



Central Bank of Nigeria Communiqué No. 78 of the Monetary Policy Committee Meeting, September 19, 2011

The Monetary Policy Committee (MPC) met on 19th September, 2011 to review domestic economic conditions during the first eight months of 2011 and the challenges facing the Nigerian economy against the backdrop of developments in the international economic and financial environment in order to reassess the challenges facing monetary policy for the rest of 2011.

On the global scene, the Committee noted that current international developments presented substantial economic uncertainties, clouding the outlook for global growth and inflation. These developments included: increasingly weak and volatile global financial markets, deepening debt crisis in the Eurozone, global implications of slow growth at a time of limited fiscal flexibility, rising commodity and food prices, and costly natural disasters. There is a general expectation that there would be a slowdown in almost all advanced economies in the near term, raising fears of a second recession. These developments, in the Committee's view, affect the domestic economy through trade and financial flows. Also,

international financial markets present a very volatile and uneven picture, reflecting a high degree of uncertainty.

The Committee also noted that, there is increasing concern about the sustainability of public debt globally. The high fiscal deficits suggest that policies to usher in fiscal discipline are critical for restoring public confidence in Government finances. The Committee welcomed the Federal Government's expressed intent to contain fiscal deficits within credible limits over the medium term.

On the domestic front, the MPC noted that inflationary pressures faced by the domestic economy had slightly moderated following the series of monetary policy tightening measures adopted by the Bank, complemented by a favourable harvest. The output growth remained robust, although the current security challenges could undermine investors' confidence and output in the near term. Nonetheless, the inflation outlook appears uncertain despite the expected favorable agricultural production, the stability in expectations engendered by the imminent conclusion of the banking sector reforms, and the prospects for a return to a regime of fiscal prudence in the medium-term following the reconstitution of the Federal Government of Nigeria (FGN) Economic Management Team. It is against this backdrop that the Committee considered the

monetary policies required to attain the objectives of price and financial stability in the short to medium term.

Key Domestic Macroeconomic and Financial Developments

Output and Prices

The Committee observed that the output growth rate for the second quarter 2011 remained robust. Provisional data from the National Bureau of Statistics (NBS) indicated that real Gross Domestic Product (GDP) grew by 7.72 per cent in the second quarter of 2011, which is above the 7.69 per cent recorded in the second quarter of 2010. Overall GDP growth for 2011 is projected at 7.85 per cent which is slightly lower than the 7.87 recorded in 2010. The non-oil sector remained the major driver of growth, recording 8.82 per cent growth rate compared with 1.81 per cent for the oil and gas sector in the second quarter of 2011. The growth drivers remained agriculture, wholesale and retail trade, and services, which contributed 2.48, 1.88 and 2.52 per cent, respectively.

Domestic Prices

The Committee noted that the moderation in inflationary pressures, which commenced towards the end of the second quarter of 2011, continued into the third quarter. The year-on-year headline inflation rate decreased from 9.4 per cent in July 2011 to 9.3 per cent in August and core inflation decelerated from 11.5 per cent to 10.9 per cent during the same period. However, food inflation rose to 8.7 per cent in August 2011, from 7.9 per cent in July.

The harvesting of early maturing crops, especially maize, tomatoes, vegetables, potatoes and fruits played a key role in the moderation of headline inflation. The recently announced government policies and programmes are likely to have a salutary impact on agricultural output, if speedily implemented. These expectations are however currently under threat from anticipated fiscal injections, increased government borrowing to finance the huge fiscal deficit in the 2011 budget, the recent upward revision of electricity tariffs and the anticipated deregulation of petroleum product prices, among other factors.

Monetary, Credit and Financial Market Developments

Broad money (M2) grew by 8.55 per cent in the eight months to August 2011, which annualized to a growth rate of 12.82 per cent. Aggregate domestic credit (net) grew by 14.72 per cent in August 2011 when compared with the level in December, 2010. On

annualized basis, the growth in net domestic credit translated to 22.08 per cent compared with the growth rate of 15.0 per cent in the corresponding period of 2010.

The growth in aggregate credit was accounted for by increases in credit to the Federal Government and the private sector. Credit to the Federal Government grew by 18.99 per cent, which annualized to 28.48 per cent, close to the indicative benchmark of 29.29 per cent for 2011. Similarly, credit to the private sector grew by 10.88 per cent, which annualized to 16.32 per cent, as against the benchmark of 23.34 per cent. With the banking crisis approaching a final resolution with the recapitalization of banks, it is expected that banks will increase lending once integration issues are concluded.

Interest rates in all segments of the interbank money market rose in response to the upward review of the MPR at the previous MPC meeting. The Inter-bank and Open Buy Back (OBB) rates both opened at 7.49 per cent on July 27, 2011 and rose to 11.0 per cent and 10.36 per cent on September 15, 2011, respectively. The retail lending rates which had remained relatively high, however, declined during the period. The average maximum lending rate declined to 22.27 per cent in August, 2011 from 22.42 per cent in July. The weighted average saving rate rose to 1.46 per cent from 1.42 per cent over the same period. The consolidated deposit rate declined during the period from 2.42 to 2.30 per cent. Thus, the spread between the average maximum lending rate and the consolidated

deposit rate narrowed marginally from 20.0 per cent to 19.97 per cent during the period.

The bearish performance of the stock market continued during the review period as the All-Share Index (ASI) decreased by 15.5 per cent from 24,980.20 at end-June, 2011 to 21,106.67 on September 16, 2011. Market Capitalization (MC) decreased by 15.7 per cent from ₦7.99 trillion to ₦6.73 trillion during the same period. Despite the bearish performance, the equity market was more or less fairly valued as reflected in the NSE Price-Earnings (PE) ratios of 10.82 in August 2011, which was close to the 10-year 8-month median of 11.57. Moreover, the performance of the NSE during the review period is consistent with the performance of other stock markets around the world, and reflects lingering risk aversion and deleveraging on the part of foreign institutional investors who are key players on the NSE.

