1,125.37	4,552.88
Aug. 2012	12,416.40	5,953.41	6,462.99	2,938.76	2,796.56	142.2	9,477.64	3,156.85	6,320.79
Sep. 2012	9,945.14	3,358.57	6,586.57	2,542.85	2,277.44	265.41	7,402.29	1,081.13	6,321.16
Oct. 2012	11,395.17	3,576.34	7,818.83	2,118.23	1,960.36	157.87	9,276.95	1,615.99	7,660.96
Nov. 2012	10,370.22	4,272.42	6,097.80	3,925.45	3,794.48	130.96	6,444.78	477.94	5,966.84
Dec. 2012	10,474.61	3,318.75	7,154.99	2,109.62	1,999.63	47.29	8,364.99	1,319.12	7,107.70
Total H2 2012	63,466.93	24,611.59	38,854.47	16,822.06	15,835.21	924.14	46,644.90	8,776.40	37,930.33
Total 2012	119,015.01	46,783.20	72,231.81	37,026.69	35,253.41	1,773.28	81,988.35	11,529.82	70,458.53

Figure 4.9
Foreign Exchange Flows through the Economy
(July 2011 – December 2012)



4.3 Capital Market

Capital market weighed downby profit takingactivities of investors, among others.

The capital market witnessed improved performance in the second half of 2012, compared with the first half and the corresponding period of 2011. This development was due largely to enhanced earnings, improved investor sentiments and foreign portfolio investments. In addition, the Inclusion of FGN bonds on the JP Morgan's Government Bond Index of Emerging Markets (GBI-EM) in October 2012 and the announcement by Barclays Capital to similarly include FGN bonds in Barclays Emerging Markets Local Currency Bond Index (EM-LCBI) re-awakened the interest of foreign institutional investors in the Market.

Financial markets' fragilities, especially in the Euro-zone continued to facilitate the redirection of capital flows in favour of emerging and developing economies, including Nigeria. Positive activity in the market was also as a result of various measures taken by key stakeholders such as the Federal Ministry of Finance (FMF), the Securities and Exchange Commission (SEC), the Central Bank of Nigeria (CBN), the Nigerian Stock Exchange (NSE), the Debt Management Office (DMO) and the Asset Management Corporation of Nigeria (AMCON) to develop the capital market. Measures taken by the NSE in the areas of its "five pillars" transformation strategy contributed in boosting investor confidence.

Box 2

Inclusion of Federal Government of Nigeria (FGN) bonds on the JP Morgan's Government Bond Index of Emerging Markets (GBI-EM)

JP Morgan Chase & Co, a United State financial services firm and one of the world's biggest underwriters of emerging-market debt, included the Federal Government of Nigeria (FGN) bonds on its benchmark Government Bond Index of Emerging Markets (GBI-EM) in October, 2012. Nigeria became the second African country after South Africa to be included in this widely followed index. The firm included Nigerian debt maturing in 2014, 2019 and 2022 in a gradual inclusion which started October and finished by December 2012. Nigeria bond in the GBI-EM possess a weight of 0.59% in the index and has about $170 billion of assets under management benchmarked against it.

The development was due to improvement in the Nigerian economic outlook as policy makers remove restrictions on foreign investment, control inflation and stabilized the country's currency. In addition, robust growth in the economy of the country in the face of daunting challenges in global recovery pointed to the resilience of the economy and boosted confidence in its risk profile perception. The attractive yield in the sovereign bond market of the country has recently earned the market its place as investor delight.

Nigeria's inclusion in the index will prompt investors and asset managers who track the index to buy the country's bonds to match changes. This will, therefore, raise the visibility of the Nigerian bond market on the international scene, placing what has been so far deemed a 'frontier' market a step closer to more mainstream investment destinations. The development has improved the country's risk profile perception and re-awakened the interest of foreign investors in the FGN bond Market. As a result, capital inflows into the country's debt market have increased with the expectations of availability of more funds that could be lent to companies and households.

4.3.1 Equities Market

The All-Share Index (ASI) increased by 30.0 per cent to 28,078.81 at end-December 2012, from its level of 21,599.56 at end-June 2012, and by 35.5 per cent, when compared with the level at end-December 2011. Market Capitalization (MC) for equities also increased by 30.0 per cent to ₦8.97 trillion at end-December 2012 from ₦6.90 trillion at end-June 2012, and by 37.4 per cent when compared with the ₦6.58 trillion recorded at end-December 2011 (Table 4.8 and Figure 4.9).

The reforms of the capital market by the SEC and NSE; and the inclusion of selected Nigerian government bonds in the JP Morgan Government Bond Index-Emerging Markets (GBI-EM), not only boosted the confidence of international institutional investors in the Nigerian bond market, but re-awakened local institutional investors appetite for equities.

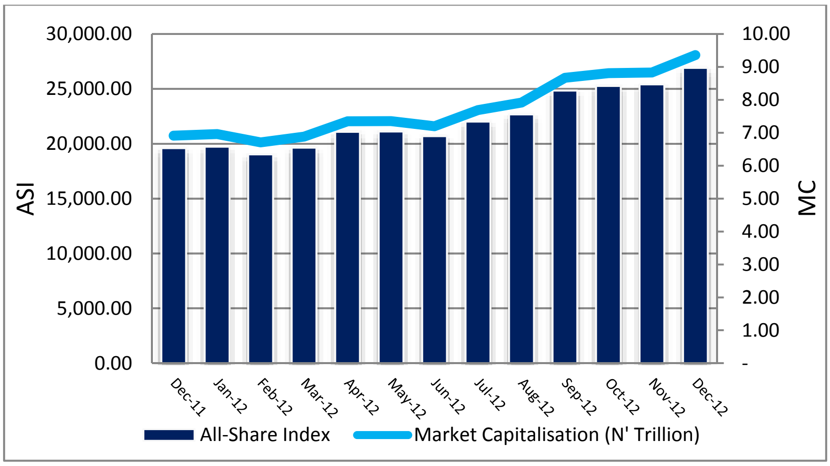
The ASI's 35.45 per cent year-to-date increase (the strongest performance since the global financial and economic crisis), was driven mainly by strong performance in consumer goods and banking sectors. The Bloomberg NSE Consumer Goods Index grew by 42.29 per cent and the Bloomberg NSE Banking Index increased by 23.84 per cent over their levels in 2011. The performance of two other sectoral indices - the Bloomberg NSE Insurance and the Bloomberg Oil and Gas indices, however, declined by 17.45 per cent and 30.53 per cent, respectively, over their levels at end-December 2011.

Table 4.8
NSE All-Share Index (ASI) and Market Capitalization (MC)
(December 2011 – December 2012)

Date	ASI	MC (Equities) (N' Trillion)
Dec-11	20,730.63	6.53
Jan-12	20,875.83	6.58
Feb-12	20,123.51	6.34
Mar-12	20,652.47	6.55
Apr-12	22,045.66	7.03
May-12	22,066.40	7.04
Jun-12	21,599.56	6.90
Jul-12	23,061.38	7.34
Aug-12	23,750.81	7.56
Sep-12	26,011.63	8.28
Oct-12	26,430.92	8.42
Nov-12	26,494.44	8.47
Dec-12	28,078.81	8.97

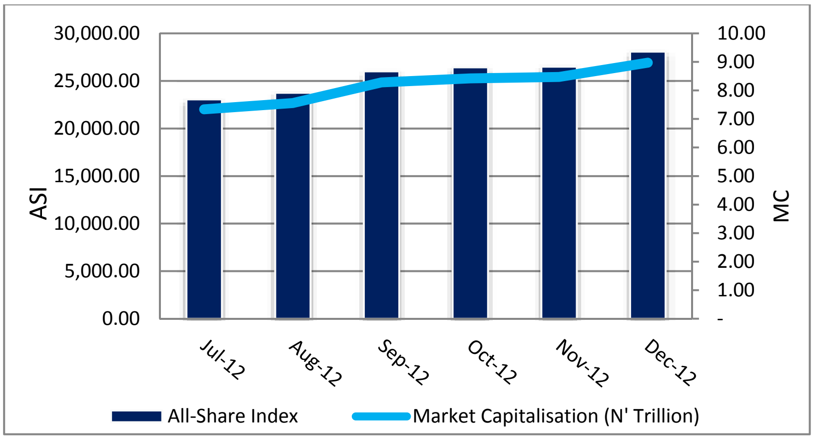
Source: NSE

Figure 4.10
NSE ASI and MC (December 2011 – December 2012)



Source: NSE

Figure 4.11
NSE ASI and MC (July – December 2012)



Source: NSE

4.3.2 Market Turnover

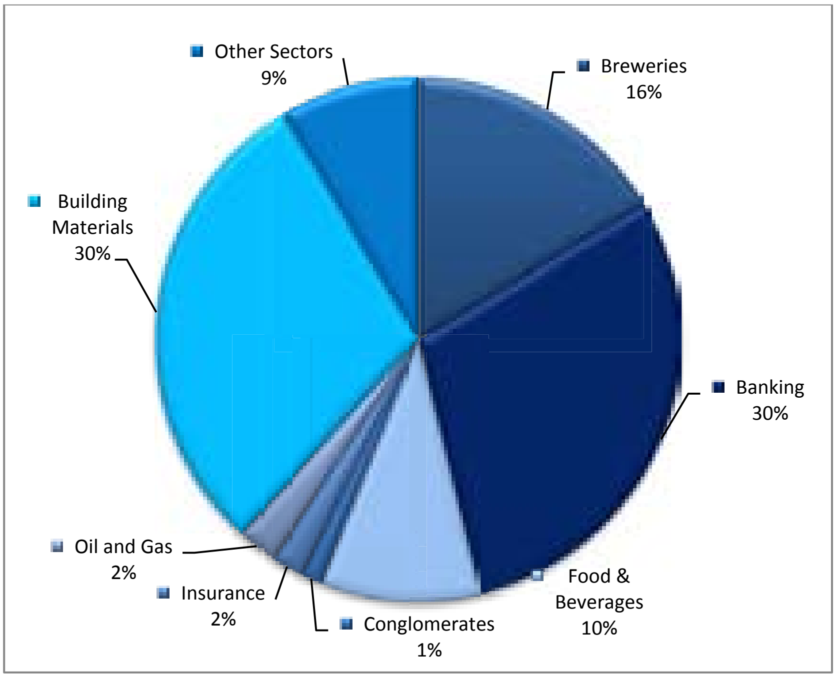
Aggregate stock market turnover in the second half of 2012 decreased by 18.43 per cent to 43.03 billion shares, valued at ₦340.76 billion, in 528,468 deals, compared with 52.75 billion shares valued at ₦789.34 billion, in 427,848 deals in the first half of 2012. Relative to the second half of 2011, market turnover increased by 7.41 per cent from 40.06 billion shares valued at ₦262.75 billion, in 497,025 deals.

4.3.3 Sectoral Contribution to Equities Market Capitalization

Dangote cement remains most capitalizedindividual equity.

