Central Bank of Nigeria Communiqué No. 67 of the 212th Monetary Policy Committee Meeting, January 4-5, 2010

The Monetary Policy Committee (MPC) met on 4th and 5th January, 2010 to review domestic economic conditions in 2009 and the challenges faced by the Nigerian economy against the backdrop of developments in the international economic and financial environments in order to chart the course for monetary and financial sector policies for 2010.

On the international economic scene, the Committee noted that developed countries that were most adversely affected by the severe economic and financial crises had started showing signs of recovery. The apparent rebound in global economic activity was being driven mainly by rising manufacturing activity, recovering housing markets and the restoration of consumer confidence. Although central banks around the world have undertaken large interest rate cuts and measures to inject liquidity into their economies, the risks still remain that the current rebound may be sluggish and that the global economy would remain credit-constrained in the near-to-medium-term, as financial institutions continue to maintain their cautious approach to credit extension.

The Committee also noted that commodity prices, including crude oil prices, have resumed an upward trend due largely to the fiscal and monetary stimuli, and the prospect of economic recovery in advanced economies. The rising commodity prices have, however, renewed concerns about the resurgence of inflation in the near-term. The Committee further noted that emerging and developing market economies, on their part, have continued to show strong resilience to the financial crises and recorded positive growth rates despite the harsh international economic and financial environment in 2009.

On the domestic scene, the MPC underscored the need for strengthening on-going reform efforts in the banking sector aimed at engendering desirable medium term economic growth path consistent with price and financial stability. It further underlined the need to fast-track the proposed reforms in some key sectors of the Nigerian economy, and in particular, the power sector, to attract the much-needed private sector/foreign investment. This, the Committee noted, was necessary because of the benefits in terms of the growth-enhancing and employment-creating potentials that these reforms and opening-up of the sectors would have on the rest of the economy.

Key Domestic Macroeconomic and Financial Developments

Output and Prices: Provisional data from the National Bureau of Statistics (NBS) indicated that real Gross Domestic Product (GDP) grew by 8.23 per cent in the fourth quarter of 2009, up from 4.50, 7.22 and 7.07 per cent in the first, second, and third quarters, respectively. Overall GDP growth for 2009 was projected at 6.90 per cent which is significantly higher than the 5.98 per cent recorded in 2008. The non-oil sector, as a group, remained the major driver of growth although this was complemented by the sharp increase in the growth of the oil sector GDP following the relative peace in the Niger Delta in the second half of the year. The Committee observed that the higher than anticipated real output growth recorded in Nigeria despite the harsh international economic environment mirrored the trends in some sub-Saharan African countries and further buttresses the view that African countries were better able to withstand the global economic and financial crises relative to other regions of the world. The Committee felt that on the basis of the robust economic growth recorded and the sustained implementation of appropriate policies, further improvement in output could be expected in 2010.

The headline inflation rate, as measured by the year-on-year increase in the all item consumer price index, was 12.4 per cent in November 2009, up from 11.6 and 10.4 per cent recorded in October and September, respectively. The outcome was, however, lower than the headline inflation of 15.1 per cent recorded in December 2008. Food inflation which hovered between 12.5 and 12.90 per cent in the third quarter rose to 13.5 per cent in the fourth quarter of the year. Inflation outlook for 2010 remains uncertain, but a combination of both domestic and international economic developments, namely the impact of the planned full deregulation of petroleum products prices, the expansionary fiscal outlay, the quantitative easing measures undertaken by the Bank, the resolution costs associated with the banking sector reforms, possible capital inflows to strengthen commercial banks balance sheets, and the rising international commodity prices, pose serious threats to domestic price movements and, hence, inflation risk in the months ahead. Against this background, the Committee emphasized the need to continue to monitor price developments with a view to creating an enabling environment for sustainable economic growth and employment.

