

**Central Bank of Nigeria Communiqué No. 77 of the Monetary Policy Committee
Meeting, July 25 – 26, 2011**

The Monetary Policy Committee (MPC) met on 25th and 26th July, 2011 to review domestic economic conditions during the first half of 2011 and the challenges facing the Nigerian economy against the backdrop of developments in the international economic and financial environment in order to chart the course of monetary policy in the second half of the year.

On the global scene, the Committee noted with concern the enormity of the challenges being faced by the US and euro zone countries as well as the major emerging market economies such as the fiscal position of Brazil, possible real estate bubbles in China and seemingly intractable inflation in India, which may impact the Nigerian economy adversely through several channels. The economic slowdown and the commodity price inflation in the international economy as well as the rapid increase in prices of some asset classes in some emerging market economies remain serious threats to the global economic recovery. There are continuing widespread threats of inflationary pressures fuelled by the sustained high energy, commodity and food prices in the global economy. Headline inflation in many of the major emerging market economies is now exceeding 6 per cent and is running close to or above central banks' targets in a number of other larger economies.

The performance of the global financial markets was mixed. Many national currencies in Africa depreciated against the US dollar while in many emerging markets, currencies appreciated vis-à-vis the US dollar during the first half of 2011. Furthermore, most stock markets around the world showed weak recovery during the period due to high inflation, weakening consumer confidence and government finances, particularly in the US and euro zone. The unfolding debt crises in the European periphery could damage confidence and output in the near-term while the US debt and unemployment situation pose grave danger to the international economy given the reserve currency role of the US dollar and the size of the US economy. It is not unlikely that the US will lose its AAA rating and actual default is possible unless a deal can be worked out between the White house and the Congress.

On the domestic scene, the Committee noted that inflationary pressures which were traceable to the high expenditure levels associated with the April 2011 general elections as well as the effects of rising international energy, commodity and food prices had moderated by June 2011. This development was due in part to the tight monetary policy stance of the Bank since September of 2010. However, the Committee observed that the inflation outlook appears uncertain owing to the expected implementation of the new national minimum wage

policy and the imminent deregulation of petroleum prices. Significant injection of liquidity from FAAC in the third quarter coupled with the impact of AMCON recapitalizing intervened banks to the tune of N1.6 trillion will both add to inflationary pressures. The Committee welcomed the favorable growth projections but cautioned that the current security challenges, infrastructural bottlenecks and the uncertainty in the international economy as well as fiscal developments could undermine investors' confidence and output growth in the near term.

The Committee expressed serious concerns about the continued sluggish growth of credit to the private sector during the first half of the year which is attributed, among other factors, to the heightened credit risk in the real economy as a result of the persisting structural problems occasioned by the inadequate power supply and critical infrastructure deficit. It also observed that the lending rates of deposit money banks (DMBs) remained relatively high.

Key Domestic Macroeconomic and Financial Developments

Domestic Output:

Provisional data from the National Bureau of Statistics (NBS) indicate that real Gross Domestic Product (GDP) grew by 6.64 per cent in the first quarter of 2011 down from the 7.36 per cent in the corresponding period of 2010. The non-oil sector remained the major driver of growth recording 8.65 per cent growth rate in the first quarter of 2011. Overall, GDP growth rate was projected at 7.80 per cent for 2011, which the Committee believed, is still reasonably robust by major emerging market standards, but which may be placed at risk in the event of crystallization of various negative developments in the developed and emerging markets.

Domestic Prices:

Inflationary pressures remained elevated during the first quarter of 2011 but moderated towards the end of the second quarter. The year-on-year headline inflation rate, declined from 12.8 per cent in March and 12.4 per cent in May 2011 to 10.2 per cent in June 2011. The downward movement in inflation in June 2011 was due to the moderation in both food and core inflation. Food inflation fell for the first time since February 2008 to below 10 per cent. It declined from 13.6 per cent in March and 12.2 per cent in May to 9.2 per cent in June 2011. Core inflation decreased from 12.8 per cent in March and 13.0 per cent in May to 11.5 per cent in June 2011. Staff projections indicate that both headline and

food inflation would continue to moderate in the second half of the year. However, core inflation is projected to increase during the same period driven mainly by cost of energy, power and imports.

Monetary, Credit and Financial Market Developments:

Broad money (M2) grew by 5.66 per cent in June 2011 over the end-December 2010 level, which when annualized, translated to a growth rate of 11.32 per cent. Aggregate domestic credit (net) grew by 2.30 per cent in June 2011 over the 2010 December level which annualized to a growth rate of 4.60 per cent. The sluggish growth in aggregate credit was mainly due to the weak expansion in private sector credit which grew marginally by 1.45 per cent or 2.9 per cent on an annualized basis.

Interest rates in all segments of the interbank money market moved up in response to the upward review of the MPR for most part of the period since the last meeting of the MPC. The weighted inter-bank call rate, which stood at 9.73 per cent prior to the last MPC meeting rose steadily, peaking at 13.64 per cent on June 13, 2011 while the OBB rate also trended upward reflecting the increase in the MPR. Developments in the interest rate structure indicated that retail lending rates remained relatively high. The average maximum lending rate declined to 22.02 per cent in June 2011 from 22.19 per cent in May 2011 while the average prime lending rate declined to 15.76 per cent from 15.81 per cent during the same period. Thus, the spread between the average maximum lending rate and the consolidated deposit rate narrowed marginally to 19.22 per cent in June 2011 from 19.40 per cent in May 2011.

Stock market performance remained bearish during the review period as the All-Share Index (ASI) decreased by 3.4 per cent between March 31, 2011 and July 21, 2011. Market Capitalization (MC) also declined by 3.4 per cent during the same period. The Committee noted that the Nigerian stock market performance is consistent with the stock market performances around the rest of the world, and reflects a growing risk aversion on the part of portfolio investors as well as domestic concerns on the ongoing banking sector resolution. This will be addressed later in this communiqué.