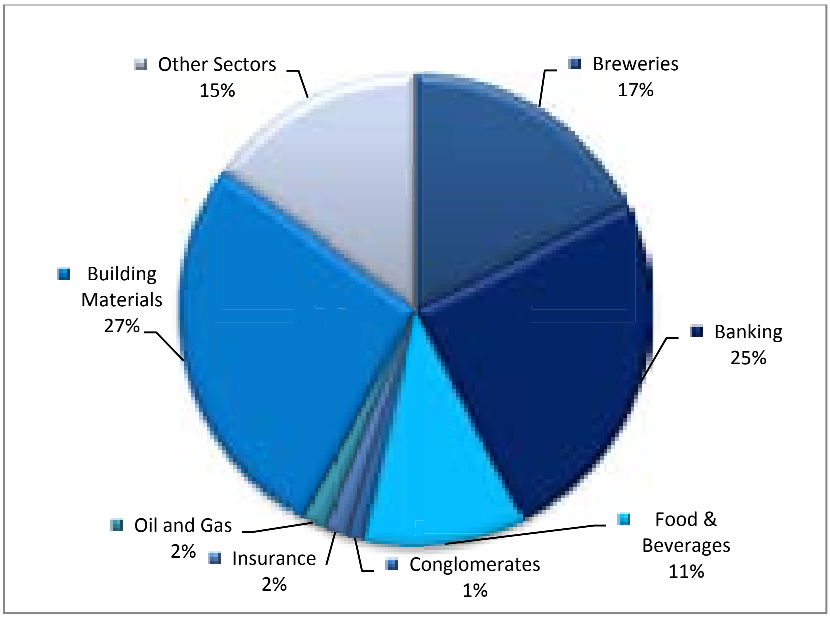
The building materials sub-sector was the most capitalized sector. However, its share in overall market capitalization dropped to 27.0 per cent at end-December 2012 from 30.0 per cent at end-June 2012. Compared with the 29.0 per cent at end-December 2011, the sub-sector's share of market capitalization dropped by 2.0 per cent. Other leading sub-sectors were banking; breweries; and food, beverages and tobacco with respective market shares of 25.0, 17.0 and 11.0 per cent, at end-December 2012.

Figure 4.12
NSE Market Capitalisation by Sector as at End-June 2012



Source: NSE

Figure 4.13
NSE Market Capitalisation by Sector as at End-December 2012



Source: NSE

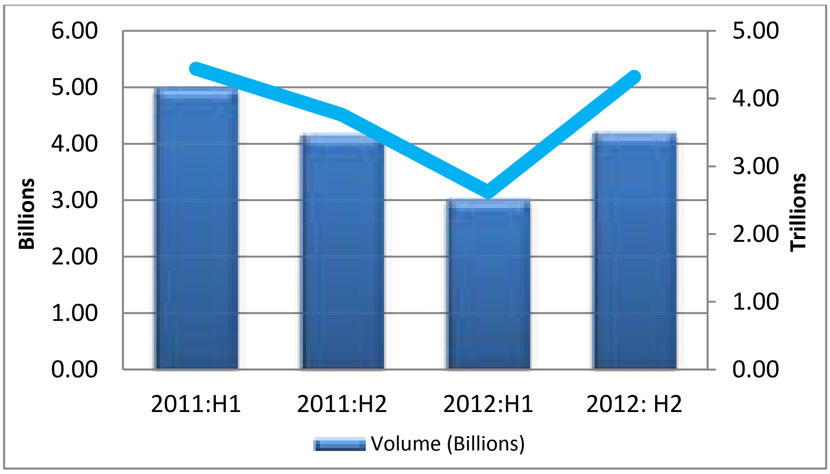
4.3.4 Bonds Market

The bonds market in Nigeria consists of FGN bonds, State Government bonds and corporate bonds.

4.3.4.1 Federal Government (FGN) Bonds

The value of FGN Bonds outstanding stood at ₦4.08 trillion at the end of the second half of 2012, representing an increase of 8.51 per cent, compared with ₦3.76 trillion at the end of the first half. Total transactions in FGN Bonds in the over-the-counter (OTC) market in the second half of 2012 was 4.22 billion units valued at ₦4.32 trillion in 24,082 deals, compared with 3.04 billion units valued at ₦2.62 trillion in 20,357 deals in the first half of 2012 and a turnover of 4.19 billion units worth ₦3.76 trillion in 29,625 deals recorded in the second half of 2011(Figure 4.15).

Figure 4.14
Volume and Value of FGN Bonds (2011 – 2012)

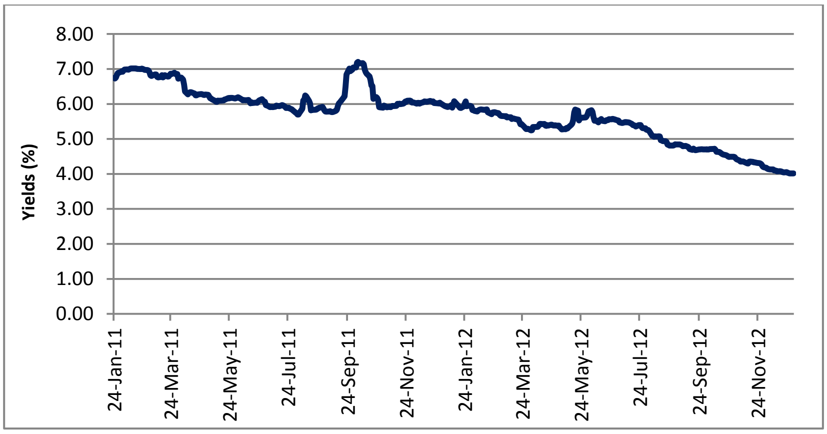


Source: NSE

4.3.4.2 FGN Eurobond

The Federal Government of Nigeria's Eurobond was traded in the London Stock Exchange (LSE) during the review period. Yields on the bonds decreased to 4.02 per cent at end-December 2012 from 5.55 and 6.01 per cent at end-June 2012 and end-December 2011, respectively. The decrease in the Eurobond yield was largely as a result of improved confidence in the economy following the inclusion of FGN bonds on the JP Morgan's Government Bond Index of Emerging Markets (GBI-EM) in October 2012. Following this, Barclays Capital has also included Nigeria on its own index. Furthermore, Nigeria benefitted from the increased demand for emerging and developing economies' sovereign debt instruments following the debt crisis in the euro area as well as low yield in the advanced economies (figure 4.15).

Figure 4.15
10-Year U.S. Dollar-denominated Bond Yields for Nigeria
(January 24, 2011 – December 31, 2012)

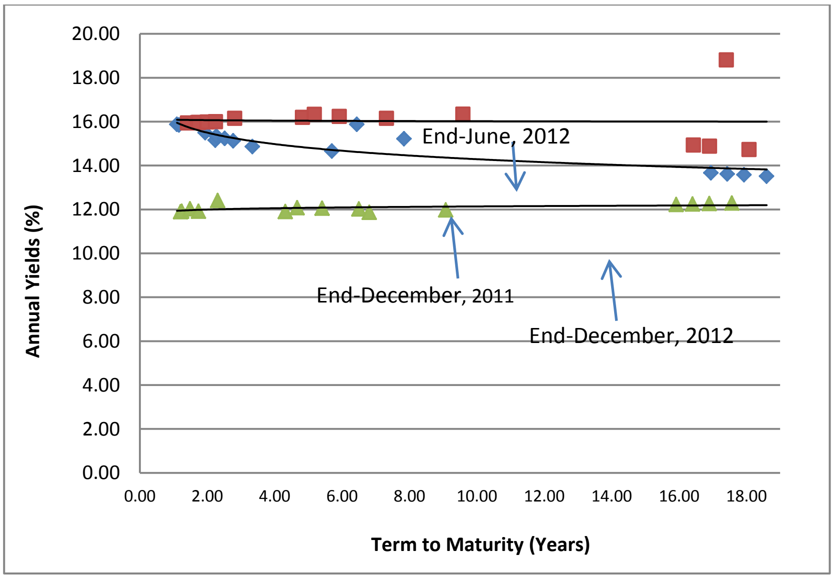


Source: Bloomberg

4.3.4.3 Yields on Federal Government Bonds

The FGN bonds yield curve at end-December 2012 shifted downwards by 396 basis points compared with the position at end-June 2012 and by 280 basis points compared with the level at end-December 2011 (Figure 4.16). The downward trend in FGN Bonds yields was attributed to the listing of the FGN bonds on the JP Morgan Index which led to increased patronage of the sovereign debt market by foreign investors. In addition, Standard and Poor's (S&P) upgrade of the country's credit rating further improved institutional investors confidence in the Nigerian debt market. Other factors included improved liquidity position due to matured treasury bills as well as the release of FAAC fund. Positive inflationary expectations further increased investor sentiment toward re-investment in short term securities, despite the MPR, liquidity ratio & CRR positions. Also, rate of returns on treasury bills remained higher than savings & deposit rates, which also motivates domestic investors appetite for these papers. In addition, domestic debts mirrored the downward trend in Nigeria's Eurobond yields.

Figure 4.16
FGN Bonds Yield Curves
(End-December 2011 vs. End-June 2012 vs. End-December 2012)



4.3.4.4 State/Local Government Bonds

The total value of state/local government bonds issued in the second half of 2012 was ₦341.0 billion, same as in the first half of 2012. The development was traced to the listing of the Ekiti State ₦20.0 billion, fixed rate development bond and the Benue State ₦13.0 billion fixed rate development bond in the review period.

4.3.4.5 Corporate Bonds

In the second half of 2012, the value of outstanding corporate bonds increased marginally to ₦1.40 trillion from the ₦1.39 trillion recorded in the first half of 2012.

CHAPTER 5
ECONOMIC OUTLOOK

5.1 Overview

Global output was projected to increase by 3.5 per cent in 2013 due largely to expected rebound in China's growth. The projected global growth is higher than the 3.2 per cent estimated for 2012, but weaker than 3.9 per cent recorded in 2011. Output is expected to remain sluggish in advanced economies but relatively robust in many emerging market and developing economies. In addition, unemployment is likely to remain elevated in many parts of the world as downside risks increase considerably. Overall, there is a great risk of global growth in 2013 falling below 2.0 per cent, unless critical policy actions are embarked on and sustained in the euro area and the United States. In the Euro area, the expected policy action is the implementation of the fiscal compact while in the United States complete resolution of the Fiscal Cliffis called for. China is expected to continue her market-oriented structural reforms and rebalancing of the economy towards growth in domestic private consumption. In other emerging market and developing countries, the policy actions required differ but the general challenge is to rebuild macroeconomic policy space in all countries. A broad set of indicators of global industrial production and trade suggests that global growth has not strengthened further. Specifically, activity in the euro area periphery is expected to be softer than envisaged, with signs of stronger spillovers of that weakness to the region's trading partners.

