CENTRAL BANK OF NIGERIA

MONETARY POLICY REVIEW

February 2012

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Central Bank of Nigeria

Mandate

▪Ensure monetary and price stability

▪Issue legal tender currency in Nigeria

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

▪Promote a sound financial system in Nigeria

▪Act as banker and provide economic and financial advice to the Federal Government

Vision

To be one of the most efficient and effective of the world's central banks in promoting and sustaining economic development.

Mission Statement

To be proactive in providing a stable framework for the economic development of Nigeria through the effective, efficient and transparent implementation of monetary and exchange rate policy and management of the financial system.

Core Values

- Meritocracy
- Leadership
- Learning
- Customer - Focus

CONTENTS

Table of Contents

List of Tables

Page

List of Figures

STATEMENT BY THE GOVERNOR

Monetary policy in the second half of 2011 was shaped by both domestic and global events. On the global front, the European debt crisis which culminated in the sovereign debt downgrading of some key European countries had implications for the rest of the world. Some of the identified risk factors that put the ratings of several European banks under pressure included: deteriorating sovereign creditworthiness; elevated economic uncertainty; high funding spreads and reduced market access at a time when many banks faced large debt maturities. Firms were confronted with evolving challenges, such as more fragile funding conditions, wider credit spreads, increased regulatory burdens and more difficult operating conditions. Furthermore, the crisis in Syria and the uncertainties associated with Iran and North Korea's nuclear programmes contributed to apprehensions about energy prices and global output growth.

On the domestic scene, a number of factors informed the decision to tighten monetary policy during the review period. These included; the rising level of domestic inflation, significant increase in capital spending especially in the fourth quarter of 2011, need to ensure exchange rate stability, declining oil prices and foreign reserves, increased demand for foreign exchange, fiscal dominance as well as capital flow reversals. Also, the interbank placement guarantee which was extended thrice since 2010 terminated at end-December 2011.

The thrust of monetary policy during the review period was the containment of rising domestic liquidity and exchange rate pressure as well as the negative spillover from developments in the global economy.

The short to mediumterm outlook for the economy suggests that the plan to remove subsidy on petroleum products would put significant pressure on domestic prices. Monetary policy will continue to be proactive to contain the pressure.

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

CHAPTER 1
OVERVIEW

…maintenance of price stability remained the main focus of monetary policy in the second half of 2011

The maintenance of price stability remained the main focus of monetary policy in the second half of 2011. The challenge of managing the excess liquidity from monetary easing of 2009 – 2010 fiscal years combined with the expansionary fiscal stance, and the relatively uncertain global economic outlook, defined the monetary policy stance in the review period. The CBN employed the Monetary Policy Rate (MPR) to anchor short-term interest rates, and to rein-in inflation expectations. Open market operations (OMO) supported by reserve requirements and discount window operations (including the Standing Facilities, repos and reverse repos), remained the major instruments of monetary policy in the second half of 2011. Efforts were made to improve communication through more regular dialogue with market and other critical stakeholders, to shape-up market sentiments and to track the pace of economic activity during the review period. The Monetary Policy Committee (MPC) held three regular meetings and one extraordinary meeting and increased the Monetary Policy Rate (MPR) by a cumulative 400 basis points to 12.0 per cent during the review period. The Bank also implemented some administrative and regulatory measures to rein-in excess liquidity and the attendant pressures in the foreign exchange market.

……period witnessed significant expansion in domestic liquidity arising from expansionary fiscal policy …

The period witnessed significant expansion in domestic liquidity arising from expansionary fiscal policy and from the lagged effect of monetary easing that was undertaken during the 2009-2010 period to cushion the effects of the global financial and economic crisis. The surge in liquidity was largely on account of bunching of capital expenditures, significant drawdown on the Excess Crude Account (ECA) and purchase of troubled assets of Deposit Money Banks (DMBs) by the Asset Management Corporation of Nigeria (AMCON). Consequently, growth in broad money (M2) stood at 15.4 per cent at end-December 2011 compared with 4.5 per cent (annualized at 9.0 per cent) in June 2011. The development reflected significant increases in both net foreign and domestic assets of the banking system.

Inflationary pressures persisted in the review period, necessitating further tightening of the stance of monetary policy. Headline inflation (year-on-year) stood at 10.3 per cent in December 2011, which was slightly higher than 10.2 per cent recorded in June 2011 mainly on account of upward movement in food prices and transportation cost usually associated with end of year festivities. Core and food inflation, on year-on-year basis, stood at 10.8 and 11.0 per cent, respectively, compared with 11.5 and 9.2 per cent in June 2011.

Demand pressure increased significantly at the wholesale Dutch Auction System (wDAS) segment ……….. exchange rate was relatively stable, although it marginally depreciated in all segments of the market.

Interest rates rose generally, following the progressive review of the MPR from 8.0 to 12.0 per cent and cash reserve ratio from 4.0 to 8.0 per cent. Interbank interest rates as well as the lending and other interest rates adjusted upwards. However, the impact of this development on credit to the real sector was moderated by the Bank's interventions, particularly in some critical sectors like agriculture, Small and Medium Scale Enterprises (SMEs) and infrastructure.