External Sector Developments

At the wDAS, the exchange rate closed at N151.61 (including the 1% commission) on 22nd July, 2011, representing an appreciation of 2.14 per cent over the N154.91/US\$ on 23rd May, 2011. The Inter-bank selling rate opened at

N156.67/US\$ on 23rd May, 2011 and closed at N152.33 on 22nd July, 2011, representing an appreciation of 2.77 per cent. At the BDC segment of the market, the exchange rate closed at N166.00/US\$ on 22nd July, 2011, representing a depreciation of 4.40 per cent over the opening rate of N159.00/US\$ on 23rd May, 2011. In the light of this, the Committee noted that the premium between the rates at the wDAS and the interbank rate narrowed towards the end of the review period, while that between the wDAS and the BDCs widened which is not unconnected with the measures taken to limit sales to BDCs. However, while strengthening of currency is an important factor in mitigating inflationary pressures, the spread may lead to arbitrage by players and fuel unhealthy speculation.

The Committee noted the modest accretion to external reserves in recent months, but remained concerned about the sustained low level of accretion in the face of higher oil output, higher oil exports volume and higher oil prices. Gross external reserves stood at US\$33.73 billion as at 21st July, 2011, representing an increase of US\$1.84 billion or 5.77 per cent over the level attained on 30th June, 2011. Given that the current oil price level may not be sustained in the event of a slowdown in global economic recovery, the Committee reiterated the need for pursuing policies to foster macro-economic stability, economic diversification as well as encouraging foreign capital inflows.

The Committee commended the CBN for the limit placed on the foreign exchange sales to the BDCs. However, in view of the widening premium between the wDAS and BDC rates, the Committee encouraged the CBN to review the existing limit. The decision and communication in this regard will be made by the Bank.

With regard to banking system stability, the Committee was informed that 3 of the intervened banks had signed Transaction Implementation Agreements (TIAs) and 3 more are expected to sign TIAs within the next two to three weeks. The remaining two are already the subject of interest from prospective core investors, and the CBN is closely monitoring developments. It is expected that all the intervened banks would be fully re-capitalized by 30th September, 2011.

Committee's Considerations

The Committee recognized the decline in inflation rate and the slow down in GDP growth rate as well as credit to private sector which would ordinarily advice maintaining rates at current levels. However, the consensus of the Committee is that the outlook is uncertain due to dark clouds on the International horizon and the rising spectra of a structural fiscal deficit. In view of

the need to proactively address the impact of huge injections of liquidity in the third quarter to correct the negative real interest rate situation in the market and attract foreign capital inflows to build up reserves to protect the economy against possible external shocks, the Committee decided as follows:

Decisions:

1. To tighten monetary policy by a majority decision of 10 to 2.
2. To raise the MPR by 75 basis points from 8.0 per cent to 8.75 per cent by a majority vote of 8 members in its favour, 1 member favoured 50 basis-point increase while 3 members voted for holding the MPR at 8.0 per cent.
3. To maintain the corridor at +/- 200 basis points around the MPR.

Sanusi Lamido Sanusi, CON

Governor

Central Bank of Nigeria

July 26, 2011

PERSONAL STATEMENT BY MPC MEMBERS:

1.0 ALADE, SARAH

Headline inflation moderated to 10.2 percent in June 2011, a full 200 basis point down from 12.4 percent recorded in the previous month. This decrease in inflation rate is due to a combination of factors: easing of food prices as early harvest begins and sustained policy tightening. Although inflationary pressure is abating, expansionary fiscal stance has the potential of pushing up inflation with the release of N1.3 trillion in July, the largest monthly distribution to the three tiers of government so far this year. In a low inflation environment, monetary policy should necessary be tilted towards addressing growth concerns, however when fiscal stance is expansionary, efforts at containing inflation must be sustained. I am inclined therefore to support an increase of 75 basis points.

While headline inflation declined by more than 200 basis points to 10.2 percent in June from 12.4 percent recorded in the previous month, the lowest since April, 2008, upside risk to inflation still exist. As the global food and energy prices remain elevated a combination of early harvest due to stable and favorable rainfalls in parts of the country, and the impact of sustained monetary tightening is containing inflation. The outlook going forward is that the usual seasonal effect during harvest would help sustain the current downward trend in headline inflation, as food inflation moderated to 9.2 percent in June from 12.2 percent in May, the highest decline so far this year. Available forecast points to continued decline in both food and headline inflation in the months ahead. A combination of expected increase in agricultural production this year due to widespread and stable rainfall across the country as forecasted by the Nigerian Meteorological Agency (NMA) and the effect of various government programs to aid agriculture, all point to dampened inflationary outlook going forward. However, global commodity prices remain at an elevated level and given that Nigeria import food stuff such as rice, elevated global commodity prices may heighten upside risks to domestic inflation.

While there are still pockets of downside risks in international economic environment, growth prospects remain robust Although Greece's debt crisis has been dealt with by the European Union, there are still concerns about the sustainability of the deal. In the United States there is still no bipartisan agreement on how to increase the debt ceiling that could allow the government to borrow to finance expenditure rather than defaulting on its debt. Expectation is that come August 2, 2011, the United States government would have secured the necessary votes needed to extend the debt limit. However, there is still a slim chance that United States may default on its debt obligations which could have a dampening impact on global growth. Barring a default by

the United States, global growth prospects remain on good footing and the continued high commodity prices may contribute to domestic inflation.

Core inflation also decreased but there is an elevated risk going forward. Core inflation which edged up to 13 percent in May declined to 11.5 percent in June. Housing and electricity /gas and other fuels accounted for about 5.2 percent of the increase in core inflation. While staff estimate project a continued decline in headline inflation, core inflation is projected to remains stubbornly high, fluctuating between a low of 12.3 percent to a high of 14.8 percent for the remainder of the year. To help mitigate this trend, monetary tightening will be needed.

Global commodity prices remain elevated although with some risks. Commodity prices are generally on solid footing. Oil prices hover around \$97 per barrel and rising. Gold prices also reached their highest level of \$1600 an ounce last week. Prices of other precious metals are also increasing. As an oil exporting country, this trend is a welcome development as it would contribute to further reserve build up and increased investors' confidence in the economy, but it also has implication for domestic inflation. The foreign exchange reserves grew by approximately \$2 billion from a month ago reflecting the trend in oil prices, however, demand pressure at the foreign exchange market remains elevated. If the United State debt problem is unresolved come August 2, 2011, global commodity prices could crash with far reaching implication for the revenue forecast of the Nigerian economy.