External Sector Developments

At the wDAS, the exchange rate, during the period (July 27 – September 15, 2011) opened at N150.00/US\$ and closed at N153.52/US\$,representing a depreciation of N3.52 or 2.35 per cent. At the inter-bank segment, the selling rate opened at N151.80/US\$ and closed at N156.30/US\$, representing a depreciation of N4.50 or 2.96 per cent during the period. The exchange rate recorded a

modest appreciation at the BDC segment where the selling rate opened at N163.00/US\$ and closed at N158.00/US\$, representing an appreciation of N5.00 or 3.07 per cent. The appreciation recorded in the BDC segment of the market was attributed to the increased supply of foreign exchange by the CBN and the removal of ceilings on DMBs' sales to BDCs.

The Committee noted that the premium between the rates at the WDAS and the interbank stabilized towards the end of the review period, while that of the BDCs narrowed significantly, suggesting the need to sustain existing measures to improve the efficiency of the market.

The Committee also noted the modest accretion to external reserves during the period. Gross external reserves stood at US\$34.85 billion on 15th September, 2011, representing an increase of US\$1.12 billion or 3.32 per cent above the level of US\$33.73 billion attained on July 21, 2011. The increase was mainly accounted for by increased inflows of royalties into the federation account, reflecting the upward trend in international oil prices and stable oil production in the Niger Delta. Besides, foreign direct and portfolio investments increased over the last eight months. Foreign capital inflows for the first eight months of 2011 stood at US\$5.66 billion which is US\$1.06 billion or 23.04 per cent higher than the US\$4.60 billion recorded in the corresponding period of 2010.

The Committee's Considerations

The key concerns noted by the Committee were:

1. Continuing expansionary fiscal stance and high component of recurrent expenditure;
2. Liquidity surge expected from AMCON intervention, following conclusion of bank recapitalization;
3. Sharp rise in month-on-month headline inflation rate despite falling headline inflation rate on year-on-year basis;
4. Need to have positive real interest rates; and
5. Persisting demand pressure in the foreign exchange market, driven by significant liquidity injections and reflecting structural deficiencies that have perpetuated the import dependence of the economy.

The Committee considered that given the difficult and uncertain international environment, it is important to ensure that the current trends in growth are sustained and price stability is maintained. The recent data on inflation showed that the headline inflation rate has been maintained within single digit for two consecutive months. However, concerns remain about sustaining the present inflation trend. The Committee viewed the rise in the monthly headline inflation rate in August which, while justifiable from the point of view

of the large household expenditures on account of festivities, was sharp and out of line with the trend in the preceding 11 months. Besides, the anticipated high liquidity in the near future would have a bearing on inflation. The fiscal stance continues to be expansionary. The announcement of a target of one (1) per cent annual reduction in government recurrent spending when viewed in the context of the anticipated injections associated with the implementation of the new national minimum wage, suggests that the fiscal retrenchment is likely to be drawn-out. In addition, there is the weight of structural factors such as the announced hikes in electricity tariffs and the expected removal of petroleum subsidy. Moreover, the AMCON injection of N3.0 trillion is going to add to liquidity surge with attendant adverse impact on prices. It is for these reasons that the Committee felt the need for further tightening of monetary policy.

On the other hand, the Committee noted that rates have been increased in the last four consecutive MPC meetings and that high lending rates increase the cost of finance for SMEs and this has an adverse consequence for growth and job creation. However, having considered the arguments for and against tightening, the Committee voted for maintaining the stance of tightening in the short term.

The Committee emphasized that for monetary policy to be effective it would need to be complemented by other policies, both structural

and fiscal. Monetary policy can only address the monetary aspects of inflation while fostering growth and financial stability. The need for accelerating fiscal retrenchment and structural adjustment can therefore not be overemphasized.

Decisions:

In the light of the above considerations the Committee decided as follows:

1. A majority of 8 to 3 members voted for a tightening of monetary policy.
2. Seven (7) members voted for a 50 basis-point increase in MPR from 8.75 to 9.25 per cent. One (1) member voted for a 100-basis-point increase in MPR. The 3 remaining members voted to maintain the MPR at the current rate.
3. A Unanimous decision to:
 - a. maintain the current symmetric corridor of +/-200 basis points around the MPR; and
 - b. retain the current CRR of 4.0 per cent

Sanusi Lamido Sanusi, CON

Governor

Central Bank of Nigeria

September 19, 2011

PERSONAL STATEMENTS BY MPC MEMBERS:

1.0 ALADE, SARAH

Headline inflation declined marginally to 9.3 percent in August 2011 from 9.4 percent recorded in July, but food price inflation increased from 7.9 to 8.7 in spite of the favourable harvest. The monetary tightening effected so far by the Central Bank of Nigeria (CBN) has helped to contain inflation; however, inflation expectations need to be firmly anchored. Base on this, I believe that a moderate increase in monetary policy rate is needed at this point as a premature change in the policy stance could harden inflationary expectations, thereby diluting the impact of past policy actions.

While both headline and core inflation declined, food inflation increased from 7.9 percent in July to 8.7 percent in August. Headline and core inflation declined to 9.3 and 10.9 percent respectively; however, food inflation increased reflecting global volatility in food prices. This should come as a surprise as the usual seasonal effect during harvest did not help to moderate food price inflation in the middle of harvest season. The outlook on food price inflation will be hinged on the trend in global commodity prices.

