CENTRAL BANK OF NIGERIA COMMUNIQUÉ NO. 64 OF THE MONETARY POLICY COMMITTEE MEETING, JULY 7, 2009

The Monetary Policy Committee (MPC) met today to review and discuss the latest domestic and international developments and their implications for the Nigerian economy. The Committee noted the continued adverse effects of weak global demand and falling crude oil production on Nigeria's external and fiscal performance during the second quarter of the year. The MPC noted the reported prospects of economic recovery in some emerging market economies. However, this development is not likely to offset the continued weak economic performance in advanced economies. In view of the openness of the Nigerian economy, the Committee observed that the growth prospects may weaken in the remainder of 2009, more so that inflationary tendencies appear to be persisting.

Key Economic and Financial Developments

Domestic Output

Provisional data from the National Bureau of Statistics (NBS) indicated that the Gross Domestic Product (GDP) at 1990 constant basic prices grew by 4.85 per cent in the first quarter of 2009. It is estimated to grow by 5.13 per cent in the second quarter of 2009 compared with 5.20 per cent in the corresponding period of 2008. The non-oil sector is estimated to grow by 8.03 per cent in the second quarter of 2009 mainly as a result of the performance of agriculture (2.84 per cent); wholesale and retail trade (2.20 per cent); and services (2.28 per cent).

The NBS forecast showed a lower growth of 5.75 per cent in overall real GDP for 2009, compared with 6.41 per cent in 2008, notwithstanding the projected weak performance of the global economy.

Price Developments

Inflation

The Committee noted the marginal decline in headline year-on-year inflation rate to 13.2 per cent in May from 13.3 per cent in April 2009. The persistence of high food inflation at 15.7 per cent in May compared with 15.3 per cent in April remains a matter of serious concern given its overwhelming weight in the consumer price index (CPI) basket. It is, however, expected that the headline inflation would slow down in the coming months on account of slack demand and the likely improvement in the supplies of agricultural produce.

Monetary Developments

Provisional data indicated that broad money (M2) decelerated sharply by 4.9 per cent in the first five months of 2009 in contrast with the growth of 29.9 per cent during the corresponding period of 2008. On a year-on-year basis, M2 grew by 15.6 per cent, mainly on account of the decline in net foreign assets and slowdown in credit to private sector. The decline in net foreign assets reflected the fall in oil export receipts and deceleration in other inflows, calling for policy initiatives to improve the availability of foreign exchange in the system. The slowdown in credit to private sector is not unconnected with the slack domestic demand as well as financial squeeze, requiring a combination of credit and structural measures to ensure that there are no enduring adverse effects of credit slowdown on growth and employment.

Interest Rates

Key interest rates at the inter-bank market rose in May and June 2009. The weighted average inter-bank call rate on unsecured transactions stood at 12.5 per cent in April, 13.2 per cent in May and 18.6 per cent in June. In the first few days of July, the inter-bank call rate ranged from 21 to 22 per cent. The weighted average open buy back rates in April, May and June were 7.1, 7.2 and 7.7 per cent, respectively. The average spread between the call rates and the rates on secured transactions has been very high at 1090 basis points in June, 600 basis points in May and 540 basis points in April.

The average prime lending rate rose from 19.34 per cent in April to 19.53 per cent in May 2009 while the average maximum lending rate declined from 23.17 per cent in April to 22.86 per cent in May. The weighted average rate on all categories of deposits rose from 5.98 per cent in April to 6.13 per cent in May 2009. Thus, the spread between the two rates is higher than the current inflation rate, which provides a unique opportunity to banks to improve efficiency and reduce lending rates.

Exchange Rates

The MPC noted with satisfaction that recent measures to stabilize the Naira exchange rate have posted some positive outcomes. The Naira exchange rate has stabilized at the rDAS in recent weeks while in the other segments, the rates have appreciated, thereby narrowing the arbitrage opportunities.

However, the premium over the rDAS rate has remained significant. The present situation offers an opportunity to further narrow the gap between the two rates by measures aimed at further liberalizing the inter-bank foreign exchange market.