Budget release in July is the highest so far this year, and could pose an inflationary threat to the economy. The Federal Accounts Allocation Committee (FAAC) distributed N1.317 trillion (US\$8.72 billion) in July, although some of the money will go into infrastructure spending (power and transportation) with huge import content. The potential inflationary impact cannot be ignored. This increase in current budget allocation coupled with distribution in the coming months, calls for a cautious approach to monetary policy.

The immediate impact of the newly negotiated Minimum Wage implementation cannot be ignored. The government has agreed to pay the minimum wage negotiated with the civil servants, starting August of this year, while the exact time of implementation for many state governments is not known, there is bound to be an inflationary impact. Most of the additional income will be spent on food and housing with its associated inflationary impact.

Based on the above, although monetary policy should be tilted towards growth concerns such as promoting private sector credit growth at this stage since inflation is abating, the threat of expansionary fiscal operations, anticipated AMCON injection and the need to move interest rate into positive territory calls

for an increase in policy rate. Therefore, I will recommend an increase in monetary policy rate by 75 basis points and no change in the corridor.

2.0 BARAU, SULEIMAN

I like to make the following statement.

○ Context Setting

▪ Developments since the last MPC

It is modest to say that the rather consistent, and one might say, aggressive tightening stance of monetary policy in the recent past has started to elicit positive results. These include;

- Staff reports based on figures release by the National Bureau of Statistics (NBS) indicate that all measures of inflation declined in June, 2011. The year-on-year Headline Inflation declined from 12.4% in May to 10.2% in June. Similarly Food Inflation declined to 9.2% while Core Inflation also declined to 11.5% in June.
- Money Markets, while remaining volatile, have largely trended adjustments in the Monetary Policy Rate (MPR).
- The Naira Exchange Rate appreciated in the WDAS and Interbank Markets even though they depreciated substantially in the BDC segment.
- Real GDP growth at 6.64% in the second quarter, though a decline from first quarter estimate of 7.36%, is still very impressive.
- Accretion to reserves – the various measures we have implemented have reversed the declining trend in the level of our foreign reserves.
- **Outlook;** Staff projections are generally very optimistic:
 - Good prospects for GDP growth rate to 7.92% for the third quarter (July – September, 2011) from 6.64% in the second quarter.
 - Inflation is expected to moderate further, even though core inflation is forecast to accelerate.
 - Accretion to external reserves likely due to high oil prices.
 - Stability in the foreign exchange market, while recognizing the rising premium between WDAS and BDC rates.

- **Pressure points and other challenges.**

In spite of the rather optimistic view depicted by staff projections above, I contend that we still have the following potential pressure points;

- Governments' fiscal operations – recent FAAC releases and 99.53% budget performance for recurrent and 34.01% performance for capital expenditure from the beginning of the year to date are source for concern. In addition, current budgetary provisions and performance are inherently inflationary.
- The impact of minimum wage adjustment particularly by the State Governments would exacerbate the inflationary risk.
- Volatility in money market rates is a source of concern with obvious challenge to our Open Market Operations.
- The Naira exchange rate has been stable and has appreciated in the WDAS and interbank segments but the premium between rates in this and that of the BDC market is a source of concern.

- **Financial Stability concerns through**

- Potential mark to market losses arising from any further tightening, upward adjustment of the MPR. This is a source of concern particularly for the intervened banks that are in the final stages of the M/A transactions.
- The activities of AMCON in terms of potentially huge liquidity injection from further asset purchase and the recapitalization of the intervened banks.

- **Developments in the External Sector**

- Sovereign debt crisis and the threat of imported inflation. The possibility of a default by the United States of America and further downgrade of sovereign rating of Greece are major source for concern. On the one hand, these and other developments may hamper foreign inflows into Nigeria, on the other hand the tilt of balance may negatively affect oil prices. The latter may exacerbate fiscal challenge. We are certainly going through interesting and potentially explosive times.
- The threat of imported inflation as prices of imported goods continues to rise in the countries of our trading partners.

○ Recommendation

My recommendation is largely guided by the above points that led to following conclusions.

- That monetary policy prescriptions should be forward-looking.
- In spite of the deceleration in inflation numbers, core inflation is forecast to increase while the earlier mentioned gains have to be sustained. The balance of risk is therefore in my view tilting overwhelmingly towards acceleration. There is also potentially the threat of imported inflation.

In the light of the foregoing, I recommend the following;

- Continuation of our Monetary tightening strategy
- Increase in MPR by 0.75bps from 8% to 8.75%
- Maintenance of the corridor of minus and plus 2%
- Aggressive use of open market operations in tightening but particularly to respond to liquidity, interest and possible exchange rate volatility.

3.0 GARBA, ABDUL GANIYU

Decision

I vote for:

- I. Holding the MPR at 8%
- II. Maintaining the Asymmetric Corridor for SLF and SDF
- III. Tightening MS through (a) changing the guidelines on calculation of LR to exclude Repos in calculation of LR with an appropriate adjustments period to be administratively determined and (b) mop up of excess liquidity through aggressive OMO.

Justification

- I. An impact analysis of the tight monetary policy regimes from the January MPC, through the March and May suggest that MPC policies seemed to have contributed to the decline in inflation in June and, to the stability of the exchange rate from June 2011. Given the lag effects of policy, it is most likely that the effects of the MPC policies in the first half of 2011 have not been fully realized in July 2011. Holding MPR at 8% should allow for the

addition impacts to be realized between now and the next MPC in September.