Global commodity prices have been volatile and can put undue pressure on headline inflation. Food price shocks tend to have large second-round effects especially when food component is high in the consumption basket and where inflation expectations are not firmly anchored. Therefore the

possibility that commodity price swings can make it hard to meet a headline inflation target is a reason for continued tightening.

Minimum Wage increase, electricity tariff increase the removal of petroleum subsidy could pose upside risk to inflation in the short-run. The planned policy to remove the subsidy on fuel product by the Federal government of Nigeria and the minimum wage increase could further aggravate inflationary pressure in the economy and monetary tightening is needed to counter the effects of these policy actions which are good for long-run economic growth.

Real interest rate continues to be negative. To remain competitive and benefit from the increased investment inflows to emerging markets as a result of uncertainties in advance countries, real interest rate needs to be corrected for inflation with monetary policy.

AMCON activities in the recapitalized banks are injecting liquidity in the system. As AMCON tries to conclude the resolution of the troubled banks by bond issues, more liquidity will be injected into the system, putting additional pressure on the inflation dynamics. A loose monetary policy stance could further push inflation up.

Monetary tightening is needed to preserve the value of the domestic currency. Despite strong fundamentals (high oil prices, increased oil output, high GDP growth rate), the naira continues to depreciate against the US dollar. Although a number of factors could be responsible, one of such factor is the supply side effects of money supply. Tightening monetary policy will ease the pressure on the foreign exchange market and help stabilize the foreign exchange market.

While there are still pockets of downside risks in the domestic banking sector, the resolution action taken by the Central Bank is helping to restore confidence in the banking sector. The return in confidence needs to be solidified by concrete action, such as giving the banks the space to consolidate their position play in the market. There are indications that foreign direct investment inflow has resumed and a well anchored inflation would help attract foreign investors to the country. However, this will require a balancing act: while abrupt easing could encourage banks to take on more risks, further monetary tightening could squeeze liquidity conditions in the market with adverse impact on economic activities.

Based on the above, I would support a moderate increase in monetary policy rate as a premature change in the policy stance could harden inflationary expectations, thereby diluting the impact of past policy actions.

2.0 BARAU, SULEIMAN

A. KEY DEVELOPMENTS SINCE THE LAST MPC

- A.1 It is remarkable to note that year-on-year headline inflation rate moderated to 9.3% in August from 9.4% in July, 2011. The major drivers for the decline being clothing, footwear and healthcare costs. Food inflation, however, increased from 7.9% to 8.7% over the same period driven by adjustments in processed food, fish and seafood, oil and fats, potatoes and other tubers. Clothing, footwear and healthcare costs were also responsible for the decline in core inflation from 11.5% to 10.9% during the review period.
- A.2 It is also significant to note that Gross Domestic Product (GDP) grew modestly from 6.64% to 7.72% for quarter one and two respectively.

- A.3 In the foreign exchange markets, the Naira depreciated between July and September in the WDAS market by N3.57 or 2.36% and interbank market by N4.50 or 2.96%. However, the Naira appreciated in the Bureau De Change (BDC) segment by N5.00 or 3.16%. The premium between WDAS and BDC rates narrowed positively to below 2% in August from 9% that was earlier witnessed.
- A.4 Developments in respect of foreign reserves management have also been positive. Net flows have been positive, with foreign reserves increasing by 3.32 per cent to US\$34.85 billion from US\$33.73 billion on September 15, 2011 and on July 21, 2011 respectively.

B. CONTEXT – Pressure points

In order to make a recommendation for policy, it is important to critically examine the above developments and to form a view on the direction of issues that are important and critical.

Inflation - It is true that inflation rate has trended down, but the upside risk to inflation going forward are real for the following reasons;

- Increased fiscal spending arising from the rush to comply with year-end budgetary spending. Capital expenditure performance currently at less than 30% gives room for radical increase in spending in the next few months.
- Month-on-Month headline inflation actually inched upward during the review period, suggesting that the year-on-year inflation rate needs to trend downward on a sustained basis over time.
- Threats of imported inflation is still real,

- The declining trend in year-on-year headline inflation needs to be observed beyond two months that we witnessed to give comfort, that the trend is sustained.
- Liquidity from activities of AMCON is also a threat.
- The need to bring MPR to positive real rate territory is a compelling one that commends further tightening.
- Likely removal of petroleum subsidy is a political decision that could be implemented at very short notice.
- Compliance with minimum wage demands at all tiers of government, could potentially exacerbate the liquidity situation.

Foreign Exchange Market

In spite of the recent tight monetary stance, speculative demand for foreign exchange at all segments of the market has not abated. This is a major indicator of systemic liquidity surfeit. Meanwhile, it will be unwise to depreciate the Naira based on speculative demand given the potential impact of unguarded depreciation on prices and inflation.

Market rates and Growth

Even though market volatility has reduced, market interest rates have trended upwards to reflect recent adjustments in MPR. The challenge is how to achieve positive real rates of interest (low inflation and higher lending rates) without negatively impacting credit and GDP growth. It is important to note, however, that we recorded GDP growth in the last quarter inspite of our tightening stance, underscoring the huge liquidity still left in the system.

C. Recommendations

In view of the foregoing, I make the following recommendations;

- Continuation of the tightening stance of monetary policy
- Upward adjustment of MPR by 50bps from 8.75 to 9.25 per cent
- Maintenance of the corridor of +/- 2 per cent around the MPR
- Cash Reserve Ratio to remain at 4 per cent

3.0 GARBA, ABDUL GANIYU

Decision

I vote for:

- I. Holding the MPR at 8.75%
- II. Maintaining the Asymmetric Corridor for SLF and SDF
- III. Quantitative Tightening through more aggressive OMO to keep operating targets (OBB and Call Rate) around MPR+200 basis point. As observed from available data, the OBB and Call Rate averaged 8.13% and 8.6% respectively in the period between July MPC and September MPC meetings. Clearly, the operating targets were well below desired targets leaving ample room for further tightening using OMO.