In Nigeria, output growth appears promising despite the slowing global growth. The 7.1 per cent 2012 real GDP growth reported by the IMF is 1.1 and 2.3 percentage points higher than that of sub-Saharan oil exporters and the whole of sub-Saharan Africa, respectively. The non-oil sector remained the major driver of growth recording 8.2 per cent increase in contrast to the oil sector, which contracted by 0.2 per cent. The continued decline in the contribution of the oil sector to growth due to lower production could hamper growth prospects in 2013. Although the economy relies heavily on oil and gas, there has been little or no new investment in the sector for quite a while. In addition, the severe flooding in several parts of the country in 2012, which damaged housing, agricultural and oil assets, as well as the continuing security challenges, pose downside risks to growth in 2013.

Quantitative easing in leading advanced economies have kept interest rates low, prompting strong capital flows to emerging markets where rates were generally high. In the Euro area periphery, bond spreads declined but asset prices, particularly equities, rose generally. This improvement in global financial conditions continued in the fourth quarter of 2012. But uncertainty and risk emanating from the slower-than-desired pace of economic recovery, the continuing fiscal stand-off in the United States of America and sharp contraction in euro area economic activities make 2013 a challenging year for capital markets around the world. At the operational level, capital markets will experience diminished activity because of the checks on Brokers (proprietary) trading for their own account (under the Dodd-Frank Act's Volcker Rule). The migration of unregulated derivatives trades to the more transparent over-the-counter exchanges will also cause diminished capital market activity. In the advanced, emerging market and developing economies, there is regulatory overhang requiring the capital market to restructure and realign towards compliance with a myriad of regulations.

The rise in world stock markets in 2012 led by Brazil, Russia, India and China would continue in 2013. In the United States,the resolution of fiscal policy issues, another year of accommodative Federal Reserve Bank actions and improving corporate profits would skew the macro and market risks to the upside.

In the domestic market, stock prices have responded to the change in market mood from apprehension in early 2012 to optimism for better performance in 2013. There was good reason for the sense of optimism by the end of 2012. Market capitalisation rose by 37.4 per cent to ₦8.974 trillion while the All Share Index (ASI) also rose by 35.4 per cent to 28,079 in the year, compared with the decline of 17.7 per cent in market capitalisation and 16.77 per cent decline in All Share Index in 2011. The outlook for 2013 is for further growth in the market in the hope that corporate profits would continue to grow, especially that of banks that constitute 31 per cent total market capitalization. It is also hoped that inflation would continue to decline, the exchange rate will remain stable to encourage capital inflow, and domestic economic growth will continue to be robust. In addition, fiscal consolidation, positive stock valuations and global economic recovery will support capital market growth in 2013. The risk to the outlook comes from concerns about continued recovery in the global economy. Adverse economic conditions in the United States of America, Japan and the euro area could trigger capital reversal in the market since foreign portfolio investors account for 70 per cent of activities in the market.

In the foreign exchange markets, improvement in economic outlook in the United States, persistent structural weakness in the euro area, aggressive intervention by central banks, credit risk differentiation among emerging market economies, and excess global liquidity will be the key drivers of capital flows. The US dollar has regained traction against all major currencies supported by an improved growth and fiscal consolidation outlook combined with rising European risk. While the G4 currency re-pricing is underway; the US dollar is poised to strengthen against the euro, British pound sterling and Japanese yen. The protracted euro area crisis has lowered the profile of the euro and the uncertainty has not abated. In Asia, the Japanese yen'sweakness may intensify in the second quarter of 2013 but close the year at 95 per USD. Africa's strongest currency, the South African rand has been adversely affected by persistent labour unrest and weak external demand.

In the domestic market, the naira is expected to remain stable. The Central Bank's policy is to maintain the foreign exchange rate band at 155 (+/- 3). The Bank may, however, depending on the macroeconomic environment, adjust the mid-point of the exchange rate band to 160 naira, consistent with the budget 2013 provision but maintain the +/- 3 per cent corridor. Foreign exchange reserve at the end of 2012 was

US$44.18billion, while the ECA closed at US$9.66billion. Oil price performance suggests that the reserve level will continue to grow in the near- to medium-term. The risk to this outlook include decline in oil prices and export volume as a result of increased oil production in the United States, sharp contraction in global economic growth, and rise in domestic political disturbances which would affect oil production and export.

The money market continues to be characterised by low short-term interest rates and quantitative easing in major financial centres, low inflation, slow economic recovery, and a trend towards corporate, high yield, and emerging market bonds in search of yield spreads. Whereas nearly all the factors that helped bond market performance in the past two years remain firmly in place, bond yields are at very low levels relative to their levels in the immediate past periods. This indicates that yields will fall little in the near- to medium-term (and by extension, for prices to rise) than was the case one or two years ago. At the same time, it leaves a greater latitude for yields to rise (and prices to fall) if one or more elements of the fundamental backdrop were to change.

The outlook for investors in bonds is one of two possibilities: the overall bond market may deliver returns within one to two percentage points of its yield in 2013, if the environment improves or at the least, stay unchanged. Otherwise, fixed-income securities could have significant downsides.

Bond yields declined at 2012 year end, relative to January 2012. Activities were relatively low in the last week of 2012 as bond yields rose slightly, driven largely by a decline in demand for fixed income securities. Liquidity tightness at the money market and profit taking activities by investors may have led to the observed uptick in bond yield, as prices declined.

Table 5.1
FGN Bond Yield in 2012

Yields	28-Dec-12	6-Jan-12	Change (Points)
3 Year	11.99	15.75	(3.76)
5 Year	12.15	15.80	(3.65)
7 Year	11.96	15.64	(3.68)
10 Year	12.00	15.32	(3.32)
20 Year	12.26	14.02	(1.76)

Global inflation in 2013 is projected to hover around 3.0 - 4.0 per cent and about 6.3 per cent in developing countries. In high income countries, however, it is projected to gradually decrease to around 1.6 per cent in 2013 down from 2.0 per cent in 2012 in the advanced economies. Headline inflation is expected to further moderate in developed economies in 2013 as large output gaps and low wages in many countries keep inflationary expectations low. In the developing economies, however, higher oil prices and some country-specific supply-side constraints may exert upward pressure on inflation.

Domestic inflation is expected to moderate in 2013 to single digit on the average, on the back of stable exchange rates, increased productivity and subdued money supply growth. It is expected that core inflation will moderate relatively below food inflation and the drivers of core inflation are unlikely to rise significantly.

5.1.1 Global Output[1]

Provisional data from the World Economic Outlook (WEO) indicate that global output growth in the second half of 2012 was 3.2 percent, lower than the 4.00 per cent recorded in the first half of 2012 and was projected to increase to 3.5 percent in the first half of 2013. This is 0.1 percent decline compared with the forecast of October 2012. The outlook for the global economy is premised on policy actions that would support modest growth recovery in the euro area and the United States as well as Japan's stimulus plan. Similarly, effective policies in the emerging markets and developing economies are also expected to support a modest growth. Growth in the advanced economies was 1.3 per cent in the second half of 2012, down from 1.6 per cent in the first half of 2012 and was expected to accelerate to 1.4 per cent in the first half of 2013. In the emerging and developing economies, growth was 5.1 per cent in the second half of 2012 as against 6.3 per cent in the first half of 2012.

In Developing Asia also, growth declined to 6.6 per cent in the second half of 2012 from 8.0 per cent in the second half of 2011 and was projected at 7.1 per cent in the first half of 2013. Likewise, in Latin America and the Caribbean countries, output growth decelerated to 3.0 per cent in the second half of 2012 from 4.5 per cent in the first half of 2012 and was projected to improve to 3.6 per cent in the first half of 2013.

The IMF also indicated that annual output growth for 2013 in the advanced countries would be 1.4 per cent; emerging and developing economies, 5.5 per cent and developing Asia, 7.1 per cent. Similarly, the report showed that output growth in Latin America and the Caribbean would be 3.6 per cent; 3.4 per cent in the MENA region, and 5.8 per cent in sub-Saharan Africa, (Table 5.1).

In 2013, growth in the emerging market and developing economies is expected to reach 5.5 per cent. Supportive policies have underpinned much of the recent acceleration in activity in many economies. But weakness in advanced economies will restrict global trade volumes because of the effect on external demand, as well as on the terms of trade of commodity exporters, given the assumption of lower commodity prices in 2013. Moreover, the space for further policy easing has diminished, while supply bottlenecks and policy uncertainty have hampered growth in some economies such as Brazil and India. Although economic conditions in sub-Saharan Africa have remained generally robust relative to the sluggish global economy, its impact is limited by the contribution of the sub-region to global trade. The near-term outlook for sub-Saharan Africa remains broadly positive though downside risks have intensified, stemming mostly from the uncertain global economic environment. The impact would be most severe in countries with undiversified export base and lowand policy buffers.

The outlook for the Middle East and North Africa region is mixed. Oil-importing countries are witnessing tepid growth, and the moderate recovery expected in 2013 is subject to heightened downside risks. For the Arab countries in transition, political challenges may likely undermine growth, especially with policy buffers largely eroded. The region's oil exporting bloc is expected to record some level of growth in part due to Libya's post-war recovery, increase production in Iraq and possible restoration of peace in the Strait of Hormuz.

Table 5.2
World Economic Outlook (WEO)

	2011	2012	2013	2014
A. World Output				
World Output	**3.9**	**3.2**	**3.5**	**4.1**
Advanced Economies	**1.6**	**1.3**	**1.4**	**2.2**
USA	1.8	2.3	2.0	3.0
Euro Area	1.4	-0.4	-0.2	1.0
Japan	-0.6	2.0	1.2	0.7
UK	0.9	-0.2	1.0	1.9
Canada	2.6	2.0	1.8	2.3
Other Advanced Economies	3.3	1.9	2.7	3.3
Emerging & Developing Economies	**6.3**	**5.1**	**5.5**	**5.9**
Central and Eastern Europe	5.3	1.8	2.4	3.1
Commonwealth of Independent States	4.9	3.6	3.8	4.1
Developing Asia	8.0	6.6	7.1	7.5
Latin America and the Caribbean	4.5	3.0	3.6	3.9
Middle East and North Africa	3.5	5.2	3.4	3.8
Sub-Saharan Africa	5.3	4.8	5.8	5.7
B. Commodity Prices (US' Dollars)				
Oil	31.6	-1.0	-5.1	-2.9
Non-fuel	17.8	-9.8	-3.0	-3.0
C. Consumer Prices				
Advanced Economies	2.7	2.0	1.6	1.8
Emerging & Developing Economies	7.2	6.1	6.1	5.5

Source: IMF World Economic Outlook Update, January 2013

5.1.2 Global Inflation

Global consumer prices fell in 2012 relative to 2011 in the advanced economies, emerging market and developing economies. This was driven mainly by falling commodity prices and weak demand. In the advanced economies, consumer prices fell to 2.0 per cent in 2012 from 2.7 per cent in 2011. In the United States, consumer prices dropped from 3.1 per cent in 2011 to 1.7 per cent in 2012 as a result of lower commodity prices and weaker demand. In the euro area, consumer prices declined from 2.7 to 2.2 per cent in 2012. Inflation in advanced Asia comprising Japan, Australia, New Zealand and the newly industrialized economies decreased from 1.6 per cent in 2011 to 1.2 per cent in 2012. Japanese inflation rose marginally from -0.3 per cent in 2011 to 0.0 per cent in 2012. In developing Asia comprising China, India, and the ASEAN-5, inflation fell from 6.5 to 5.0 per cent. In Latin America and the Caribbean, inflation declined marginally from 6.6 percent in 2011 to 6.0 per cent in 2012. Consumer prices in the MENA region rose relative to 2011 levels. Among oil exporters in the region, inflation rose to 11.1 per cent from 10.1 per cent, while among oil importers, it decreased from 8.5 per cent in 2011 to 8.3 per cent in 2012. In Sub-Saharan Africa (SSA), inflation is expected to fall to 9.1 per cent in 2012 from 9.7 per cent in 2011.