- II. The Impact analysis also reveals the following key problem areas in the first half of 2011.
 - a. The **operating targets** of Monetary Policy (OBB and Call Rate) have become more volatile since January though, the volatility seemed to have eased from June to a steady decline.
 - b. The interest rate spread (difference between Prime and lending rates) has grown progressively to above 6% in May suggesting rising inefficiencies in financial intermediation.
 - c. Similarly, the spread between lending and deposit rates has widened even more with deposit rates being highly inelastic to the MPR changes while both Prime and Maximum have been rising. This has raised risks of dis-intermediation. I have also observed that the growth of quasi-money has significantly slowed down significantly in the last year.
 - d. The exchange rate premium has widened starting from 24th June 2011 to about 9.5% on 20th July 2011. This has been explained as a reaction to regulatory limits on supply of forex to BDCs.
 - e. The Market capitalization and stock market index declined by a monthly average 1.7% and 1.3% in the first half of 2011.
 - f. The growth in the economy has slowed down in the first half of the year compared to 2010 while rising unemployment remains a key concern.
- III. The commitment of the Central Bank to a stable exchange rate policy remains the right policy as the exchange rate remains the most important price in Nigeria and its effects on the general price level is not only significant, the response to a devaluation is instantaneous. I have been convinced from discussion at the MPC that the exchange rate premium can be effectively reduced to pre-June 24th by relaxing the supply constraints that was imposed on forex supply to BDC. This is because the supply constraint was causal to the premium.
- IV. I am also convinced that an MPR hike will have adverse effects on the capital market, widen the interest spreads further and deepen inefficiencies in the money market while having little or no effects on the deposit rate that has hovered around 1% in the first half of 2011.

- V. I am also concerned about the fact that a higher MPR may have adverse effects on financial market stability through its effects on the portfolio of banks with exposures to sovereign debt. As we conclude the reform of banking sector by September 2011, it is important that the policy regime is relatively stable.
- VI. The growth in public debt and in the structure of public expending as well as the dis-connect between public revenue and oil prices remain key risks to the economy. However, I am not convinced that monetary policy is a potent tool for dealing with the challenges of Nigeria' fiscal policy regime. Continuous dialogue with the fiscal authorities is critical. Also, it may also be important to strengthen the micro prudential guidelines and, banking supervision to ensure that banks comply with key legislations such as the provisions of the Fiscal Responsibility Act (Sections 44, 45 and 46 which sets the conditions for government borrowing from DMBs and the CBN and criminalizes violations). Compliance with the FRA 2007 is critical to improving the fiscal policy regime and the bank can help the process by insisting on compliance to the key provisions of FRA 2007 concerning lending by DMBs to governments.
- VII. I am also concerned about the option of raising MPR to achieve positive real rates of interest. First, the real deposit rate has been unresponsive to MPR increases hence, will remain significantly negative. Second, given the gloomy global economy outlook (threat of US debt default, Greek debt default and Euro-zone crisis and possible problems in the BRIC that may slow global economic growth), Nigeria faces a commodity price risk and, capital flow risks. Attracting hot money in these risky and uncertain times may not be in the medium to long term interest of Nigeria. The lesson from the global sovereign debt crisis is that **Nigeria must rein in public borrowing** and public debt to avoid the Greek, Ireland and Portugal dilemmas and crisis. This is more so, since Nigeria has not recovered from the experience of the last debt crisis which took over half a century to resolve.
- VIII. My decisions are based on (I) to (VI) above.

4.0 KIFASI, DANLADI

DECISION FOR POLICY ACTION:

Inflationary pressure, which remained elevated in the first quarter of 2011, moderated towards the end of the second quarter of the year, following the series of monetary policy tightening adopted by the MPC in recent past.

2. The year-on-year headline inflation rate, which rose to 12.8% in March, 2011 from 11.1% in the preceding month declined to 12.4% in May and further to 10.2% in June, 2011. Food inflation declined from 12.2% in May to 9.2% in June while core inflation equally fell from 13.0% to 11.5% during the period.
3. The outlook for inflation in the near term is promising, given the expected increase in agricultural products in response to various government policies and programmes to address supply bottlenecks. Furthermore, the expectations of stable and widespread rainfall across the country by the Nigerian Metrological Agency, as well as CBN staff projections of the headline inflation to fluctuate between 9.3% and 10.4% in the next six months lend credence to this optimism.
4. The key risks to the outlook appear to be the impending implementation of the new minimum wage policy and the possible deregulation of petroleum product prices. However, given the recent agreement between the Nigerian Labour Congress and Federal Government to accommodate the payments of arrears in the 2012 budget, the anticipated liquidity impact of the implementation of the minimum wage policy will be minimized. Moreover, the approved salary adjustment at the Federal Government level is only affecting the Consolidated Public Service Salary Structure (CONPSS), the minimum of which is currently, ₦17,073.00 per month, indicating a marginal variance from the new minimum wage of ₦18,000.00.
5. Similarly, the deregulation of petroleum product prices will not, in the near term, impact on the liquidity in the system as its implementation programme is yet to be concluded and approved and hence will not become effective by the end of the third quarter of the year.
6. The inflation rate of 10.2% at the end of June, 2011 is within the budget estimate for the year and considering the adverse effect of any further monetary policy tightening on economic growth and private sector credit; it would be counterproductive for the MPC to further increase the MPR.
7. Given the anticipated influx of foreign capital, following the removal of restrictions on government securities' holdings by foreigners, the pressure in the foreign exchange market, particularly in the Bureau de Change (BDC) segment, may subside in the near term. Thus, if the current exchange rate policy is sustained, the naira exchange rate would likely remain stable in the near term.
8. In view of the above, I recommend that the current monetary policy stance be sustained. The MPR should be retained at the current level of 8% for the next two months when another review will be due for consideration.

5.0 LEMO, TUNDE

The Global economic conditions show the resurgence of inflationary threats with headline inflation rising in most of the major countries except Japan. Recent events have also heightened a possible slowdown in global economic growth. The risk of United States default (if a deal on credit ceiling is not struck by the Executive and the Congress by August), possible debt crises in parts of Europe, possibility of real estate price bubbles in China, inflation concern in India as well as loose fiscal stance in Brazil – are severe headwinds that confront the global economy and expose Nigeria to significant commodity price shock with very serious consequence on the revenue stream, given Nigeria's dependence on crude oil export.

Provisional data from the National Bureau of Statistics (NBC) indicated that real GDP is projected to grow at 7.8% in 2011, a shade lower than the previous year's growth of 7.87%. It further indicated that inflationary pressures of the first quarter moderated towards the end of the second quarter, largely due to the marginal decline in domestic food prices. However, core inflation remains high (13% in May 2011) and staff estimate indicates possible slight increase by December, 2011.

The fiscal operations of government remain a cause for concern and may have serious implication for liquidity management. This will be compounded by the implementation of minimum wage (by the sub-national governments), upward review of the Multiple-Year Tariff Order (MYTO) and growing domestic debt. Already, we have started noticing the crowding-out of the private sector.