Justification

- I. First, I am convinced that a more aggressive OMO to achieve the upper limit of the symmetric corridor (MPR+200 Basis Point) will substantially tighten liquidity without the unintended consequences of a higher MPR.
- II. Second, I expect inflation to trend downwards driven mainly by expected fall in food prices in September and October as food crops are harvested and marketed. I am mindful of the multi-dimensional global crisis with vortex in

the US, EU, Japan and the BRICs and the possible implications for commodity prices. The pass through effects will depend largely on (a) the exchange rate and (b) domestic production and demand. There are speculations about imminent removal of subsidies on petroleum products and increase in electricity tariffs. However, both policies are more likely to cause shifts in the general prices (a correction) than a sustained increase in prices.

- III. Third, in an inflation-unemployment trade-off, I give greater weight to employment creation for economic, social and security considerations. While SMEs which tend to have high **employment elasticities** have limited access to credit in the retail end of the money market, higher interest rates will limit access further and, increase the likelihood of current loan portfolio's becoming non-performing: a threat to jobs, growth and stability.
- IV. Fourth, while a positive real rate of interest is desirable to attract foreign investment, achieving it through MPR hikes generates a trade-off: between foreign capital inflows (FDI and Portfolio) on one hand, and local businesses growth and jobs on the other hand. I vote in favor of local businesses and jobs. I am not convinced that given the volatility and instabilities in the global economic system and the declines in the Nigerian capital market that portfolio flows is good for the economy. Furthermore, with the competitiveness challenges of Nigeria vis a vis its needs to create decent jobs, I am not convinced that Nigeria will attract the right FDI inflows with the highest growth (output and productivity) and employment elasticities.
- V. Fifth, between January and August, the Capital market has lost about two Trillion Naira and Staff projections estimate a bottoming up at 15,000 All Share Index (ASI). It is of course rational to expect that asset prices will fall as interest rate rises. Consequently, there is a strong chance that the likely effects on the equities market, the bond market and, indeed, the forex market will be incompatible with policy goals (growth, job creation and stability).

- VI. Sixth, I am not convinced that interest rate hike at this point will address some of the core challenges such as (a) the likely AMCON effects; (b) the FAAC Effects; (c) banking system risks of exposure to government debts (FGN Bonds and Treasury Bills); (c) excessive Federal Debts and distortions in spending structures or (d) subsisting inefficiencies in the financial system indicated by the excessively high overheads and, high interest rate spreads.
- VII. Seven, I am convinced that many of the challenges are institutional and, to a lesser extent structural. The implication being that such institutional and structural challenges require institutional changes, new incentive systems and outcome inspired and outcome-oriented fiscal actions.
- VIII. Finally, harmony between the fiscal system and monetary system is critical to the medium to long term success of fiscal and monetary policies and indeed, macroeconomic management. It is of the outmost necessity, that the fiscal system be brought into harmony with monetary policy and to be **bounded** by the requirements for price stability, sustained growth in investment, employment, productivity and output. It is also, important that monetary system is similarly, bounded.

4.0 LEMO, TUNDE

The global economy continues to grow sluggishly as USA now grapples with the effects of a downgrade and the impact on the yield on her bonds. The risk exists of another global recession arising from the growing sovereign debt crises in Europe as well as the concern about the excess capacity in the Chinese real estate market. This has implication for the sustainability of the existing high community prices.

The National Bureau of Statistics (NBS) projected a growth rate of 8.39 per cent for the Nigerian economy during the fourth quarter of 2011. Overall, GDP growth for 2011 was projected at 7.80 per cent in 2010. This is a welcome development in spite of the consistent increase in MPR in the last few months as well as not-too-impressive growth in the credit to the private sector. The modest increase in External Reserves which stood at USD34.85b as at September 15, 2011 is a welcome development but additional reserve accretion is required to build up robust external reserve to cushion the possible effect of a crash in crude oil price in the near future. Exchange rates remain fairly stable and generally within the 3% band with a near convergence of WDAS and BDC rates. This equilibrium may however be threatened by the build-up of liquidity pressure resulting from the repayment of NNPC debt, implementation of new minimum wage, fiscal activities resulting from the implementation of 2011 Budget at the benchmark price of USD75 per barrel as well as additional injection resulting from AMCON activities following conclusion of intervened banks' recapitalization.

INFLATION:

Developments up to the third quarter of 2011 indicate that the inflationary pressures are moderating following the series of monetary policy tightening measures adopted by MPC at the last 4 meetings. However, estimates from the National Bureau of Statistics indicate that year-on-year core inflation is expected to hit 10% in November 2011. The possibility of fuel subsidy removal as well as increase in electricity tariff may also exacerbate the pressure. Short-term money market rates have moved up in tandem with our tightening mode in the last few months and whereas negative real interest persists in Nigeria, it is heartwarming to note that the gap has narrowed substantially. This, in addition to the relatively stable exchange regime has led to a significant increase in capital flow in the

last few months. MPC should push harder towards positive real interest regime to enhance Nigeria's competitiveness as an attractive portfolio and FDI destination.

DECISION:

In view of the foregoing therefore and in order to consolidate on the gains of the past, I vote for the continuation of the tightening mode and recommend an upward adjustment of MPR by 50 basis points i.e. from 8.75% to 9.25% while the existing symmetric corridor of +/- 2% around the MPR remains unchanged. This stance will help to fight the expected surging inflation resulting from the increase in fiscal activities, stem expected elevated demand for foreign exchange and accelerate our march towards positive real interest rates.