Inflation in 2013 is estimated at around 3.0 - 4.0 per cent globally and around 6.3 per cent in developing countries. In high income countries however, it is projected to gradually decrease to around 1.6 per cent by the end of the first quarter of 2013 and remain around that level throughout 2013. Although the outlook is subject to both upside and downside risks with considerable consequences for low income countries, which are sensitive to price fluctuations duetohigh reliance on primary commodities, narrow range of policy instruments and weak fiscal and monetary buffers.

5.1.3 Global Oil Prices

Weak global growth and increased domestic oil production in the US, traditionally the Organisation of Petroleum Exporting Countries' (OPEC) largest customer, have led to forecast of a fall in oil prices in 2013 and a reduction in the ability of OPEC to influence prices. However, both the U.S. Energy Information Administration (EIA) and OPEC have raised their forecasts for global oil demand in 2013. The EIA has raised its 2013 growth forecasts by 110,000 barrels per day (bpd) to 1.05 million bpd in

2013. Global oil demand is now expected to total 90.2 million bpd in 2013. OPEC's projected is forecast oil demand to increase by 840,000 bpd, 80,000 bpd higher than its previous estimate. Prices for Brent Crude (equivalent to Nigeria's Bonny Light) have gained approximately 10.0 per cent year-to-date hitting a 10-month high of over $118 a barrel. OPEC forecast an average of US$110.00 per barrel in 2013 as it intends to keep production stable after the November 2012 cut. Others expect prices to average US$102/bbl, just 3.0 per cent lower than in 2012. While oil prices may slip slightly in the first quarter, supply and demand conditions will be largely balanced as a result of expected non-OPEC supplies of 1.1 million barrels per day from shale oil fields.

5.1.4 Global Trade

Growth in global trade volume decelerated sharply during 2012 to 3.8 per cent from 6.1 per cent in 2011. Developments in global trade flows were mainly owing to declining import demand in the euro area (the world's largest trading bloc) and weakness in other high-income economies, as well as from a slowdown in some of the larger developing economies including, China, India and Brazil. The outlook for 2013 is a growth of 4.3 per cent, a reduction of 1.2 per cent from the earlier forecast by the United Nations. Developing countries and economies in transition would continue to have weak demand for their exports in 2013 as a result. Also, the slight increase in international protectionism, and the protracted impasse in the world multilateral trade negotiations, would adversely affect international trade flows.

The World Trade Organisation (WTO), in September 2012, cut its forecast of growth in global trade volume in 2013 to 2.5 per cent from 3.7 per cent. The organisation warned that the situation was likely to get worse rather than better citing the euro zone crisis as the main drag on growth.

5.1.5 Domestic Output Growth

The NBS estimated real GDP growth rate for 2012 at 6.58 per cent compared with 7.1 per cent projected for the year and down from 7.5 per cent in 2011. The decline in GDP growth was due to external shocks from the contraction in the volume of trade with Nigeria's major trading partners including the euro area that experienced recession and weak recovery in the US and China. The NBS has projected a growth rate of 7.7 per cent in 2013 in its revised economic outlook for 2012-2015. It highlighted a number of factors that necessitates cautious optimism regarding the country's growth projections in the short- to medium-term. These include: the continued pass-through effects of the increase in pump prices with the partial removal of fuel (PMS) subsidy, periodic fuel scarcity across the country, increase in electricity tariff, and increase in import tariffs of some major food items, security challenges, and weather–related shocks particularly the recent flooding experienced in most parts of the country.

5.2 Outlook for Inflation and Monetary Policy in 2013

5.2.1 Inflation Outlook

Inflation at the end of the second half of 2012 was 12.0 per cent down from 12.9 and 12.6 per cent at the end of the first half of 2012 and end of the second half of 2011, respectively. The moderation would continue in 2013.

Staff estimates indicate that Headline inflation would hover around 9.7 and 11.0 per cent in March and June 2013, respectively. The estimate is 10.0 per cent confident that in June 2013, headline inflation (year-on-year) will lie between 10.8 – 11.1 per cent; while core and food will lie between 11.5 - 11.9 and 10.1 – 10.5 per cent, respectively.

The upside risks to this projections include uncertainty about the domestic pump price of premium motor spirit (PMS), global crude oil prices and demand, intensification of insecurity, and the management of the 2013 budget of all tiers of government in the country.

Figure 5.1
Fan chart for Headline Inflation

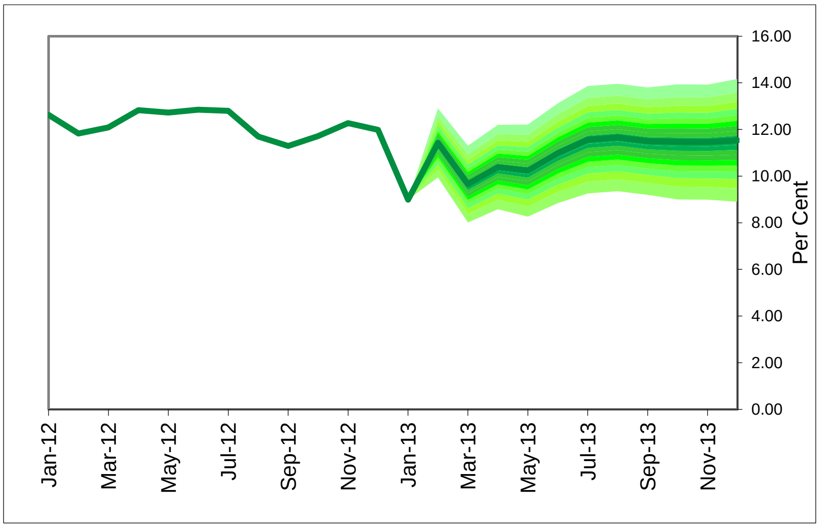


Figure 5.2
Fan chart for Core Inflation

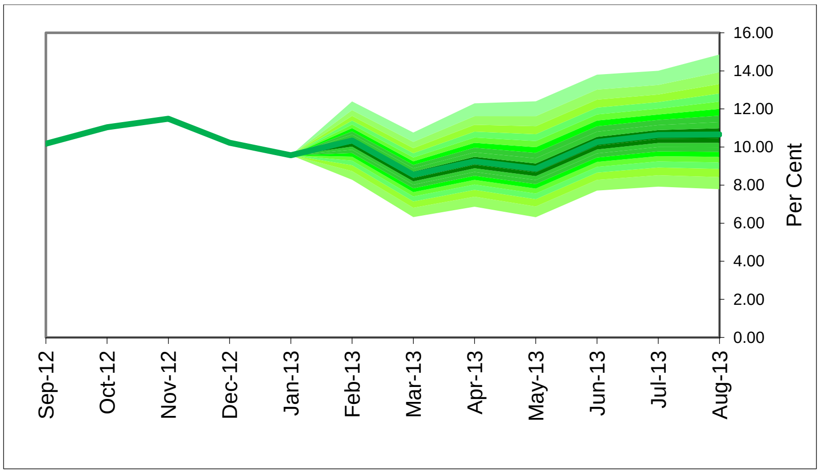


Figure 5.3
Fan chart for Food Inflation

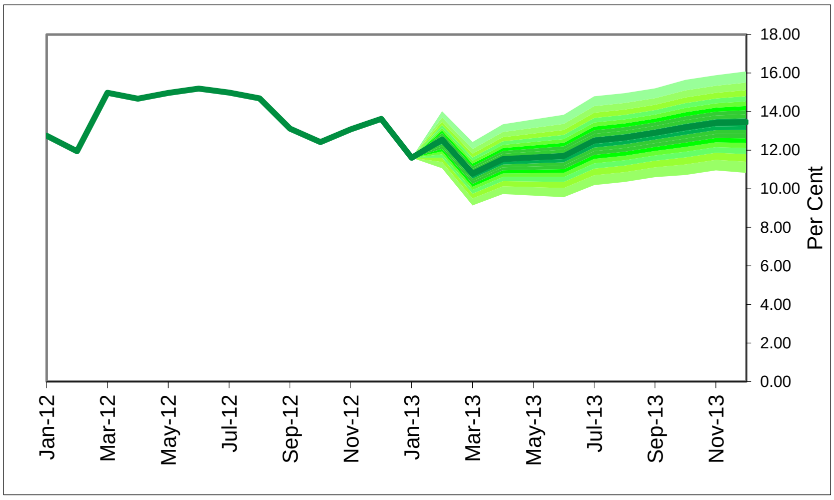


Table 5.3
Confidence Interval Estimates for the Forecast of 2013 Inflation at 10% and 90% Confidence Band

Components	Period	Central Path	Confidence Interval	
Headline			**10%**	**90%**
	2013Q1	9.7	9.5 – 9.8	8.0 – 11.3
	2013Q2	11	10.8 – 11.1	8.8 – 13.1
Food				
	2013Q1	8.5	8.4 – 8.7	6.3 – 10.8
	2013Q2	10.3	10.1 – 10.5	7.7 – 13.8
Non-Food				
	2013Q1	10.8	10.6 – 10.9	9.1 – 12.4
	2013Q2	11.7	11.5 – 11.9	9.6 – 13.8

Source: Research Department, CBN

APPENDICES

Central Bank of Nigeria Communiqué No. 84 of the Monetary Policy Committee Meeting of Monday and Tuesday July 23 and 24, 2012

The Monetary Policy Committee met on July 23 and 24, 2012 with 11 out of the 12 members in attendance. The Committee reviewed the economic conditions and challenges in the first half of the year against the backdrop of developments in the international economic and financial environments with a view to considering the monetary policy options for the remaining part of 2012.