Presently, while credits to Federal and State/Local Governments grew by annualized rates of 10.18% and 27.28% respectively in June, 2011, credits to private sector grew only marginally by annualized rate of 2.9%.

While it is heartwarming to note that demand for foreign exchange has moderated with slight appreciation in WDAS rates, it is important that monetary policy should be proactive to rein in the possible liquidity surfeit that may result from the recent FAAC release of N1.3 trillion possible injection of N1.6 trillion additional AMCON recapitalization of the intervened banks and what appears to be unabating monthly drawdown of excess crude as a result of the implementation of a very high oil benchmark price of USD75.

In addition to the above, negative real interest rates regime requires correction in order to mobilize domestic savings and attract much needed foreign capital inflow to build up foreign reserve as a buffer in the light of the global economic condition and the heightened risk of commodity price shock.

In the light of the above, I am strongly in favour of a much tighter monetary policy stance through a raise in MPR by 75 basis points while the symmetric corridor remains unchanged at +/- 200 basis points around the MPR.

This stand will help to confront the expected liquidity surfeit, reduce demand for foreign exchange to permit aggressive reserve build-up to protect the economy against possible external shocks.

6.0 MOGHALU, KINGSLEY CHIEDU

This meeting of the Monetary Policy Committee is faced with a decision in the face of conflicting trends. I am encouraged by the report that headline inflation has declined to 10.2 percent from 12.8 percent reflecting the positive impact of previous monetary tightening decisions taken by the Committee and a moderation in food prices. Has the time come, then for the MPC to put a hold on policy rate increases in its move towards normalization and away from the quantitative easing measures of 2008 – 2010 in response to the global financial crisis and its impact on the Nigerian banking and monetary system?

Clearly, in my view, the answer is no. There remains an overwhelming case for increasing interest rates, and I vote for a rate increase by 75 basis points (0.75 per cent), for the following reasons:

Firstly, expansionary fiscal spending by the Federal Government, represented in the anticipated 710.71 billion in additional disbursements to Federal, State and Local governments to compensate for the difference between the proposed and approved benchmark crude oil price, by the Federation Account Allocation Committee (FAAC) has potential inflationary implications. The fact that 99.53% per cent of the recurrent component of the budget has already been spent in the first half of 2011, as opposed to 34.01 percent of the capital expenditure, and the increasing domestic borrowing to finance the deficit profile of government spending points to continuing, if not increasing, risks of rising inflation. The forward-looking nature of monetary policy makes monetary tightening measures imperative in the face of this scenario.

Secondly, there will likely be an inflationary impact of the implementation of a new minimum wage, which appears imminent.

Thirdly, while headline inflation has moderated, and is projected to continue that trend until the end of 2011, core inflation is projected to increase, growing to 14.8 per cent. This calls for a continued monetary tightening stance.

Fourthly, while financial stability has been progressively achieved over the past 18 months and there appears to be clear visibility on the full stabilization of the banking sector by year-end, the necessary liquidity injections of not less than 1.6 trillion naira in Asset Management Corporation of Nigeria (AMCON) bonds to recapitalize the CBN-intervened banks requires a forward-looking response by monetary policy in order to counter inflationary threats.

Fifthly, it remains essential to move into and sustain interest rates in positive territory in order to reduce the pressures on the exchange rate. These pressures are demonstrated by the significant divergence between the interbank and parallel market exchange rates even where the naira has appreciated in formal markets in recent weeks as a result of the lifting of restrictions on importation of capital. An increase in the Monetary Policy Rate will attract more capital into Nigeria. This will reduce the amount of funding from the Wholesale Dutch Auction System (WDAS) foreign exchange market from the country's foreign reserves, saving reserves to cope with capital flight – a clear downside of speculative capital inflows – if and when it occurs. This approach is desirable, pending the implementation of medium to longer term reforms in the real economy that will reduce pressure on foreign currency demand as a result of the extremely import-dependent nature of the Nigerian economy, which makes the exchange rate a major channel of inflation. Nigeria remains grossly uncompetitive for global capital flows, which remain necessary for the country in the context of foreign investment and the absence at this time of a real turn-around of the real economy.

Finally, the global economic outlook is exhibiting ominous signals, with implications for a country that depends on a single, volatile commodity – crude oil – for most of its revenue. The debt problems in the USA, and Greece and the whole euro zone, threats to continued growth in China and

India, point to a possible recurrence of adverse external shocks that would wreck Nigeria's budget assumptions of the price of crude oil if global demand weakens considerably as a result of global economic developments.

I conclude by noting that one is fully aware of the potential downside of continued monetary tightening, including the potential negative impact on growth, credit to SMEs and the real sector. But this argument is attenuated by two counter-arguments. The first is that, with the economic and fiscal situation that confronts us, strategic choices at a higher and wider level must be made, ranked, as they must be, in order of priority. Price stability remains a core mandate of the MPC. The second, and perhaps even more important, is that the real reasons for low levels of credit to manufacturing SMEs, agriculture and the other sectors essential for a real economic transformation are structural and go well beyond what monetary policy can achieve on its own. It is important to

emphasize the limits of monetary policy as part of the overall management of the economy.

This calls for a sustained strategic focus on fundamental economic reforms and the management of fiscal policy, and effective collaboration between fiscal and monetary authorities to achieve that outcome.

7.0 OLOFIN, SAM

Going by our staff report, short term economic outlook for the domestic economy suggests robust output growth projected at 7.92 percent and 8.39 percent for third and fourth quarters of 2011 respectively. The year-on-year headline inflation rate is declining and likely to hover around 9.3 and 10.4 percent in the next two quarters. These positive developments need to be considered along with the fact that there are now strong indications of light at the end of the tunnel, with respect to restoring stability to the financial system. This is likely to have been accomplished by the end of the third quarter of 2011. This positive outlook may therefore suggest the need for a monetary policy stance that gives greater weight to growth considerations than we have done hitherto.