5.0 MOGHALU, KINGSLEY CHIEDU

I had hoped that I would vote at this meeting of the Monetary Policy Committee in favour of holding the Monetary Policy Rate steady at the rate of 8.75 per cent, or at the most voting for further tightening by 25 basis points. My expectation was based on the reports that following a series of rate increases by the MPC, inflation was moderating.

The nuances evident in the staff reports and projections, however, lead me to support another rate increase by 50 basis points, bringing the MPR to 9.25 per cent. Two main factors in my view account for the need to continue tightening. The first is the current and anticipated liquidity injections into the financial system through Asset Management Corporation of Nigeria (AMCON) and fiscal expenditure by the Federal Government in the last quarter of 2011. AMCON bonds of about 3 trillion naira covering purchases of non-performing loans in

banks and the recapitalization of the CBN-intervened banks will result in enhanced liquidity over the medium term. While one is encouraged by the commitment of the fiscal authorities to fiscal retrenchment, as evidenced by the policy stance of the reconstituted Economic Management Team, this goal will take a number of budget cycles to attain. In the short term, monetary policy tools must be deployed to contain the consequences of an expansionary fiscal stance until fiscal and monetary policy converge on measures to control inflation. Moreover, increases in electricity tariffs and the anticipated – and necessary - deregulation of petroleum product prices are likely to have an inflationary impact.

Secondly, while interest rates have been moving in a real positive direction given rate increases and the moderation of inflationary threats, it remains necessary to accelerate and sustain this process in order to increase Nigeria's competitive advantage as an investment destination, which is presently at a disadvantage when compared to countries such as Ghana and South Africa. Moving real interest rates into positive territory relative to inflation will also contribute to increased deposit and savings rates when, as expected, the CBN withdraws its interbank guarantee on December 31, 2011 and commercial banks have to compete more actively for deposits.

For the reasons above, combined with the staff projections of increased inflationary trends before a return to reduced inflation over the next six months, it is necessary to increase the MPR by 50 basis points as a precautionary measure to obviate the inflationary factors that still lie ahead and to consolidate the evident gains of the monetary tightening stance maintained by the MPC over the past several months.

I also vote for maintaining the symmetric corridor at plus/minus 2 per cent and retaining the cash reserve ratio at 4 per cent.

I conclude by noting a need to maintain a more cautionary stance about tightening going forward in light of an uncertain global economic outlook in which a return to global recession cannot be ruled out.

6.0 OLOFIN, SAM

It is cheering news that headline, year-on-year, inflation rate has declined to 9.3 percent in August, 2011, and core inflation rate has fallen to 10.9 percent, even if food inflation has risen slightly to 8.7 per cent compared with the figures that were before us at the last meeting. This development can be partly attributed to monetary policy tightening measures that have been in place over the last two quarters or thereabout. We have over the last couple of months been wondering whether a single digit inflation rate is attainable in 2011 or not, and if so, would it be sustainable and for how long. Going by the reports we have before us at this meeting, we can answer the first part of the question in the affirmative. However as to whether the observed declining trend in inflation rate is sustainable over the medium term remains debatable if not out-rightly no, for a number of reasons. First, the observed decline in inflation rate is also partly attributable to a seasonal factor of improved harvests and consequent decline in domestic food prices. There is however no evidence that the prices of imported food which account for nearly 50 percent of food inflation are declining. Secondly, with respect to developments in the financial sector, there have been significant developments, indicative of the resolution of the crisis which threatened the stability of the sector and which has been receiving attention since August 2009. The recapitalization measures taken by AMCCON to rescue some of the intervened deposit money banks that were gravely in

danger will continue to exert some measure of inflationary pressure through additional liquidity injection into the financial system.

Thirdly on the fiscal side, there is strong evidence that the Finance Ministry under the leadership of the new minister would be strongly committed to fiscal discipline and fiscal consolidation from now onwards. However as much as this may be true, there is very little that can be achieved by way of one percent reduction in recurrent expenditure in the 2012 federal budget. The inflationary pressure of current level of fiscal deficit is likely to be further exacerbated by the ongoing implementation of the new minimum wage policy; very imminent removal of subsidy on petroleum products, and the proposed increase in electricity tariffs among others. In the light of the foregoing it is doubtful if it is yet 'Uhuru', and that the time has come for a major review of the monetary tightening policy stance that the Committee has pursued over the last couple of meetings. There is yet much to be done to bring the inflation rate to a sustainable one digit level over the short to medium term.

It may be true that we do stand the risk of stifling growth in SMEs if the rate of interest continues to rise beyond what they can afford to make their businesses profitable, and this may be capable of having negative impact on the level of employment. However there is no strong available evidence to suggest that the level of economic activity of SMES depends heavily on borrowing from the money or capital market to finance their businesses. As for large scale enterprises, the observed and predicted robust performance of over-all GDP growth, which continues to hover around 7-8 percent, tend to suggest that the tight monetary policy measures introduced over the last three to four meetings have not had significant negative impact on their performance. We may therefore still have some leverage room for further tightening by way of raising the MPR to hedge against what appears to be non-abating inflationary pressures over the short to medium term. In addition to this, the observed

decline in the rate of inflation over the last two months notwithstanding, the MPR still remains negative in real terms. There may be other factors which contribute to overall business climate that would need to be attended to if we are to attract significant inflow of foreign capital. However, our negative MPR puts the country at a less than competitive position relative to comparable other African economies such as South Africa and Ghana. If we are to become more competitive in attracting net-flow of external funds, be they portfolio investment or FDI which would be needed for boosting growth as well as our external balance position, we would need to further raise the MPR towards the goal of achieving a more competitive positive rate. There is therefore a strong argument for continuing with our current tightening stance by way of upward adjustment of the MPR, albeit, at a steady gradual rate rather than through an aggressive potentially disruptive upward spike. I would therefore vote a 50 basis point upward adjustment in the MPR rate.