The Global Economy

The Committee noted the continued fragility of global economic recovery and the increased downside risks to growth in 2012. In particular, the sovereign debt and financial sector problems, together with recession in the UK and some Euro zone countries and reduced growth rate in the US continue to affect China, India and Brazil's export-driven growth. This has necessitated a downward revision of the projected global output growth for 2012 by the IMF in the July 2012 WEO Update. While the effort to fix banks and sovereign balance sheets by the European Central Bank using long term refinancing operations eased funding constraints and broadly rallied the assets markets, these gains were short-lived due to the intensification of policy uncertainty after the Greek and French elections, strong dampening effects of the financial fragility in the Euro Area peripheral states and public resistance of austerity measures. In the advanced economies, the weakness in the labor and housing market, the elevated debt level of the households and the need to fix the encumbered balance sheets of banks are likely to continue to constrain growth prospects. Consequently, the growth forecast in the advanced countries was downgraded by 0.2 percentage points to 1.4 per cent in 2012 relative to the April WEO estimates.

In the United States, reduced retail sales and investment, growth rate concerns about public debt and the uncertainty over domestic fiscal plans due to failure to reach an agreement on near-term tax and spending policies constitute severe threats to economic recovery. Thus, output growth in the US for 2012 was revised slightly downward to 2.0 per cent from 2.1 per cent by the IMF in the July 2012 WEO.

In the Euro area, Real GDP growth is expected to contract from an annual rate of about 1.4 per cent in 2011 to -0.3 per cent in 2012 with France, Italy and Spain leading the contraction in growth. The revised growth rate of 1.0 per cent for

Germany in July is an improvement of 0.4 per cent over the April 2012 IMF growth projections. The risk to growth in the euro area is amplified by geopolitical uncertainties and the risk of stagnation and long-term damage to potential growth as unemployed workers lose skills and new entrants find it difficult to join the active labor force.

In the UK, despite the Bank of England's monetary measures to stimulate growth, the effect of the Treasury's fiscal consolidation for reducing the budgetary risk remains strong, leading to weak business and consumer confidence. Thus, real GDP growth was projected at 0.2 per cent against the initial projection of a contraction of 0.4 per cent. Spain's latest round of austerity measures failed to reassure investors and markets, as the country's borrowing costs continued to rise.

In emerging economies, the lag effect of past policy tightening has continued to weaken internal and external demand thereby limiting growth. In China, real GDP growth slowed to 7.6 per cent year on year in the second quarter of 2012, compared with 8.9 per cent in the fourth quarter of 2011, due mainly to weak external conditions, particularly sluggish demand from the euro area. Real GDP growth forecast for 2012 has been reduced to 8.0 per cent from earlier forecast of 8.2 per cent. India's real GDP growth moderated to 5.3 per cent, year on year, in the first quarter of 2012 compared with 6.2 per cent in the fourth quarter of 2011, with the projection for 2012 put at 6.1 per cent compared with 7.1 per cent in 2011.

Output performance in Sub-Saharan Africa is projected at 5.4 per cent in 2012. While exports to Europe have dropped, strong terms of trade and increased trade diversification towards emerging markets have helped support growth in the region. A major issue in the region, however, is that inflationary pressures and reduced fiscal space present limited flexible policy options for manoeuver, especially if downside risks materialize.

Overall, the slowdown in global economic activities would have serious implications for the Nigerian economy in the following respects: A softening in the demand for oil and consequent decline in oil revenues; reduction in foreign exchange earnings which would impair the build-up of external reserves and consequently exert pressures on the exchange rate; increased budget deficit as government would not be able to realize its revenue projections; and increased public sector borrowing to finance expenditure outlays.

Key Domestic Macroeconomic and Financial Developments

Output and Prices

The revised GDP growth rate projected by the National Bureau of Statistics (NBS) for the Q2 2012 at 6.37 per cent was higher than Q1 2012 level of 6.17 per cent, indicating increased momentum in the economy. Overall, GDP growth for 2012 was projected at 6.38 per cent, down from the realized growth rate of 7.74 per cent in 2011. The projected decline in GDP growth for 2012 is attributable to a number of factors including: the estimated loss of about ₦207.41 billion in national output during the nation-wide strike in January; the dampening effects of low crude oil demand from major trading partners notably the US, Euro area, and China; falling oil prices, and weak aggregate domestic demand following rising prices across major segments of the economy; as well as the prevailing security concerns.

The non-oil sector remained the major driver of growth recording 7.52 per cent increase in contrast to the oil sector which contracted by 0.24 per cent during the period. The Committee noted the sustained slowdown in the growth in agricultural output of 4.08% in the second quarter compared with 4.15% in the first quarter, traceable to the continued security challenges which affected a large part of the farming population in the northern parts of the country during the period. The Committee also expressed serious concerns over the continued decline in the contribution of oil to GDP, which became apparent from the second half of 2011, and intensified through Q1 and Q2, 2012. Its contribution to growth, declined by 0.40 per cent apiece in the third and fourth quarters of 2011, and declined to 0.40 and 0.04 per cent in Q1, 2012 and Q2 2012, respectively. There are serious concerns over continuing fiscal leakages, bunkering and oil theft in the Niger-Delta area.

This notwithstanding, the Committee was pleased to note that the growth projections were against the backdrop of severe weaknesses in the global economy. Thus, domestic output growth was anchored by the positive impact of the banking sector reforms as well as the initiatives by government to stimulate the real economy such as improvement in national electricity generation which rose to 2,900 MW/h as a result of increased gas supply to the thermal stations, increased water level at the hydro stations, and the resuscitation of some dormant generating stations.

The Committee noted significant downside risks to growth in the near-term, in particular the fall in the average spot price of Nigeria's reference crude, the Bonny Light, from US$121.10 in the first quarter of 2012 to US$109.32 in the second quarter, and the current security challenges which continue to pose a threat to agriculture and manufacturing.

Prices

The Committee noted the threat of Inflationary pressure which has re-emerged since the beginning of 2012. The year-on-year headline inflation rose to 12.9 per cent in June, 2012 against the 12.7 per cent in May 2012. Core inflation rose to 15.2 per cent in June, 2012 from the 14.9 per cent level in May, though food inflation, declined from 12.7 per cent in May to 12.0 per cent in June 2012. The major drivers of headline inflation during the period were food and non-alcoholic beverages and housing, water, electricity, gas and other fuels. The acceleration in core inflation in the second quarter was traced to increases in the contributions of processed food and housing, water, electricity/gas and other fuels.

The Committee noted that in addition to the lag effects of the partial removal of petroleum subsidy in January, other factors fuelling the upside risk to inflation in the near-term include borrowing by government to cover large fiscal deficits in the 2012 budget, and the upward review of electricity tariffs and import Duty on wheat and rice in July 2012.

Monetary, Credit and Financial Market Developments

Broad money supply (M2) grew by 1.35 per cent in June 2012 over the level at end-December, 2011, translating to annualized 2.70 per cent growth, which was lower than the growth rate of 10.77 per cent year-on-year. Relative to December 2011, aggregate domestic credit (net) declined by 2.73 per cent in June 2012, annualized to a decline of 5.46 per cent. The decline contrasted sharply with the growth of 49.76 per cent year-on-year. Although overall credit to the private sector increased by 3.60 per cent, the Committee noted that credit to state and local governments grew by 14.23 per cent or 28.46 per cent. On annualized basis, credit to core private sector grew by 3.2 per cent or 6.4 per cent when annualised. Consequently, the Committee reiterated its earlier advice that the CBN should put in place appropriate measures that would enhance the flow of credit to the core private sector, and fix the transmission mechanism.

The Committee noted that rates in all segments of the money market trended upward between May 21 and July 11, 2012. Inter-bank call and OBB rates which opened at 14.61 and 14.43 per cent, closed at 15.55 and 15.50 per cent, respectively. The increase in the rates was a reflection of the tight liquidity in the banking system traceable to the aggressive open market operations, given that the MPR remained unchanged during the period.

Retail lending rates remained high in June 2012 as the average maximum lending rate remained unchanged at 23.44 per cent in June 2012. On the other hand, the consolidated deposit rate fell marginally from 3.83 per cent in May to 3.82 per cent in June. In view of these developments, the Committee reiterated its earlier call to put in place an appropriate mechanism for reducing the interest rate spread, while stabilizing interbank rates to sustain liquidity and facilitate intermediation in the banking system.

External Sector Developments

Gross external reserves as at July 19, 2012 stood at US$37.16 billion, representing an increase of US$ 0.33 billion over the level of US$36.83 billion at end-May 2012. The exchange rate at the wDAS-SPT opened at N157.26/US$ on May 21 and closed at N157.43/US$ on 12th July 2012, representing N0.17k or 0.11 per cent depreciation during the period. At the interbank segment, the selling rate opened at N158.80/US$ and closed at N161.20/US$, with a period average of N161.60/US$, representing a depreciation of N2.40k or 1.51 per cent. At the BDC segment of the market, the selling rate opened at N160.00/US$ and closed at N163.00/US$, representing a depreciation of N3.00k or 1.87 per cent for the period. During the period, the naira weakened to as low as N163.00/US$ due to developments in the external economy and the CBN had to intervene significantly in the interbank market to restore stability. The Committee expressed concern about the declining accretion to external reserves. The Committee noted that the premia between the rates at the wDAS and the interbank and between the wDAS and the BDCs narrowed towards the end of the review period, and therefore urged the Bank to sustain the existing measures to discourage speculative demand in the market.

The Committee's Considerations

Against the backdrop of the foregoing review of the global and domestic economic and financial environments, the Committee observed that monetary policy faces a difficult task in terms of delivering price stability. Domestic conditions indicate rising unemployment, poverty, declining growth and rising inflation. Consequently, the money and foreign exchange markets appeared to be operating at sub-optimal levels. It noted that with the weakened global outlook underpinned by the slowdown in economic activities in the US, and major emerging economies like Brazil, China and India, contraction in output in the Euro area along with the persisting debt crisis which is proving difficult to resolve, lower demand for crude oil and lower crude oil prices, coupled with the lower domestic output growth, build-up of inflationary pressures, slowdown in the accretion to external reserves and the attendant pressures on the exchange rate as well as possible shortfall in the projected revenue for 2012, the ominous signs for the domestic economy are evident. In this regard, therefore, monetary policy is faced with very difficult choices, as whatever policy action taken must be weighed against the possible trade-off(s) and implications for the wider economy.

The Committee further noted that the inflation environment remained uncertain with the possible pressures coming from the core component in the medium term. Domestic inflation has maintained its upward trend, and is expected to remain within that region over the six month forecast period. More so, the Committee observed that since its meeting in May 2012, growth prospects continued to be threatened by developments in Europe, China, India and the US, as well as the very slow progress in structural reforms and poor implementation of the capital budget for 2012.

The Committee observed further that during 2008-2009 when oil prices declined sharply and the domestic currency came under intense pressure, the CBN was able to defend the Naira because the nation had buffers, having accumulated substantial foreign exchange reserves when oil prices were high, but that this time around that luxury does not exist, as the excess crude account has largely been depleted, and is still being depleted by the tiers of government.