However, while the domestic economic outlook looks quite favourable enough to allay fears on inflationary pressure that prompted our current monetary tightening stance, a number of other factors would suggest otherwise. First it is doubtful that the downward trend in headline inflation rate can be sustained beyond the seasonal impact of likely bumper harvests in the agricultural sector. Similarly it is doubtful that the rise in global food prices which accounts for a significant component of imported inflation would decline significantly over the short to medium term. Perhaps more worrisome is the prospects of fiscal stance that is not likely to alter significantly in the short to medium term. We are still facing the prospects of a highly inflationary deficit financing posture of the fiscal authorities, and preponderant emphasis on recurrent as opposed to capital expenditure programmes. This may be further accentuated by the newly enacted minimum wage bill and the delayed but ultimately inevitable deregulation of the downstream oil sector.

A major development since the last MPC meeting is the equally worrisome outlook in both the developed and emerging economies; developments that are likely to impact negatively on commodity prices and volume of demand particularly for petroleum exports which still account for the bulk of our export earnings and government revenue. The prospects of a weakening of the current global recovery or sliding into a double dip recession in the developed

economies cannot be entirely ruled out. For a highly import dependent economy like ours which relies heavily on foreign exchange earnings from a single commodity to finance domestic consumption and investment spending, a likely sudden sharp decline in oil prices represents a major exogenous disturbance and downside risk to the seemingly bright prospects in the domestic economy. This needs to be addressed also.

Given the backdrop of the foregoing, the conclusion can be drawn that in addition to the challenges of growing the real sector of the economy there are still major challenges that may not warrant an early easing of the ongoing tight monetary policy stance. The prospects for growing the real sector and achieving significant reduction in our level of import dependence as a means of curbing inflation in the short to medium term remains a major policy challenge due to structural rigidities. The major available instrument for ensuring growth and price stability in the short to medium term still lies heavily on our ability to grow our foreign reserves. Despite a recent increase of \$1.90 billion or 5.96 percent growth between June and July 2011 to a new level of \$33.79 billion, it has either been stagnating or declining despite rising oil prices. We therefore need a combination of measures that would enable us reduce the inflationary pressure of expansionary fiscal policy stance, as well as hedge against the possibility of major slump in oil prices in a worst case scenario. A further upward adjustment of the MPR may therefore be necessary, not only as a signaling measure but as a means of reducing excessive liquidity that may be fuelling speculative demand for foreign exchange, thereby easing the pressure on the Naira and the need to run down reserves. There are of course other sources of leakages that need to be plugged that are beyond the purview of the Committee. Secondly further raising the MPR would further improve the prospects of gradually moving the currently negative real interest rate (compared with 5 percent for Ghana) upwards towards a positive rate. This would increase our competitiveness in attracting necessary net portfolio capital inflows, as a means of further easing the pressure on foreign reserves. Given the level of MPR before the global financial crisis that prompted erstwhile quantitative easing and reduction in MPR, we are still left with much leverage room for raising the MPR without unduly jeopardizing growth prospects in the real sector. One would therefore vote for raising the MPR by 75 basis points.

8.0 OSHILAJA, JOHN

Approaching the concluding stages of Policy Normalization now places the MPC in a position to begin contemplating further viable means by which the public's expectations of price changes might be anchored. To the extent that the external value of the Naira is a primary channel through which changes in

general domestic price levels are transmitted, the increased attention paid to safeguarding relative exchange rate stability should not surprise financial markets.

I believe the vote I casted today, favoring further tightening, serves the following key purposes:

It signifies recognition of further challenges to Monetary Policy posed by the continuing, and largely unadjusted, trajectory of expansionary Fiscal Policy -- at all levels of Nigeria's multi-tiered government.

It also serves to hasten the MPC's normalization process – i.e. the unwinding of QE and other accommodative measures taken in the aftermath of the Financial Crisis

Finally, it marks the start of an essential step – repositioning Nigerian financial markets as a potentially competitive destination for investment capital.

However, at a time when capital markets globally are becoming inhospitable to nations that appear to be living beyond their means, the MPC is justifiably very concerned about the comparatively relaxed posture of Fiscal Policies in Nigeria. A review of key trends in current budgets, across the board, suggests that Public Borrowing will very likely increase against high, growing, and largely unadjusted recurrent spending patterns. The risk also appears high that government execution on capital investment priorities will remain weak. Should such disturbing trends continue, becoming a dominant feature in the financial operations of Nigerian governments, then supposedly inconceivable questions of Solvency may ultimately have to be addressed. This would be most unfortunate for investments in Nigeria, because the likely adjustment required would be precisely the type of sharp exchange rate adjustment the MPC's adopted strategy is intended to avoid.

I believe the MPC recognizes that the effectiveness and success of Policy strategies we are presently embarked upon rest, to a significant degree on the pace and thoroughness with which Fiscal arms of government voluntarily make the necessary adjustments. Nigeria's governments are essentially confronted with the stark choices of either raising revenues, from an increasingly skeptical Public, or rationalizing public expenditures in ways that also credibly address the country's development challenges.

I also believe that, notwithstanding levels of capital destruction that occurred during the recent crisis, there remains sufficient capital in the global financial system for demonstrably prudent Public Financial Managers. I am also

reasonably confident in Nigeria's fundamental attractiveness to portfolio and direct investors.

It, however, remains to be seen whether the nation's Fiscal Management can rise to the challenge of gaining the sustained trust of long term investment capital. This is the capital really needed for sustainable nation-building, and not the transient capital that will invariably be attracted by initial, restorative Policy attempts. The former is the type of domestic and international capital both Monetary and Fiscal authorities in Nigeria need to realistically and assiduously cultivate. Thus, when viewed from this perspective, the vote cast today ultimately represents a judicious vote for realistic nation-building.

9.0 SALAMI, ADEDOYIN

At 10.2% in June 2011, the rate of increase in prices is at its lowest since Sept., 2009. Indeed, the slow-down in the overall rate of price increase is the sharpest experienced since July 2006. In the same vein, Core and Food Inflation are at their lowest since May 2010 and March 2008 respectively. The Outlook for inflation, according to Central Bank of Nigeria (CBN) Staff, also looks benign. Indeed by the end of the year, Staff forecast year-end Headline Inflation at 9.3%. Output data from the National Bureau of Statistics (NBS) showed slower rate of increase in economic activity in the 1st quarter 2011 – Gross Domestic Product (GDP) rose by 6.64% compared with 7.36% in the same period last year.