Demand pressure increased significantly at the wholesale Dutch Auction System (wDAS) segment of the foreign exchange market. The exchange rate was relatively stable, although it depreciated marginally in all segments of the market. During the second half of 2011, FGN bond auctions were oversubscribed due to increased liquidity in the system, the attractive coupon on the bonds and the increased interest of foreign investors in the fixed income securities.

The domestic financial markets continued to play a critical role in the implementation of monetary policy. This was facilitated by the banking sector reform especially the re-capitalisation exercise concluded in the second half of 2011 and the extension of the CBN interbank placement guarantee for some DMBs till December 2011.

The overall outlook for the first half of 2012 is mixed. Economic growth prospects appear good despite downside risks including uncertainties in the rest of the world, subsisting challenges in infrastructure, late passage of the 2012 Appropriation Bill and security challenges in some parts of the country. Inflationary pressures could intensify in the first half of 2012 from fiscal injections, exchange rate depreciation and higher pump price of Premium Motor Spirit (PMS), thereby placing monetary policy on a rather tight pedestal.

CHAPTER 2

DOMESTIC PRICE DEVELOPMENTS AND THE REAL ECONOMY

Domestic price pressures due in part to high prices of imported items, new minimum wage, and festivities-induced increase in household demand

Inflationary pressures remained elevated during the second half of 2011 owing mainly to the pass-through effects of higher prices of imported items including energy and food. Other factors that contributed to domestic price pressures included expansionary fiscal policy, implementation of the national minimum wage by the Federal Government and several State Governments, liquidity injection by AMCON and high household expenditure associated with year-end festivities.

2.1 Domestic Economic Activity

In the domestic economy, output was generally robust in spite of the deteriorating global economic conditions.

In the domestic economy, output was generally robust in spite of the deteriorating global economic conditions. Growth in real Gross Domestic Product (GDP) in the second half of 2011 was estimated at an average of 7.68 per cent compared with 8.60 per cent in the corresponding period of 2010. In the third quarter, real GDP grew by 7.30 per cent and accelerated to 7.68 per cent in the fourth quarter of 2011. The overall real GDP growth for the year was estimated at 7.32 per cent, being marginally lower than the 7.87 per cent recorded in 2010.

The non-oil sector remained the major driver of growth as it grew by 8.70 per cent compared with the oil sector which grew by 7.68 per cent in the review period. Within the non-oil sector agriculture; wholesale and retail trade; and other services; contributed 2.70, 2.65 and 2.79 percentage points, respectively. These were complemented by increases in crude oil production following the sustained peace in the Niger Delta. Other factors that accounted for output growth included improved performance of industrial, especially manufacturing activities.

The aggregate index of industrial production improved during the second half of 2011 rising by 4.30 per cent to 135.1 (1990=100) when compared with the level in the corresponding period of 2010. The increase in industrial output was attributed to improvements in the activities of manufacturing, mining and electricity production which increased by 2.10, 0.60, and 4.20 per cent, respectively.

....improved performance of the manufacturing sub-subsector was largely attributable to the cushioning effects of the CBN's interventions that moderated interest rates,

The index of manufacturing production, estimated at 98.88 (1990 =100), rose by 6.00 per cent in the second half of 2011 relative to the level in the corresponding period of 2010. The improved performance of the manufacturing subsector was largely attributable to the cushioning effects of the CBN's interventions. For instance the disbursement from the infrastructure intervention fund especially to the power sector, contributed to increase in supply of electricity from 1,673 billion KWH in June to 2,153 billion KWH in December 2011. Consequently, the average manufacturing capacity utilization rose by 3.80 percentage points to 56.10 per cent compared with the corresponding period of 2010.

In contrast, economic activity slowed globally during the period under review. World output growth rate declined to 3.8 per cent, compared with 5.2 per cent recorded in 2010, due to the persistence of the euro area debt crisis, the weak recovery of the US economy and political crisis in the Middle East and North Africa (MENA) region. Global growth further weakened due to perceptions that the euro area economy would lapse into a mild recession following additional fiscal consolidation, as well as the effects of tighter credit conditions on the real economy.

2.2 Trends in Inflation in the Second Half of 2011

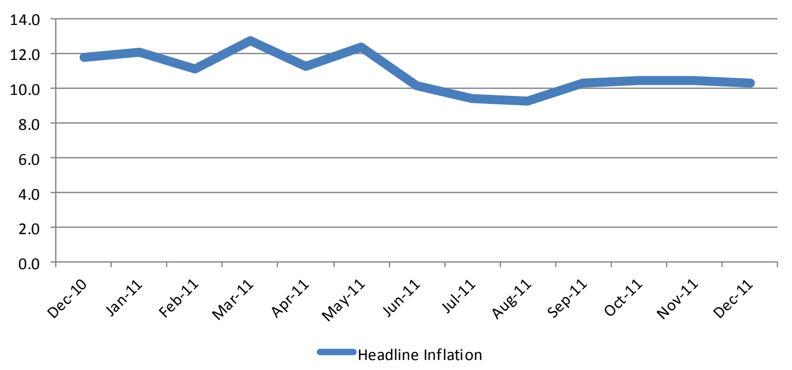
Domestic inflationary threat, which was experienced in the first half of 2011due to increased government spending in the wake of the general elections and the rising crude oil prices at the international market moderated slightly in the third quarter and remained within lower double-digit throughout the rest of the period.