7.0 OSHILAJA, JOHN

My vote today is based on recognition of the increasingly likely need, in the near to intermediate term, for Nigeria's Monetary Authorities, to begin contemplating credible and persuasive "supply-side FX initiatives"; i.e. sustainable initiatives aimed at stimulating increased capital flows to the economy. Such flows, when also attracted from external markets, enhance a Central Bank's ability to accumulate currency reserves, i.e. reserves the country will need to maintain exchange rate stability well into future periods. Nigeria's governments spend too much on, and get far too little value for, their Recurrent Expenditures or running costs; with not enough focus and accountability placed on Capital or Investment Spending and *Execution*. One may conceptually argue that Nigeria habitually "eats" or consumes Capital earnings that could be justifiably directed

towards critical Public Investment needs. It is clear to me that, in the absence of meaningful adjustments to this historical pattern of spending priorities, Monetary Policy likely becomes one of the few credible tools left available to policy makers for taking up the slack in promoting investment. Given prevailing and foreseeable domestic and international conditions, I would advise that measures for augmenting Nigeria's reserve buffers be seriously considered, and established sooner – rather than later.

A clear first step towards this end entails ensuring that Nigerian portfolio investments, fixed income instruments in particular, at least offer competitive, real returns to domestic and international savers. I refer to private and public actors and institutions, whose surplus capital could then be redeployed, by capable players and agencies, for productive investments in much-needed physical and social infrastructure. Power, transportation, and communication systems, health-care delivery, learning institutions, financial services and so on. I believe it is time aggressive steps are taken in this direction, especially now that rates of inflation seem to be abating. In my opinion, this possibly fleeting ease (or pause) in inflation presents the opportunity an import-dependent, single-export country like Nigeria, simply cannot afford to ignore or be complacent about. There are urgent investment needs, and wide ranging public work projects to be completed. Frankly, I would have preferred that the MPC today took more assertive steps towards encouraging inflows of externally domiciled funds.

Fiscal authorities, at all levels of government in Nigeria, increasingly recognize that current rates of spending – on Recurrent Line Items and Consumables in their budgets – are fundamentally imprudent. The liquidity created by recurring fiscal operations of this nature feeds into the general economy and generates high demands for imported consumables and services. This demand is invariably reflected in exchange rates for the Naira, which fundamentally should

not be weakening against high international prices for the country's principal export i.e., oil. Excessive import demand (including growing demands for imported oil derivatives) offers the only believable explanation for what ordinarily should be an embarrassing paradox.

Unless this inordinate fiscal bias towards Consumption is constructively reoriented towards productivity-enhancing Investments, aimed at curbing the domestic economy's unfettered appetite for imports, the long-run macroeconomic stability needed to jump-start revenue diversification, job growth and other desirable outcomes will remain elusive. I believe the authorities are aware of these challenges, and are beginning to appreciate the dangers inherent in prevaricating on the issue.

However, I am not encouraged by current official expressions of intent. I am concerned that reductions in Recurrent Spending planned for future Budgets are too weak. I am also concerned that Benchmark Oil Prices, to be set for budgeting purposes, will prove to be too high for what may be truly required to effectively accumulate redeployable domestic capital. I fear that while Nigeria's Fiscal Authorities are talking the "talk", they may in reality be once again prevented from "*walking*" the talk.

Moreover, to the extent that real rates of interest tend to be more easily achievable during periods of disinflation than during periods of rising inflation, the MPC might have missed a singular opportunity in not being more assertive in the stance maintained today. A larger increase in the MPR today would likely have commensurate effects on investment and lending rates tomorrow. However, the largest, most frequent, and most conspicuous credit consumers in Nigeria today i.e. its governments, do not reside in the country's demonstrably productive sectors. Agriculture reportedly consumes less than 3% of all available credit, SME's vainly struggle for access to highly-priced credit, while large

domestic and international firms either tap into foreign currency denominated bank facilities (at lower nominal rates) or extract finely priced terms from risk averse bankers for short term Naira credits.

So who's behavior would more assertive Monetary tightening really impact? As I see it, certainly not the farmer, small business man or woman who wasn't getting much credit in the first instance. Depositors, savers and investors provide borrowers an implicit cost-subsidy when they accept investment returns that do not match or exceed annual rates of inflation. They get repaid in effectively depreciated currencies with diminished purchasing power. Given the Nigerian record so far, and in the prevailing global economic climate, it is hard to see the efficacy in continuing to provide cost-subsidized funding to predominantly consumption-oriented government operations.