Taken together, slowing output and easing inflation suggest it may be time to ease up on the reversal of Quantitative Easing (QE) which started in September last year. However, CBN Staff *forecasts* show year end Core Inflation at 14.8 per cent – averaging almost 14% each month for the rest of the year. This compares with an average *actual* rate of approximately 12% in the 1st half of the year. In other words, Core inflation is expected rise in the second half of the year!

The balance of risks to inflation, international and domestic, continues to be on the downside. On the international front, the challenge which we have to consider is the impact on the economy in Nigeria of a sharp slow down in the global economic environment. The factors towards such an easing of growth are already massing – Eurozone Crisis, prospect of US debt default, prospect of a housing bubble in China, inflation in India and Brazil's management of its deficit. While the Eurozone crisis is not new, its growing dimensions continue to assume worrying proportions and presently pose a real threat to the French and German economies.

To this, we must now consider the likely impact of the increasingly real risk of US default on its debt and a prospect of slower growth in the key Emerging Market countries. India, China and Brazil which have sustained growth in the global economy have domestic challenges which may reduce economic activity in these countries with adverse implications for the global economy and the demand for oil. In other words, notwithstanding high current and futures market prices for crude oil, uncertainties in the international environment provide a basis for heightened concern about prospects for oil market conditions remaining favourable.

Concerns about the international oil market should bring urgency to the need to resolve some of the conflicting statements about Nigeria's fiscal direction and take concrete steps towards fiscal consolidation. Thus far, there has been 34 per cent and 99.5 per cent implementation of the Capital and Recurrent Expenditure appropriations in the 1st half of his year. The budget deficit of the Federal Government in the 1st half of the year which already exceeds the budget provision is likely to worsen in order to finance the implications of the new Minimum Wage Act and continuing payment of petroleum subsidy. In other words, *there is currently* no basis for anticipating fiscal consolidation in this year. The signs of a widening structural deficit are there for all to see. For how long can governments across the nation continue to live beyond their means?

While recent pressure on the exchange rate – witness the growing divergence between the official and parallel market rates – is the result of diminished Bureau du Change access to foreign exchange supply, available data, showing sharp growth in imports, suggests that the prospects for easing of pressure on the currency don't look bright. Indeed, removal of the restriction on portfolio outflows could, in the wrong circumstances, bring added pressure on the Naira. The September deadline for bank recapitalisation means a further injection of liquidity in the 3rd quarter of this year.

Given the outlook for international and domestic risks, I am in no doubt of the need to further tighten monetary policy. I am not unaware of concerns that further increases in interest could deleteriously affect the economy's growth prospects. However, in the face a high liquidity in banks, the challenge for credit growth does not appear to be the resources with which to create risk assets but the doubts about the safety of such assets. Indeed, the question to which a definitive answer is required is how much does credit growth contribute to facilitating rising levels of economic activity? On the evidence of available information, very little!

The need to ensure that we encourage savings mobilisation by attaining to positive inflation adjusted interest rates cannot in my view be over-emphasised. Negative 'real' interest rates create an incentive towards asset substitution

away from intermediate assets. This poses, in my view, a real risk to sustaining the growth prospects of the economy.

10.0 UCHE, CHIBUIKE. U.

In recent times, the MPC has consistently tightened the monetary space with the main objective of maintaining price stability. Monetary policy has no doubt been made more precarious by persistent government fiscal indiscipline and its resultant double digit inflation. This has unfortunately become a recurring factor in our economy. The current monetary policy stance of MPC is arguably, at least in part, responsible for the slight but encouraging change in the direction of inflation. This has however come at a cost: a slowdown in the economic growth of the country. This is not surprising especially given the fact that such monetary tightening tend to crowd out credit to the real sector and thus normally impact negatively on real sector growth and development. The MPC must therefore have to balance the need for real sector development and growth with its core objective of price stability. Striking the above balance may not be so difficult once it is agreed that the underlying reason for the price stability objective of monetary policy is to engender economic growth.

Given that the goal of price stability is not an end in itself, one is inclined to attach more weight to real sector economic development and growth. I will therefore not support an increase in MPR at this time. My reasons for this are both tactical and economic. At the tactical level, I believe that it is time for the MPC to pause and take stock of the impact of its aggressive tightening of the monetary space in the recent past. At the very least, this should lead to a better appreciation of the full costs (and benefits) of this policy direction.

At the economic level, one reason for my current position is the fact that the bank distress resolution scheme is still ongoing and, in my view, at a critical stage. Increase in interest rates, which will be the natural endpoint of credit tightening, will no doubt negatively impact on the health of our fragile and still recuperating banking sector. Aside from its potential for increasing loan defaults, evidence before MPC also suggests that the loans market is getting more concentrated. This has implications for risk management.

Furthermore, I am uncomfortable with the argument that continuous aggressive tightening is required in order to drive our economy into positive real interest economic space which will in turn help attract foreign investments. My position is based on the well known fact that foreign investment decisions are based on a multitude of factors which include the level of corruption, political stability, discipline and seriousness of host governments in implementing set policies. It is

in my view difficult for any meaningful long term investments to be attracted to Nigeria given the current profile of the country. The attainment of a positive real interest rate regime under the current scenario can only attract short term speculative investments. This in my view should not be the priority at this time.

The pursuit of a positive real interest rate economic regime must therefore not be seen as an end in itself. It is of doubtful utility in an economic arena with few opportunities for real sector economic growth and development. On the basis of the above arguments, I am of the view that the current status quo should be maintained.

11.0 YAHAYA, SHEHU

We recognise some of the developments that have occurred in the second quarter of this year. In particular, we note the slight downward trend in both headline and core inflation. We also took note of the slight dip in projected growth rate, as well as the appreciation in the Naira value at WDAS. Ordinarily, these developments would have indicated some pause in the trend for the tightening in monetary policy that the Committee has been doing in the last few meetings

Nevertheless, it is pertinent to re-emphasise that monetary policy should be predicated mainly on extrapolations and projections in the future behaviours of the relevant variables, not so much on the past trends. In this case, the outlook for the next two quarters is dominated by the following:

- Expected injections of liquidity arising from AMCON operations
- Demand pull effect of increases in minimum wages in the public sector (mainly at the state and local government levels)
- The effects of the above two on liquidity and thereby on demand for forex
- Continuing concerns with negative real interest rates
- Probable increases in deficit spending and debt emanating from increased recurrent expenditure and possible softening of crude oil prices due to a number of developments in the international economic system, including Nigeria's major trading partners
- Staff projections of core inflation and head line inflation are on the upward side as we go towards the end of the year

These provide a strong argument for tightening monetary policy. Such a tightening will affect bond prices, raise interbank rates and may have some effect on lending rates to the productive sector. However, it must be noted that for quite a while now, commercial bank lending to the agricultural sector has been miniscule, and from the evidence available so far, lending to the manufacturing sector has been inelastic with respect to interest rates. Furthermore, prime borrowers in the oil and gas, telecommunication sectors are unlikely to be significantly affected, since the prime lending rate tends not to respond much to rate increases. Effects of tightened monetary policy on growth of the productive sectors and job creation may therefore be insignificant.