External Reserves

Foreign exchange reserves as at July 03, 2009 amounted to US$43.19 billion (provisional) compared with US$53 billion at end December 2008. The decline in reserves mirrored mainly the relative downward drift in international crude oil prices from the levels reached in mid-2008 and the slowdown of other foreign exchange inflows. However, the decline in reserves is likely to moderate in the next two quarters owing to the expected rise in international crude oil demand arising from recent reports of improvement in the recovery prospects in the US and other developed countries and in the relatively favorable outlook for growth in some important emerging economies.

The Stance of Policy

The Committee noted that the recent economic and financial developments point to the need for policies to be focused on growth, exchange rate and financial market dynamics. Monetary and credit policies have to be therefore properly integrated with exchange rate policies. The stance of monetary policy in the coming months would be assure that liquidity, both domestic and foreign currency, is adequate to meet genuine demand and that real lending rates are moderated. To match these forces for bringing about stability in foreign exchange and domestic money markets, the CBN would undertake suitable foreign exchange and domestic open market operations in a coordinated manner in the coming months. For this purpose, the CBN would announce an advance calendar of its operations for each week so that market expectations are formed in a manner that is conducive to the realization of the objectives of policy. The CBN also proposes to have in place firm consultation procedures with bank executives prior to and after the policy meetings as a condition for bringing about a more open and transparent monetary policy.

Decisions:

In the light of the above, the Monetary Policy Committee decided as follows:

A. Interest Rate Policy

1) The Committee affirms the clearly established empirical evidence of a strong nexus between low real interest rates and economic growth. However, the strategy for achieving low interest rates will need to be based on market forces and involve a deliberate and painstaking effort aimed at addressing structural problems that had lead to high interest rates. All caps and floors imposed thus far by the Bankers' Committee have turned out to be unenforceable and counter-productive. Only a minority of banks are fully compliant. The Committee has, therefore, removed those caps.

2) The wide divergence between inter-bank rates and the Monetary Policy Rate (MPR) exerts pressures on lending rates.

As part of the strategy for achieving convergence, the Monetary Policy Framework which has the interest rate corridor as an important component is hereby restored. Consequently, the MPR would be reduced from 8.00 per cent to 6.00 per cent per annum. The corridor of interest rates would be +/- 200 basis points, with the rate on the standing lending facility at 8.00 per cent and the rate on the standing deposit facility at 4.00 per cent.

3) It is recognized that high inter-bank rates are substantially driven by the refusal of banks to lend to each other because of perceived counter-party risk. Whereas steps are being taken by the CBN to address this problem through proper bank audits, appropriate resolution frameworks and enhanced disclosure and transparency in financial statements, these will take some time before finalization and full restoration of confidence in the system. In view of the dire consequences to the real sector and the banks themselves of a sustained regime of excessively high interest rates, it is important to de-risk the inter-bank market and address the concerns of lenders and investors while the regulatory reforms are in progress.

Consequently, the CBN shall provide a guarantee on all inter-bank placements from July 2009 to March 31, 2010. This guarantee is also extended to placements with banks by pension funds. Details of operational modalities will be discussed at the Bankers' Committee meeting. However, a condition for this guarantee is that pricing must reflect the credit enhancement it provides. Overnight placements shall not be priced higher than MPR + 2%. A maximum spread of 300, 400 and 500 basis points above the MPR shall be maintained for tenors up to 30, 60 and 90 days, respectively. This will lay the foundation for evolving a risk-free yield curve at the short end. The CBN expects to conclude its work on diagnosis, resolution and disclosure policy in the banking system, latest by March 31, 2010.

4) In view of the CBN guarantee of the interbank market transactions, there will be no new loans on the Expanded Discount Window (EDW) and no extension of maturing obligations. Furthermore, all banks are required to liquidate their obligations under the EDW facility at maturity.

B. Foreign Exchange Market

1) The inter-bank foreign exchange will be liberalized with immediate effect and wDAS replaces rDAS.
2) All other restrictions imposed recently are removed and the net open position limit for banks is increased to 5% of banks' capital base.
3) All Class 'B' Bureaux-de-Change may now participate directly in the CBN window. Only those with valid licences are eligible. However, they will make a caution deposit of $20,000.00 each.
4) Class 'A' BDCs capital requirement is hereby reduced from ₦500 million to ₦250 million.

5) Allocation of foreign exchange will differ in magnitude between Class ‘A’ and ‘B’ BDCs, given the different levels of capitalization.

Sanusi Lamido Sanusi
Governor,
Central Bank of Nigeria
Abuja
July 7, 2009