The Committee also noted that the upside pressure could be further exacerbated by pressures in the foreign exchange market in view of the high demand in the market and the likely impact of the decline in international oil prices in recent weeks on the country's external reserves. Bonny light crude oil prices have not rebounded from their recent lows of around US$97 per barrel in June, partly due to the crisis in the Euro area, a major export destination of Nigeria's crude oil.

The Committee, therefore, identified a number of key concerns that it was confronted with:

i. Stemming the inflationary pressures arising from both domestic and external sources;
ii. Sustaining a stable exchange rate for the naira;
iii. Creating a buffer for the external reserves; and
iv. Mitigating the impact of the continued slowdown in global economic activities, particularly, in the US, Europe and China on the Nigerian economy.

In the Committee's view, these challenges would persist in the medium-to-long term with the attendant consequences on oil receipts. The Committee noted the fears about Europe's debt crisis which flared recently as concerns intensified that Spain would be next in line for a government bailout. It noted that the potential cost of a Spanish bailout far exceeds what is available in existing emergency funds. Already, the European decline has taken its toll on oil demand and exports. The rising global uncertainty and weaker external demand are causing headwinds for export-dependent economies. The unfavorable outlook is further strengthened by the fragile domestic conditions. The MPC is of the view that growth could further decline during the rest of the year.

Thus, the MPC is confronted with basically three choices: first, lower the MPR in the face of sustained slowing domestic output growth and concerns about global growth prospects. The MPC viewed that a lowering of the rates in the face of sustained slower growth of output and global growth prospects could further weaken the exchange rate and adversely affect reserves at a time when the country needs to build up buffers against external shocks. It also reiterated its view that the growth challenge is a result of poor record of implementation of structural reforms and the capital budget.

Second, to leave the MPR unchanged. This is against the background of upward trending inflation figures and the precarious picture painted by the six months inflation forecast of the Bank, revised upwards since the MPC meetings of May, 2012. Inflation is expected to average 12.0 per cent during the next six months with core and food inflation being much higher. The forecast is mainly due to the increase in electricity tariffs and the tariff on imported rice and wheat.

The Committee recognized that a logical response to the increasing inflationary outlook would be an increase in the MPR, especially considering the impact of sustained liquidity in the banking system on exchange rates. It was, however, conscious of the impact of higher interest rates on small businesses and the potential for higher non-performing loans on the books of banks. In addition, it is important to leave room and flexibility for further tightening should conditions so warrant in the near future.

However, it is important to note that the significant liquidity on the books of banks has not led to intermediation and lending to the real economy. Banks have continued to take advantage of high yields on government securities to direct credit away from the core private sector. In addition, the liquidity has provided ammunition for speculative activity in the foreign exchange market with implications for inflationary expectation.

Against the foregoing, therefore, the MPC reiterated the need to choose a policy trajectory that would have the least negative impact on the wider economy, to the extent that the longer-term benefits to the economy far outweigh the short-term costs. It was therefore, imperative to reduce the liquidity in the banking system and minimize the upward movement in MPR.

The Committee's Decisions

In view of the foregoing, the Committee, decided as follows:

(i) Retain the Monetary Policy Rate (MPR) at 12.00 per cent with symmetric corridor of +/-200 basis points by a vote of 10 to 1. One member voted to reduce MPR by 25 basis points to 11.75 per cent.

(ii) Voted by a decision of 10 to 1 to increase the Cash Reserve Requirement (CRR) from 8.0 per cent to 12.0 per cent with effect from July 25th. One person voted to retain the CRR at 8.0 per cent.

(iii) Unanimously agreed to reduce the Net foreign exchange Open Position (NOP) to 1.0 per cent from 3.0 per cent with immediate effect.

Sanusi Lamido Sanusi, CON

Governor

Central Bank of Nigeria

24th July, 2012

Central Bank of Nigeria Communiqué No. 85 of the Monetary Policy Committee Meeting of Monday and Tuesday, September 17 and 18, 2012

The Monetary Policy Committee (MPC) met on September 17 and 18, 2012, with 10 out of the 12 members in attendance. The Committee reviewed the conditions and challenges that confronted the domestic economy during the first eight months of 2012 against the backdrop of international economic and financial developments with a view to reassessing monetary policy options in the short-to-medium term.

The International Economic Developments

The Committee noted that the global economy showed signs of further weakness in the last three months, with the latest data not showing any evidence of improvement up to the beginning of the third quarter of 2012. The Committee also observed that the weak growth resulted from considerable financial market fragilities in the euro area with resultant negative spillover effects to other regions, uncertainty resulting from the Eurozone crisis as well as poor macroeconomic performance in other advanced economies. Rising food and energy prices is also a contributory factor.

In July 2012 IMF World Economic Outlook (WEO) update projected that global output would moderate to 3.5 per cent in 2012, which is 0.1 percentage point lower than the forecast of April 2012. Growth in advanced economies was projected to decline from 1.6 per cent in 2011 to 1.4 per cent in 2012, with the slowdown being most severe in the peripheral economies, where the dampening effects and uncertainty from tighter financial conditions are strongest.

In the US, real GDP grew at an annualized rate of 1.5 per cent in Q2 of 2012, down by 0.5 percentage point from 2.0 per cent in Q1. The sluggish growth was primarily due to declining aggregate consumption, government spending, and negative terms of trade.

The euro zone is on the brink of a double-dip recession following the contraction in output between April and June. Real output across the 17-nation bloc fell by 0.2 per cent in Q2 of 2012 while signs of further contraction are in the horizon. Rising unemployment and large scale fiscal retrenchment coupled with increased taxes in a number of countries constrained aggregate demand leading to cut-back on investment and low export growth. Unemployment level across the zone has attained a record high of 11.3 per cent, the highest since 1995, with Spain recording the highest level and Austria the least. Weak financial markets and the persisting sovereign debt crisis as well as rising energy prices led the European Central Bank (ECB) to retain its main refinancing interest rate at 0.75 per cent. EU members remain cautious about the ECB's Outright Monetary Transactions scheme, which is based on strict adherence to austerity measures and fiscal consolidation pact.

In Asia, most economies recorded significant slowdown in economic activity up to Q2 of 2012, mainly on account of weakening exports and investment. Export growth has moderated, reflecting the sluggish demand from Europe while investment remained weak due to heightened volatility of capital flows and the lagged effects of tighter domestic monetary policies. China's real GDP growth slowed to 7.6 per cent in Q2 from 8.1 per cent in Q1 due mainly to decline in net exports. Growth moderated in Japan especially in Q3 due to softening in manufacturing activity. India's real GDP, year-on-year, moderated to 5.5 per cent in Q2 of 2012 from 6.1 per cent in Q4 of 2011, mainly as a result of deceleration in private consumption. Overall, the growth trajectory for the remainder of the year tends toward a downturn, as downside risks, including weak external demand, elevated price levels, widening twin deficits, falling investments, and rising interest rates, remain heightened.

Robust economic activities in the MENA and Sub-Saharan Africa regions would partly offset the declining output growth in the advanced and emerging markets in 2012. Real GDP growth was projected at 5.0 per cent in each of the regions, underpinned by strong natural resources prices, new natural resources exploration and production in several countries, recovery from drought in the Sahel and parts of Eastern Africa, strong post-conflict recovery in some countries, improved governance practices and growing disposable income. Despite these developments, growth in the regions faces significant downside risks on the back of increased global uncertainties.

The Committee believes that the recent quantitative easing measures by the European Central Bank and the US Federal Reserve System could be responsible for the high crude oil prices in the international market. It highlighted the possible increase in carry trade and the risk of a bubble in the domestic capital market.

Domestic Economic and Financial Developments

Output

Recent macroeconomic data indicates that the economy is performing better than forecasts although growth in the first two quarters of 2012 has remained consistently below the corresponding growth rates in 2011. The provisional real GDP growth rate from the National Bureau of Statistics stood at 6.28 per cent in Q2 of 2012, up from 6.17 per cent in Q1 2012 but lower than the 7.61 per cent recorded in the corresponding period of 2011. The non-oil sector remained the major driver of growth recording a 7.50 per cent increase in contrast to the oil sector, which contracted by 0.73 per cent during the period. Overall GDP growth for fiscal 2012 has been revised upwards to 6.77 per cent from the earlier projection of 6.50 per cent. The Committee welcomed the promising growth performance although it expressed concern that the overall output growth projection for 2012 is still lower than the 7.45 per cent recorded in 2011.

The growth drivers within the non-oil sector remained agriculture; wholesale and retail trade; and services; which contributed 1.94, 1.69, and 3.16 per cent, respectively. The Committee noted that the relatively robust growth projections despite the slowing global economy reflected the continuing favorable conditions for increased agricultural production, improved security situation and power supply.

Prices

The Committee observed that the inflationary pressures experienced during the first half of 2012 appear to be moderating in the third quarter. The year-on-year headline inflation declined to 11.7 per cent in August 2012 from 12.8 per cent in July while core inflation decelerated to 14.7 from 15.0 per cent during the same period. Also, food inflation declined sharply to 9.9 per cent in August 2012 from 12.1 per cent in July. The significant decline in year-on-year food inflation was attributed to the decrease prices of both processed foods (from 4.2 to 3.6 per cent) and farm produce (from 7.9 to 6.4 per cent). The Committee observed that the inflationary pressures from the partial removal of petroleum subsidy in January, 2012 appear to have waned in Q3, 2012, and that given the relatively stable exchange rate regime, the pass-through to domestic prices was low during the period. The Committee, however, recognized the upside risk to inflation in the near-term to include increased spending in the fourth quarter and monetized capital flows following the US QE3.

Monetary, Credit and Financial Markets' Developments

Broad money supply (M2) grew by 3.50 per cent in August 2012 over the level at end-December, 2011, which annualized to 5.25 per cent. The annualized growth rate is significantly lower than the growth rate of 15.43 per cent recorded in 2011. Aggregate domestic credit (net) declined by 3.82 per cent in August 2012, annualized to a decline of 5.73 per cent from the level at end-December 2011 level. The decline in aggregate domestic credit (net) in August 2012 was due to a huge fall in credit to Government (net), which declined by 246.47 per cent or 369.71 per cent on annualized basis. This development reflected the combined effects of the significant growth in Federal Government deposits with the banking system and contraction on claims to government. The introduction of a Treasury

Single Account (TSA) appeared to have had the desired effect of reducing government borrowing.

Interest rates in all segments of the money markets rose initially, in response to the increase in the Cash Reserve Requirement (CRR) by 400 basis points at the MPC meeting of July 23 and 24, 2012. The rates, however, trended downwards toward the end of the review period. The inter-bank call and OBB rates, which opened at 17.85 and 14.99 per cent, closed at 14.19 and 13.56 per cent, respectively, during the review period. Developments in the interest rate structure indicated that the retail lending rates remained high in August 2012. The average maximum lending rate increased marginally to 23.76 per cent in August 2012 from 23.45 per cent in July. However, the average interest bearing deposit rate declined to 6.24 per cent in August 2012 from 6.64 per cent in July. Thus, the spread between the average maximum lending rate and the average interest-bearing deposit rate widened to 17.53 per cent in August 2012 from 16.81 per cent in July. The Committee expressed concerns that lending rates have remained high and enjoined the Bank to sustain its efforts towards the reduction in interest rate spread, while stabilizing interbank rates to sustain liquidity and facilitate intermediation in the banking system. The Committee noted that this can only be achieved by sustaining the current efforts at reducing overheads in the banking industry and deepening capital market reforms to diversify sources of finance for the real economy, and complement bank loans.