The argument for tightening is therefore strong. However, there is an issue as to the most effective means of tightening monetary policy. The Cash Reserve Ratio has already been raised at the last MPC meeting by 100%, and given the blunt nature of the instrument, it is probably better to leave it at this level for a while and see how its effects work out. Open Market Operations can also be used to mop up liquidity and to mitigate volatility and can be used to tighten monetary policy, but it should probably be used in conjunction with other instruments. It also imposes some costs to the central bank.

Given the above, it seems inescapable that the MPR has to be raised in order to help choke off the threats for excessive liquidity in the system. I therefore vote for an increase of 50 basis points in the MPR, to be combined with the effective use of open market operations to address anticipated inflationary pressures and help stem the pressure from forex demand, which may be difficult to contain merely through increasing sales of forex, without unduly jeopardising foreign reserves

We recognise that there are a host of other issues in the financial system, such as the widening gap between the Naira value at WDAs and at the bureau du changes and the round-tripping threats it poses; apparent inconsistency between the prices of crude oil and the rate of foreign reserve accumulation; negative real interest rates etc

These and other issues must be tackled through the regulatory mechanism of the CBN and through coordination with government fiscal policy, while the MPC focuses on deploying the instruments at its disposal to address issues within its purview.

12.0 SANUSI LAMIDO SANUSI

Governor of the Central Bank of Nigeria and Chairman of the Monetary Policy Committee

We are meeting this month on the back of the release of second quarter numbers by the National Bureau of Statistics (NBS). Our decision today, more than ever before, is being conducted against the background of balanced risks, and the need to ensure that a recent historical event does not totally beckoned our focus on expectations, and also to continue with our policy of adopting a stance consistent with our reading of economic fundamentals and the medium to long term dynamics of the economy.

There appear to me to be arguments that are both credible and persuasive on both sides of the debate between the tightening and holding options.

A number of factors can be looked at to make a credible argument for holding rates.

First and most obvious in the decline in headline inflation from 12.4% to 10.2% in June, especially when considered against the backdrop of an approaching harvest and the likelihood of further moderation in the short-term. The second reason is that GDP growth, while remaining strong at just over 6.6% in the first quarter, actually represents a slowdown from previous quarter and the corresponding quarter of last year. A third reason is the clear slowdown in credit expansion, an increasingly bearish Equities market and anecdotal evidence of increasing vacancies in the real estate market which probably is responsible for the salutary impact of rent in the inflation index. All these factors would suggest that we hold interest rates for now, considering that we are coming from a history of successive interest-rate hikes.

On the other hand, and looking beyond headline figures, there are strong arguments for tightening as well. First of all, there is no evidence at all to give comfort that the sharp decrease in headline figures is sustainable even with the harvest season upon us. The resolution of the capital condition of intervened banks will entail significant liquidity injection by AMCON in the form of new bonds in excess of N1.5 trillion. July FAAC has a huge backlog component for augmentation and we still have another N700b for distribution to the federation, ahead of August and September FAAC releases. Government spending figures up to June indicate that over 99% of recurrent budget is being spent while capital budget performance is only 34%. Finally the minimum wage of N18,000 is likely to kick in this quarter. All of these point to increasing upward pressure on liquidity and prices. Secondly, the fiscal position of government remains a huge source of concern. This committee has for at least one year been sounding the

alarm on fiscal management. The budget assumption of \$75/b and 2.3mbpd are unrealistic and unsustainable leading to a constant drain on excess reserves for "augmentation". This will spill over into a much higher debt/GDP ratio than the current 19% by year end. Government revenue base remains very narrow, debt-service ratio continues to rise, and with a high structural cost base it appears to me that Government is already locked into a structural deficit. At the sub national level, the viability of many states will be under scrutiny unless the political authorities are able to negotiate a new revenue allocation formula or the states find other sources of revenue. Because this negotiation process will be long and tortuous, I think the fiscal space will continue to be a big problem in the short term. A structural deficit would advise higher rates of interest.

Finally, the international environment is overcast with very dark clouds. Is the U.S. going to default on its debt? Has Europe really done enough to deal with its debt crises? Are high house prices in China reflective of a real estate bubble about to burst? Can India deal with its seemingly chronic inflation problem? Is the fiscal deficit in Brazil sustainable at this rate? How long with the recession in Japan last? Finally, if all these problems converge, (and it is not too unlikely), how will they affect the price of oil, the flows of capital and the Nigerian economy?.

My view is that we are living in dangerous times. The Balance sheet of the government is not strong enough to cope with a major shock. The Banking system will need more support in the event of such a shock. The main shock absorber for our economy, foreign reserves, have not been sufficiently beefed up.

The only way to build up reserves against shocks in addition of course to better fiscal controls on leakages in the oil sector is to raise interest rates into positive territory which, in addition to recent lifting of capital controls, should reduce pressure on WDAS market and help preserve the external value of the naira.

There is of course the risk of too much hot money coming in, but if we build up reserves we can cope with capital flight if it comes along.

In addition to all of the above is an inflation fact Core inflation remains very high and staff forecast is for an increase, not moderation.

For all the above reasons I am of the view that we do not only need to tighten, we need to do so aggressively and send clear signals of commitment to positive interest rates. We also need to send strong signals that, as a monetary authority, we recognize the huge risks faced by this economy from the weaknesses in the external environment, and the fiscal position of government.

For these reasons I vote for a 75 basis-point increase in rates, especially since we now have clear visibility on the banking sector resolution.