Monetary, Credit and Financial Market Developments: Over the preceding December level, broad money (M2) grew by 12.80 per cent (on annualized basis) in November 2009, which was significantly below the indicative benchmark of 20.8 per cent growth for 2009. Similarly, the annualized growth rate of aggregate domestic credit (net) as at November 2009 was 56.10 per cent, compared with the provisional benchmark growth rate of 86.97 per cent for 2009. Despite the various policy measures implemented by the CBN to ensure adequate liquidity in the banking system, reserve money (RM) was largely below the indicative benchmarks for most of 2009. The annualized growth rate of private sector credit was 26.10 per cent, significantly below the indicative benchmark of 45.00 per cent but not in itself insignificant in view of all the developments in the banking sector. The trends in money supply movement reflected the fall in net foreign assets and the slowdown in credit to the private sector. This implied slack aggregate demand, indicating the need for the continuation of an accommodative monetary policy stance.

Notwithstanding the sub-optimal monetary growth during the year, confidence in the money market has improved considerably following the inter-bank money market guarantee and other measures to strengthen the banking sector. This was reflected in the downward movement of the daily interbank call rates. Specifically, the average call rate for November was 5.25 per cent down from 6.60 per cent in October and 9.76 per cent in September 2009. The secured open buy-back (OBB) rate for November was 4.53 per cent, down from 5.80 and 6.60 per cent in October and September, 2009, respectively. As at December 30 2009, the interbank call and OBB rates were 2.91 and 2.51 per cent, respectively. The spread reflecting counterparty credit risk, has narrowed significantly from an average of 316 basis points in September to 80 basis points, 72 basis points and 40 basis points in October, November, and December, respectively.

The Committee observed that despite the falling interbank rates, the retail lending rates of deposit money banks (DMBs) were still high. The average maximum lending rate had risen to 23.1 per cent in November from 22.97 and 22.64 per cent in September and June, 2009, respectively. Also, the average prime lending rate rose to 18.93 per cent in November from 18.33 and 18.16 per cent in September and June, 2009, respectively. The Committee reaffirmed that the reduction of structural and institutional impediments as well as DMBs risk perception of borrowers could moderate the high lending rates. It also felt that current efforts by the Bank to promote the use of shared infrastructure by DMBs as well as the development of the fixed income market in conjunction with relevant agencies would further reduce cost of operation and moderate lending rates. The Committee noted the progress made so far in this area and urged an intensification of efforts and closer collaboration with political authorities to fast-track its actualization.

The weak performance of the Nigerian capital market continued throughout 2009. The All-Share Index (ASI), which was 31,450.78 in December 2008, fluctuated to 19, 851.89 (36.88 per cent) at end-March 2009, 26,861.55 (14.59 per cent) at end-June 2009, 22,065.00 (29.84 per cent) at end-September, 2009, and further to 20,827.17 on 31 December, 2009. Market Capitalization (MC), which stood at ₦6.96 trillion in December 2008 declined steadily to ₦4.989 trillion on 31 December, 2009. The NSE has attributed the bearish performance at the stock market to the harsh operating environment and the gloomy economic outlook in 2009, which affected the quarterly results of some quoted companies. However, the major stock markets around the world have shown improved investor sentiments following prospects of recovery in the medium term. It was also noted that although banking shares in general have been badly affected by losses incurred, a number of companies in the non-bank sector have had strong performance in the stock exchange.

External Sector Developments: The foreign exchange market remained relatively stable for the most part of 2009, after the initial turbulence recorded in the first quarter of the year, following measures taken by the CBN. In November, the WDAS average exchange rate stood at ₦150.85 per US dollar compared with ₦149.3578 per US dollar in October 2009, representing a depreciation of 1.0 per cent. As at end-December 2009, the WDAS average exchange rate was ₦149.58 per US dollar compared with ₦126.48 per dollar at end-December 2008. The inter-bank market rate averaged ₦151.03/$US as at end December 2009. Thus, as at end-2009, the spread between the WDAS and inter-bank market rates was insignificant. The convergence reflects renewed confidence and clarity in expectation, founded on the stability that has been sustained in exchange rates. Policy will continue to focus on avoiding volatility in exchange rates and thus retaining confidence.