8.0 SALAMI, ADEDOYIN

Welcome as data, showing Headline Inflation in Nigeria stayed under 10 percent in August 2011, is, the Year-on-Year inflation rate tells only part of the story. The most cursory glance at the Month-on-Month number shows that prices between July and August prices rose by 1.7 percent – the highest figure since August 2011. Beyond the Headline Inflation rate, available data with respect to the rate of increase in Food prices and the non-food food elements of don't give room for optimism. Food prices rose by 8.7 percent when compared with the same period last year – higher than the 7.9 percent recorded in the previous month. Indeed, increasing rate of change in food price is confirmed, irrespective of the prism (Year-on-Year or Monthly rate of change) from which we choose to view the change in food prices. This raises the question, might the 'harvest' effect already be wearing off? As for the non-food components of the Consumer Price Index (CPI), the rate of increase, measured Year-on-Year,

slowed down when compared to the figure for July. At almost 1 percent, the Month-on-Month rate of increased to 0.9 percent – higher than the 0.2 percent the previous month. Added to these, Central Bank Staff estimates indicate that Headline Inflation will end the year at 10 percent. While the rate of increase of Core Inflation is expected to ease in the months before the year end, food inflation is expected to rise. Staff outlook for inflation can be understood in the context of a number of domestic factors. I remain concerned about the fiscal outlook. While the year-to-date deficit of the Federal Government of Nigeria (FGN), at N368.76bn, is lower than the budget estimate, I am unconvinced that this year will witness any movement towards fiscal consolidation. My expectation is for a splurge of further spending as Ministries, Departments and Agencies (MDAs) aim to meet their appropriations – I will be very happy to be wrong! Furthermore, the announcement that the 2012 budget will be based on a benchmark oil price of US\$75 per barrel – notwithstanding the uncertainties in the International Economic environment – is a source for concern. Whilst the declared intention to reduce expenditure by 1 percent each year until 2015, may be politically realistic, it is not the kind of aggressive effort at budget consolidation required to rein in expenditure driven increases in liquidity. For quite a while, I have been concerned that both the policy and deposit rates have remained below the rate at which prices have risen. That headline inflation has remained under 10 percent in the past 2 months has doubtless reduced the size of negative ‘real’ interest rates. However, the disincentive impact on resource mobilisation posed by this situation cannot be understated. Whilst the high levels of systemic liquidity and the existence of the Central Bank’s guarantee on interbank market transactions creates difficulties with regard to indigenous depositors, I believe we should take the present window to create conditions which will encourage savings when the guarantee is removed. It is also the case that negative ‘real’ policy rates, a sign of easier conditions,

continues, in my judgement, to jeopardise the ability to attract the foreign capital.

However, perhaps the biggest challenge to managing prices remains the exchange rate. Despite the increase in foreign currency inflows – indeed, inflows exceeded outflows in July and August 2011 by an average of US\$400mn in each month – and higher reserves – US\$ 34.85bn as at 15th September, 2011 -, the import cover is only 7.6months. With the Naira already, vis-à-vis the US\$, trading at N153.91 today, there is very limited leeway with respect to its upper limit of N154.5. A number of factors could raise demand for foreign currency and place further pressure on the Naira. These factors include: (i) Firms placing orders ahead of year-end; (ii) Banking system liquidity, presently in excess of 50 percent; (iii) a heightened perception of risk in the Nigerian space; and evidence of upward concentration of incomes. These need to be carefully watched and managed! Loss of control over the direction of the currency will create challenges for price stability into the 1st quarter of 2012.

In recommending continuation of the regime of tightening, I am not unmindful of the challenges which unemployment poses. However, growth data, provided by the National Bureau of Statistics, continues to indicate that the economy enjoys robust growth – albeit without creating jobs. In my view, the spreading problem of job creation is amply illustrated by National Income data showing the continuing decline in private consumption. Indeed, provisional figures show private consumption fell from N18.86trn in 2009 to N17.54trn in 2010. Worse still, when adjusted for inflation, final consumption expenditure by the Private Sector is lower than government final consumption!

The challenge of job creation requires a more productive concentration on easing the binding structural constraints under which the Nigerian economic space groans.

9.0 UCHE, CHIBUKE U.

I have today voted for the MPR to be retained at the current rate of 8.75 percent. My decision is based on the following points. First, I am concerned about the fact that the current banking crisis is yet to be resolved satisfactorily. While substantial progress has been made in this direction, the fact remains that the CBN inter bank guarantee is still in place. Until the CBN is able to remove this, it would be difficult to convincingly argue that the current banking distress has been satisfactorily resolved. Because banks are essentially intermediaries, I strongly believe that raising MPR at this stage will be inimical to the resolution of this crisis.

Another point which is related to the above is the fact that raising MPR now will be unhealthy to the development and growth of the real sector. While it is true that MPR is still in negative territory especially when compared with inflation, the fact remains that most real sector borrowers are already paying real interest rates. The wide spread between deposit and borrowing rates makes it difficult for depositors to benefit from any real interest rate regime that MPC may be intending to achieve. Further raising interest rates at this stage will therefore inhibit the growth of the real sector. It will also increase the quantum of nonperforming loans in our still fragile banking sector. Although I am appreciative of the argument that increasing MPR will positively impact on FDI, I am of the view that there is need to balance this against the negative impact of such an increase on domestic enterprises. The need to create local jobs, in my view, outweighs the need to attract FDI. This is especially so in the context of the questionable utility value of FDI and its established volatility in structurally defective economies like ours.

Finally, it is important to reiterate that the link between monetary and fiscal policies is well established. Even the best intentioned monetary policy cannot

achieve price stability in a fiscal environment reputed for its indiscipline. Admittedly, with the new economic management team that is now in place, we are hopeful that we will soon begin to witness positive changes in fiscal planning. Until this happens, however MPC will always have the difficult task of balancing between increased employment through the development of the real sector and the attainment of positive interest rates on one hand, and growing domestic enterprises and attracting FDI on the other.

10.0 YAHHAHA, SHEHU

The current meeting of the MPC is being held against a background of recession concerns in Europe and the US, strong growth recovery in the emerging markets and Asia and good prospects for growth in Nigeria, albeit muted by escalating security concerns and continuing infrastructure bottlenecks

Information provided by the Central Bank has indicated an encouraging correlation between the MPR and inflation figures in 2011, although without any evidence of causation.