The Committee observed that the recovery in the Nigerian capital market continued during the review period, as equities market indicators were positive. The All-Share Index (ASI) increased by 9.96 per cent between June 29, 2012 and August 31, 2012, while Market Capitalization (MC) increased by 9.64 per cent during the same period. Equity Market Median PE ratios at 9.86 in August 2012, fell below the long-run median of 10.77 by 0.91 or 8.44 per cent, suggesting bargain valuations and an imminent rebound. The Committee observed that the performance of the NSE during the period was consistent with the global trends, especially in the wake of monetary expansion.

External Sector Developments

At the Wholesale Dutch Auction System (WDAS), the exchange rate during the period, July 25 – August 31, 2012, opened at N157.40/US$ and closed at N157.36/US$, representing an appreciation of N0.04k. The appreciation was due to the combined effects of the increase in Cash Reserve Requirement, reduction in the Net open position and the policy barring DMBs/Discount Houses from accessing Lending windows (SLF and Repo) and WDAS simultaneously. At the interbank segment, the selling rate opened at N160.05/US$ and closed at

N158.15/US$, representing an appreciation of N1.90 or 0.01 per cent. The appreciation experienced in this segment was due to increased supply of foreign exchange by oil companies to the interbank market. At the BDC segment of the foreign exchange market, the selling rate opened at N163.00/US$ and closed at N161.00/US$, representing an appreciation of N2.00k or 0.01 per cent for the period. The appreciation recorded in this segment was traced to the low demand of foreign exchange by end users vis-à-vis the high supply of foreign exchange at the interbank market and the apparent taming of speculative activities.

The Committee noted with satisfaction that the premia between the rates at the WDAS and the interbank; and between the wDAS and the BDCs; narrowed towards the end of the review period, and therefore encouraged the Bank to sustain and complement existing measures to discourage speculative demand in the market. In general, the Committee noted that the decisions taken at the last meeting of the MPC had produced the desired result.

In the same vein, the Committee expressed satisfaction with the significant accretion to external reserves during the period. Gross external reserves as at September 5, 2012 stood at US$ 41.81 billion, representing an increase of US$ 6.40 billion or 18.07 per cent above the level of US$35.41 billion at end-June 2012. External reserves increased by US$ 8.88 billion or 27.0 per cent on a year-on-year basis compared with US$ 32.93 billion at end- August 2011. The increase in the reserve level was driven mainly by proceeds from crude oil and gas sales and crude oil related taxes. The foreign reserves level could finance over seven months of imports.

The Committee's Considerations

Given developments in the global and domestic economy and the financial markets, the Committee noted that the weak global growth indices called for cautious optimism by policymakers. The resolution of the euro area debt crises remains a major concern even with the approval of the efforts of the European Central Bank to address the debt crises in the euro area by the German Constitutional Court. It further noted that its decisions at the July MPC Meeting appeared to have had some positive impact in a number of areas, namely: a deceleration in year-on-year inflation in August 2012, stability of short term interest rates around the Monetary Policy Rate (MPR), buildup in external reserves and stability in the exchange rate. However, core inflation is still high at 14.7 per cent in August. The threat of increased inflow of hot money arising from the actions of the US Fed to further stimulate the economy through its QE3 activities and its capital reversal implications were noted.

The Committee noted the rise in oil prices but cautioned against a hasty deployment of the windfall to immediate consumption as the trend could be reversed. Monetary policy could not, therefore, under the circumstance, react to what may be purely temporary developments.

Despite the threats from a combination of global and domestic factors, the Committee noted that the level of economic growth in the third quarter of 2012 remained robust and the year-end forecast would likely be met owing largely to the improvements in power supply and the steady progress of reforms, actions in respect of the alleged fraud in the petroleum subsidy regime and improved fiscal operations. The Committee noted that these measures, generally take time to impact the real economy.

With this development, the Committee observed that the inflation outcome for the remaining period of the year is likely to be lower than the initial forecast of 14.7 per cent. The Committee would continue to monitor developments in the price level, and remain firm in its commitment to price stability as its mandate. The Committee also noted that the growth rate of real output, though impressive by global trends, was on the downward trend since Q1 2010 most especially in the agricultural sector. It was of concern to the Committee that the declining output in the agricultural sector was traceable to the security challenges and high intensity of rainfall which has led to flooding in several parts of the country. It noted that the measures taken at the last MPC meeting have succeeded in stabilizing the foreign exchange market as well as enhancing the build up in external reserves.

Overall, the MPC believes that the current rise in crude oil prices and the tight monetary policy regime presented an opportunity for building reserve buffers in the light of the uncertainties surrounding the global economy.
The Committee, therefore, identified the key policy challenges to include:

1. Protecting the domestic economy and building external reserves buffer;
2. Potential large inflow of "hot money" resulting from further monetary easing in the US and Europe and improved yield on fixed income instruments;
3. Persisting high core inflation rates;

The Committee noted that this moderation in headline inflation has not been accompanied by a significant decline in core inflation. Given the unpredictability of food prices, there is a need to watch this trend as we approach year-end before altering the present monetary stance.

Decisions:

In view of the foregoing, the Committee by a unanimous vote decided as follows:

1. Retain the Monetary Policy Rate (MPR) at 12 per cent with +/-200 basis points corridor;
2. Retain the Cash Reserve Requirement (CRR) at 12.0 per cent.
3. Retain the Net Open Position at 1.0 per cent.

Thank you.

Sanusi Lamido Sanusi, CON
Governor
Central Bank of Nigeria

18th September, 2012

Central Bank of Nigeria Communiqué No. 86 of the Monetary Policy Committee Meeting of Monday and Tuesday November 19 and 20, 2012

The Monetary Policy Committee (MPC) met with nine out of the twelve members in attendance. The Committee reviewed the domestic and global economic conditions and financial environment as well as the challenges that faced the Nigerian economy during the first ten months of fiscal 2012, with a view to reassessing monetary policy options in the near-to-medium term.

The International Economic Situation

The Committee noted the continued deceleration in global output, which resulted from a combination of austerity-driven euro-zone developments, weak recovery in some Asian economies, and slowdown in major emerging market economies. In addition, high and rising unemployment, fragile financial conditions, weak housing markets, and deterioration in both public and private sector balance sheets in some major industrial countries posed major risks to global economic recovery. Thus, global output growth in 2012, which was earlier projected at 3.5 per cent in July 2012 by the IMF was revised downward to 3.3 per cent in the October 2012 World Economic Outlook; that of 2013 was also revised downward from 3.9 to 3.6 per cent. According to the October 2012 projection, there is a high probability of global growth falling below 2.0 per cent in 2012 and this would mirror the recession in the advanced economies and the slowing output growth in key emerging markets and developing economies.

Growth in the advanced economies is estimated at 1.3 per cent in 2012 and 1.6 per cent in 2013, reflecting a downward revision of 0.1 and 0.3 percentage point, respectively. The US economy continued on the path of modest recovery as real output expanded by 2.0 per cent in the third quarter of 2012 compared with 1.3 per cent in the second quarter, reflecting the positive contributions from personal consumption expenditure, government spending, private inventory and residential housing investment in the face of current low mortgage rates. However, the recent hurricane Sandy across the east coast of the United States, constitutes an immediate risk to the sustainability of the recent growth rally and its impact is expected to truncate US recovery in the last quarter of 2012. Another major risk to the medium term growth trajectory is the US "fiscal cliff". The IMF has suggested a gradual resolution of the fiscal impasse in order to avoid the possibility of a sharp contraction. The Euro zone is officially in recession in addition to the persisting uncertainty over agreements on a fiscal union, the start of European Central Bank's (ECB) oversight of European banks and the fragility of the Greek, Spanish and other peripheral economies. Real GDP in the zone is projected to contract by 0.4 per cent in 2012 with unemployment rising to 11.50 per cent. The core economies in the zone are expected to experience low but positive growth during 2012-13 while most economies in the periphery are expected to suffer sharp output contraction in 2012 because of tight fiscal policies and weak financial conditions. The German economy recorded slight recovery with unemployment falling to 6.5 per cent while the United Kingdom snapped out of a recession, recording a growth rate of 1.0 per cent after three successive quarters of contraction. Rising uncertainty about the viability of the Euro zone and the possibility that the euro area crisis will escalate remains a major downside risk to growth and financial sector stability. Overall, continued austerity measures in the euro area are having negative spill-over effect on the German economy which is now wobbling on the verge of a recession due to widespread drop in aggregate demand.

In emerging Asia, growth was estimated to have significantly weakened to less than 7 per cent in the first half of 2012. Latest data indicate that growth in China slowed for the seventh consecutive quarter to 7.40 per cent in Q3, 2012, lower than the Q2, 2012 figure of 7.60 per cent. The Peoples Bank of China (PBC) had already embarked on sequential monetary easing operations in order to loosen liquidity conditions and stimulate growth. This will, however, increase the risk of inflating real estate prices and a possible bubble with potential adverse impact on the Chinese financial system. In India, output is expected to expand by 5.80 per cent in 2012 as against 6.50 per cent in 2011 with the slowdown resulting from waning business confidence, sluggish structural reforms, policy rate hikes designed to rein in inflation, and flagging external demand. In other parts of Asia, growth has dipped, hampered by the weak performance of the Chinese economy. Most countries continue to be affected by weak export growth while the Monetary Authorities have responded with expansionary monetary policy. Output growth for 2012, at 5.1 per cent, up from 3.3 per cent in 2011for the Middle East and North Africa (MENA) region, could be considered robust in the face of global realities, but there is a sharp difference in growth performance between the oil and non-oil exporting countries in the region. For the non-oil exporting economies, growth is projected to register just above 2.0 per cent and 6.6 per cent for the oil exporting economies. Economic activities in the non-oil exporting countries have remained suppressed by the growth deceleration in the major trading partner-economies, internal conflicts and pervading political/economic uncertainties. The robust growth projection for the oil exporting countries, on the other hand, is anchored on increased government expenditure supported by historically high oil prices. Despite these developments, the Committee is of the view that growth for the MENA Region in the medium term is faced with the risk of weak external demand, instability in the region and an increasingly constrained environment for private

sector activity. However, Africa's robust growth is not likely to affect the downward trend in global output because of its small share (2.7 %) of global output.
Overall, the Committee believes that the fiscal gridlock in the US, the lingering euro zone financial and economic crisis, as well as the softening output growth in the key emerging Asian economies, could have serious implications for the domestic economy in the near-to-medium term. Specifically, any negative shock to the current high prices of crude oil would have adverse implications for fiscal revenue flows and the external current account position, even though current forecasts and developments in the Middle East do not suggest the possibility of a shock in the near term.