External reserves stood at US$42.47 billion on 29th December 2009, down from the level of US$53.00 billion recorded at end-December 2008. Overall, the net outflow of foreign exchange has moderated significantly from US$5.6 billion, US$3.8 billion, and US$931.93 million to US$138.37 million in the first, second, third and fourth quarters, respectively. Notwithstanding the decline in the level of external reserves as at end-

December 2009, the Committee was satisfied that the level of reserves remained robust and significantly higher than initially projected at the beginning of the year. However, if the elevated price of crude oil in the international market in recent months is sustained, then, given improvement in output with peace in the Niger Delta, there is likely to be an improvement in the level of foreign exchange reserves. The strong reserve position enhances the Bank's ability to maintain exchange rate stability and protect the currency from speculative attack.

The Committee's Considerations

The Committee welcomed the optimistic growth forecast for 2010 by the NBS but noted that the growth had been without employment owing to the stagnation in the manufacturing sector, and the failure to link growth in agriculture to industry. The Committee stressed the need for improvements in power and infrastructure to further enhance and sustain the growth process. In this regard, the MPC welcomes the commitment of the Bankers' Committee at its Enugu Retreat to provide the platform for increased financing for infrastructural development in support of economic growth. It restated its commitment to work with the government to create the enabling environment that will facilitate the financing of the real sector by the DMBs, including strong advocacy for the fast-tracking of stalled reforms in the power sector, including review of the tariff regimes for gas and electricity and concessioning of the transmission company.

The Committee also observed that the focus of the reform measures in the banking sector is to impact the overall efficiency and stability of the system in a manner that will ensure that banks play their appropriate roles as transmission channels for resources to the real sector. This is expected to increase credit to the growth-enhancing sectors of the economy and therefore, engender an all inclusive growth, as well as avoid a recurrence of crises provoked by over exposure to speculative and non-value-adding ventures.

The Committee further cautioned against being overly optimistic in our expectations about the outlook for the price of oil, and welcomed the prudent benchmark used in the budget for 2010. It noted that the current price of crude oil was being driven by the low value of the US dollar and the low interest rates in the US and once these reverse crude oil prices may be lower than they are today. It expressed the hope that all stake holders will give support to the Finance Ministry in keeping to this benchmark price, and resist the temptation to push for an increase based on short-term consideration.

The Committee took cognizance of the expansionary nature of the 2010 Federal budget, the continued implementation of the 2009 Budget up to Q1 2010, expected liquidity injection/inflow during the recapitalization of the troubled banks and resolution of toxic asset problems, and the eventual deregulation of the downstream petroleum sector and their possible inflationary impact. In this regard, the MPC affirmed that it will closely monitor price developments in the near-term and will take appropriate policy measures, if necessary, to ensure the attainment of price and financial sector stability.

On the other hand, the Committee recognised the need to maintain the growth trajectory of the economy, to ensure that lending rates are not placed under further upward pressure and to provide sufficient liquidity during the resolution process of the banking system.

Decisions

In the light of the above, the Committee unanimously took the following decisions:

1. The Monetary Policy Rate (MPR) will remain unchanged at 6 per cent with the asymmetric corridor of interest rates remaining at 200 basis points above the MPR and 400 basis points below the MPR.

2. The CBN will extend the guarantee on all interbank transactions up till December 31, 2010. However, the CBN has the discretion to terminate the guarantee on a case-by-case basis as part of the ongoing reform process.

3. The MPC approved the Monetary Programme for 2010/2011 and the Monetary, Credit, Foreign Trade and Exchange Guidelines for Fiscal years 2010/2011.

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January 5, 2010