Currently, the level of inflation, year on year, has trended downward, which is a positive development. Nevertheless, food inflation is still rising slightly. Moreover, the inflation figures for August show a rise as compared to the previous two months, and despite possible attribution to seasonal variations, this means that there is a question mark on the sustainability of the downward inflationary trend. In addition, government spending in the current quota of the year, both capital and recurrent, have been lower than budgeted. The budget deficit has been correspondingly lower than anticipated, which means that liquidity effects of government spending are slightly muted.

On the other hand, figures provided by the National Bureau of Statistics has projected a healthy growth for 2011, which gives greater room for flexibility for monetary policy. Nevertheless, capital expenditure spending in the budget for the first half of the year has been less than 25% and domestic consumption has also been lower. These may negatively affect growth rates.

At the moment, crude oil prices are robust. Unfortunately, threatened recrudescence of recession in Europe and the US, combined with gradually improving prospects for oil production in North Africa and the middle East, might presage a significant downside in crude oil prices in the near future. If this happens, then the stability of the Naira exchange rate, the improved foreign reserves situation in the country and the narrowing of the WDAS/BDC gap in naira exchange rate which have been witnessed in the last few months, may come under increasing pressure yet again. This is of great concern, considering the inflationary effects of a significant exchange rate depreciation in a country that is so import-dependent.

There are also concerns that the activities of AMCON and their positive effect in stabilising the banking system may translate into significant injections of liquidity into the economy, which can put pressure on prices and the exchange rate. Related to this are the possible effects of removal or reduction in oil price subsidies and raising electricity tariffs. Nevertheless, it not clear as to when these two will take effect, and the MPC has been taking into consideration the advent of these two issues for sometime now.

On the whole, there are clear concerns that, despite current downwards trend in prices, there might be a resurgence of inflation in the near term. Nevertheless, there are quite a few elements of uncertainty as to the implementation of a number of policies, their timing and their effects. Moreover,

raising the MPR, through its effects on inter bank rates, may somewhat unsettle the banking system, especially the new banks and the intervened banks. It can also, through its effects on interest rates, make it costlier for SMEs and microenterprises to borrow. Their stagnation or decline can significantly add to the already serious problem of unemployment in the country. In addition, problems of excess liquidity can also be tackled through Open Market Operations by the Central Bank.

In the light of the above arguments, I vote for holding the MPR at its current of 8.75%.

11.0 SANUSI LAMIDO SANUSI

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

The committee is meeting at a time when the deceleration of inflation which commenced from last quarter continued, albeit at a decreasing rate. In July and August, 2011 headline inflation fell to single digit for the first time in three years, reflecting both the structural impact of a good harvest and the impact of proactive monetary tightening by this committee. Given the adverse impact of high lending rates on asset quality, production costs and job creation, one sympathizes with the argument of members who propose that MPC hold rates steady at existing levels and monitor performance before continuing with further tightening in November, if necessary.

However, as it is well known monetary policy has to be forward looking and based on a careful analysis of the balance of probabilities with respect to inflation outlook. It appears to me that a number of structural and monetary

considerations continue to constitute a risk to price stability. The structural factors include uncertain outlook of world food prices especially given the spate of floods and natural disasters and the recently proposed price hike on commodities like rice by Thailand, cyclical increases in the price of farm produce as we move away from the unpredictable post-harvest season, reflecting the dearth of storage facilities, cheap transportation and market infrastructure, anticipated removal of petroleum subsidies leading to increased cost of production and transportation and likely increase in electricity tariffs as part of the ongoing purer reforms.

On the liquidity front, AMCON is expected to inject significant amount of money (in the form of Bonds) into distressed banks as part of the recapitalization process that is about to be concluded in September, 2011. Also expansionary fiscal activities are only likely to be reined-in in the medium to long run. A review of Federal Government spending up to July, 2011 shows that less than 10% was accounted for by capital expenditure Non-debt recurrent expenditure was more than 70% while over 10% was spent on debt service. The balance of 10% was accounted for by statutory transfers.

The Finance Ministry has already announced a target of 1% annual reduction in recurrent expenditure. On this basis, it is clear that in the short run at least, that the commitment and best intention of Government on fiscal consolidation will not translate into concrete results. Excellent initiatives have been announced in respect to agriculture and industry, and if faithfully executed, these should address some of the structural issues that exacerbate import-dependency, as well as diversify the Government's revenue base. But these policies take some time to work their way into results.

It therefore appears to me that in the short term, we are faced with the threats of continued liquidity injection from AMCON and Government spending. When

combined with the concerns raised above on cost push factors, this is not a time for complacency. Furthermore, real interest rates are still in negative territory even though they have been increasing over the past few months.

I have weighed the arguments of both sides and am of the firm view that in view of the outlook and expectations, there is no option than to tightening at this point. Any sign of complacency will lead to a reversal of our gains so far and potentially undermine the mandate of this committee of maintaining price stability, as well as the subsidiary objective of maintaining exchange rate stability as an integral means to achieving the end to controlling inflation.

I am however of the view that a 100bps increase at this point would be too aggressive in view of its likely impact on lending rates and also in view of the need to avoid too many sharp adjustments in the market. Furthermore, I note that inspite of our 75bps at the last meeting, monetary policy implementation was a bit off pace and rates did not quite follow suits over most of the intervening period. A return to a more diligent regime where the OBB rate closely trails the target of MPR+2 will yield result much stronger than that implied by a 50bps hike. For all the above reasons, I cast my vote with the majority as follows:

1. An increase in MPR by 50bps from 8.57% to 9.25%
2. Retention of the symmetric corridor of +/-2%
3. CRR and liquidity ratio to remain current levels.