Domestic Economic and Financial Developments

Output

The National Bureau of Statistics has revised the real Gross Domestic Product (GDP) growth for fiscal 2012 downwards to 6.61 per cent from the earlier projection of 6.85 per cent, indicating that the economy is encountering growth challenges not previously anticipated. The estimates revealed a real GDP growth rate of 6.48 per cent in the third quarter of 2012, up from 6.39 per cent in the second quarter but lower than the 7.37 per cent recorded in the corresponding period of 2011.

The Committee noted with concern the continuing decline in the contribution of the oil sector to growth, in an area of strong oil price performance, which became apparent in the last half of 2011 and also the decline in the contribution of agriculture to growth since Q3, 2011, in spite of the investment in the Agricultural transformation initiatives of the Federal Government. The relatively robust growth projections for 2012 despite the slowdown in the global economy reflected the continuing favorable conditions for increased agricultural production, the impact of the banking sector reforms and the initiatives by government to stimulate the real economy. In this regard, the Committee welcomed the recent improvements in electricity generation which has impacted positively on manufacturing activities and overall capacity utilization. The Committee enjoined the Federal Government to sustain the efforts.

The Committee, however, observed that the recent flooding in several parts of the country, current security challenges and corruption scandals posed serious downside risks to growth in the near-to-medium term. Indeed, it noted that the full impact of the widespread flooding was yet to manifest while the cost to the economy was yet to be estimated. The committee noted the combined effects of the high tariffs, floods and drought on global wheat supplies which have led to higher prices of wheat in Nigeria.

Prices

The Committee noted that inflationary pressure, which moderated in the third quarter of 2012, re-emerged in October 2012. The year-on-year headline inflation inched up to 11.70 per cent in October 2012 from 11.3 per cent in September while food inflation increased to 11.1 per cent from 10.2 per cent in September. Core inflation continued its sequential four-month moderation to 12.40 per cent from 13.10 per cent in September while the risk of food inflation remained hawkish, thus creating mixed price signals. The major drivers of inflation during the period include food and housing, water, electricity, gas and other fuels. The pick-up in food inflation contradicted recent trends and may not be unconnected with effects of the floods on farmlands, the impact of which poses an upside risk to inflation in the near-term, coupled with continued imported food inflation. Although core inflation continued its moderation, the Committee considered the current level to still be elevated, driven largely by: processed foods (3.7 per cent); housing, water, electricity, gas and other fuels (4.2 per cent); clothing and footwear (1.4 per cent); transport (1.10 per cent); furnishing, household equipment and housing maintenance (0.7 per cent); and education (0.6 per cent). However, the major drivers of core inflation remained outside the scope of monetary policy alone which was helpless in addressing the structural components of inflation. In the meantime, fuel prices have risen generally above the official pump price even without the total removal of oil subsidy.

Monetary, Credit and Financial Markets Developments

Broad money supply (M2) grew by 8.23 per cent in October 2012 over the level at end-December, 2011, which annualizes to 9.87 per cent. Aggregate domestic credit (net) declined by 3.48 per cent in October 2012. The decline in credit to government between June and October implies that the Federal Government is increasingly becoming a net creditor to the banking system which perhaps reflects the impact of better fiscal management including the introduction of Treasury Single Account. Interest rates in all segments of the money market moderated between September 19 and October 30, 2012, reflecting increased liquidity in the banking system induced by the release of statutory revenue to sub-national governments, the repayments of matured CBN bills and absence of repo operations during the review period.. The interbank call and OBB rates, which opened at 16.77 and 16.40 per cent on September 19, 2012, closed at 12.03 and 11.70 per cent, respectively, on October 30, 2012. The average interbank call and OBB rates for the period were 11.68 and 11.38 per cent, respectively.

The foregoing notwithstanding, the Committee was concerned that the moderation in money market rates was only beneficial to prime customers, who enjoyed a fair degree of reduction in rates on their loan facilities. The average prime lending rate declined from 16.96 per cent in July to 16.48 per cent in October. The average maximum lending rate, however, increased from 23.45 to 24.65 per cent during the period while the weighted average savings and term deposit rate stabilized at 5.30 per cent during the period. The Committee, therefore enjoined the Bank to fast track the financial inclusion strategy to ensure the effectiveness of the transmission mechanism of monetary policy with a view to improving the financial intermediation process, and reducing the high spread between deposit and lending rates in the banking industry.

The Committee observed that the rally in the Nigerian capital market continued as equities market indicators trended upward in the review period. The All-Share Index (ASI) increased by 22.37 per cent from 21,599.57 to 26,430.92 between June, 29 and October 31, 2012. Market Capitalization (MC) also increased, by 22.15 per cent, from N6.90 trillion to N8.42 trillion during the same period. The positive performance of the ASI and MC were due to strong investor confidence following improved second quarter financial performance of blue-chip companies, as well as excellent results from a reinvigorated banking industry.

External Sector Developments

At the Wholesale Dutch Auction System (wDAS), the exchange rate during the review period opened at N157.36/US$ on August 30, 2012 and closed at N157.30/US$ on October 31, 2012, representing an appreciation of N0.06k or 0.04 per cent. The average wDAS exchange rate during the period was N157.33/US$. At the BDC segment of the foreign exchange market, the selling rate opened at N161.00/US$ on August 30, 2012 and closed at N159.00/US$ on October 31, 2012, representing an appreciation of N2.00k or 1.24 per cent for the period. At the interbank segment, the selling rate opened at N158.10/US$ on August 30, 2012 and closed at N157.06/US$ on October 31, 2012, representing an appreciation of N1.04k or 0.66 per cent. The appreciation recorded in all segments of the market could be traced to the combined effects of tight monetary conditions, improved supply of foreign exchange to the market by oil companies; increased inflows from portfolio investors and the policy that barred the DMBs from accessing the CBN Lending window (SLF and Repo) and wDAS simultaneously.

The Committee noted with satisfaction the premia between the rates at the wDAS and the interbank and between the wDAS and the BDCs narrowed towards the end of the review period, from N0.74/US$ and N3.64/US$ to N0.03/US$ and N1.68/US$, respectively, suggesting the need to sustain and further complement existing measures to discourage speculative activities in the foreign exchange market. In general, the Committee noted that the decisions taken at the previous MPC meetings were yielding the desired results.

The Committee expressed satisfaction with the significant accretion to external reserves which stood at US$ 45.68 billion as at November 15, 2012, representing an increase of US$ 10.27 billion or about 29.00 per cent from the level of US$35.41 billion at end-June 2012. External reserves had increased by US$ 13.04 billion or 39.95 per cent over the December 2011 level of US$ 32.64 billion. The increase in the foreign reserves level was driven mainly by proceeds from crude oil and gas sales and crude oil-related taxes, as well as reduced funding of the wDAS due to increase inflow of foreign direct investment. The foreign reserves level could finance over 10 months of imports. The Committee urged the Central Bank to continue to monitor the inflow and destination of FDIs and remittances conscious of the risks to financial stability of a rapid outflow of hot money.

The Committee's Considerations

The Committee noted that developments in the global economy characterized by general uncertainty on the back of the deceleration in global growth sustained by the fragile financial conditions, weakening labor and housing markets and deteriorating public and private balance sheets across advanced and emerging economies, have implications for the domestic economy and, therefore, demand careful consideration in arriving at an appropriate decision of monetary policy. The uncertainty surrounding the resolution of the fiscal cliff in the US and the downside risk created by Hurricane Sandy on US output in Q4 are also important factors to consider. The Committee noted that if the fiscal cliff was not resolved quickly, it would negatively impact the already ballooning deficits and subsequently tip the economy into a recession with downside risks to oil price developments. The Committee noted that the lack of clear direction for the resolution of the Euro area crises will continue to signal a likely recession in the area in the near term. Developments in the domestic economy in the past three months highlight some new pressure points to macroeconomic stability.

The Committee was of the view that despite the high interest rates, additional shocks to the economy emanating from the devastating floods, imported inflation and the upward adjustment in electricity tariffs continue to stoke inflationary pressure. The Committee noted the conflicting price signals coming from the latest inflation numbers from the National Bureau of Statistics, with headline and food inflation trending upwards, while core inflation rate continued to moderate for the fourth consecutive month. This according to the Committee has created uncertainty as to the appropriate policy stance at this time. However, since the factors underpinning the inflationary pressures were mainly structural, a monetary response may not be appropriate at this time. Furthermore, the Committee observed that while there were compelling arguments for monetary easing at this time based on the continuous moderation of core inflation, slowdown in GDP growth and evidence of fiscal prudence, the short-term gains may not be sufficiently adequate to overturn the long term implications of sending a wrong signal that the tightening cycle was permanently over. With regard to the balance sheet of the Federal Government, the Committee was of the view that it has become imperative to shift away from looking at the size of the deficit and borrowing alone, to emphasizing the quality of expenditure and decisions on the allocation of resources. The Committee commended the fiscal authorities for keeping the fiscal deficit firmly in line with the 2012 budget and improving the revenue profile of the Federal Government by plugging several of the fiscal leakages. It called on the Government to significantly increase capital spending and increase its focus on improving on governance and transparency in the public service. On the oil price benchmark used in the 2013 budget, the MPC reaffirmed its support for the maintaining the US$75/barrel proposed by the fiscal authorities and noted that this has become even more critical in light of evidence that output projections may have been overly optimistic. In this regard, the Committee called on the Government and the National Assembly going forward, to borrow from the Chilean experience with regard to the setting of the parameters for the preparation of the National Budget to avoid the perennial rancor between the Executive and the Legislature on benchmark oil price. Specifically, the Committee called for the setting up of an independent legal structure that will set the benchmark output and price underpinned by the long term trajectory of output and price, by independent experts who are shielded from political interference and interests.

In view of these developments, the Committee was faced with three choices:

(i) An increase in rates in response to the up tick in headline and food inflation;

(ii) A reduction in rates in view of declining core inflation and GDP growth;

(iii) Retaining current monetary policy stance in view of conflicting price signals and global uncertainties;

The Committee's Decisions

The Committee considered and rejected option 1 as being potentially procyclical considering the structural nature of recent inflationary pressures. While acknowledging the merit of the arguments in favour of option 2, it was also rejected as likely to send wrong signals of a premature termination of an appropriately tight monetary stance.

The Committee therefore, decided by a unanimous vote to maintain the current policy stance i.e. to retain the MPR at 12 per cent with a corridor of +/- 200 basis points around the midpoint; and retain the CRR at 12.0 per cent and the Liquidity Ratio at 30 per cent.

Thank you.

Sanusi Lamido Sanusi, CON
Governor
Central Bank of Nigeria

20th November, 2012