....headline inflation which was 10.2 at end-June declined to 9.4 and 9.3 per cent in July and August, but rose to 10.3 per cent in September, 2011.

Headline inflation, on year-on-year basis, which was 10.2 per cent at end-June declined to 9.4 and 9.3 per cent in July and August, respectively, but rose to 10.3 per cent in September, 2011. It peaked at 10.5 per cent in October and November but moderated to 10.3 per cent at end-December 2011. The decline in inflation during the early part of the third quarter was attributable to tight monetary policy which was complemented by early harvests. However, inflation assumed an upward trend in the latter part of the year due to fiscal expansion, the implementation of the new national minimum wage policy and the anticipated deregulation of petroleum prices.

Food inflation which was 9.2 per cent at end-June declined to 7.9 and 8.7 per cent in July and August, respectively, before rising to 9.5 per cent in September, 2011. It, thereafter, stabilized at 9.7 and 9.6 per cent in October and November, respectively, before rising to 11.0 per cent at end-December 2011. Core inflation rate, which rose to 11.5 per cent apiece in June and July 2011, declined to 10.9 per cent in August. It later increased to 11.6 per cent in September 2011, moderated marginally to 11.5 per cent, each, in October and November before declining to 10.8 per cent at end-December, 2011.

Figure 2.1
Headline Inflation (Dec. 2010 - Dec.2011)



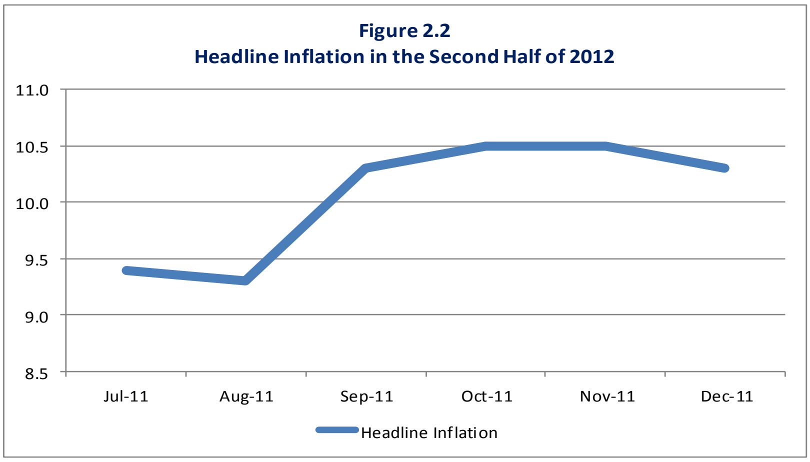


Table 2.1
Inflation Rate
(December 2010 - December 2011)

	Headline Inflation			Core Inflation			Food Inflation		
Date	CPI	Y-Y	12-MMA	CPI	Y-Y	12-MMA	CPI	Y-Y	12-MMA
Dec-10	114.20	11.80	13.70	112.60	10.90	12.40	115.40	12.70	14.70
Jan-11	115.60	12.10	13.50	114.50	12.10	12.40	114.30	10.30	14.20
Feb-11	116.70	11.10	13.20	115.50	10.60	12.10	117.70	12.20	13.90
Mar-11	118.30	12.80	13.00	117.50	12.80	12.10	118.10	12.20	13.60
Apr-11	117.70	11.30	12.70	117.90	12.90	12.10	119.00	11.60	13.20
May-11	118.70	12.40	12.60	118.90	13.00	12.20	118.50	12.20	13.20
Jun-11	119.90	10.20	12.30	119.80	11.50	12.10	120.10	9.00	12.70
Jul-11	120.30	9.40	12.00	120.10	11.50	12.10	120.40	7.90	12.10
Aug-11	122.30	9.30	11.60	121.20	10.90	12.00	123.70	8.70	11.60
Sep-11	124.00	10.30	11.40	123.50	11.60	11.90	124.80	9.50	11.20
Oct-11	124.60	10.50	11.10	124.80	11.50	11.70	125.00	9.70	10.80
Nov-11	124.70	10.50	11.00	124.60	11.50	11.70	125.40	9.60	10.40
Dec-11	126.00	10.30	10.80	124.80	10.80	11.70	128.10	11.00	10.30

Source: National Bureau of Statistics (NBS)

Table 2.2
Selected CPI Component Contribution to Overall Change (Year-On-Year) July - December 2011

Date	11-Jul	11-Aug	11-Sep	11-Oct	11-Nov	11-Dec
Food	7.89	8.70	9.47	9.65	9.62	11.01
Housing Water, Electricity, Gas & Other fuel	16.56	17.23	14.74	15.77	13.77	16.52
Transport	12.28	12.25	9.00	14.10	10.38	13.99

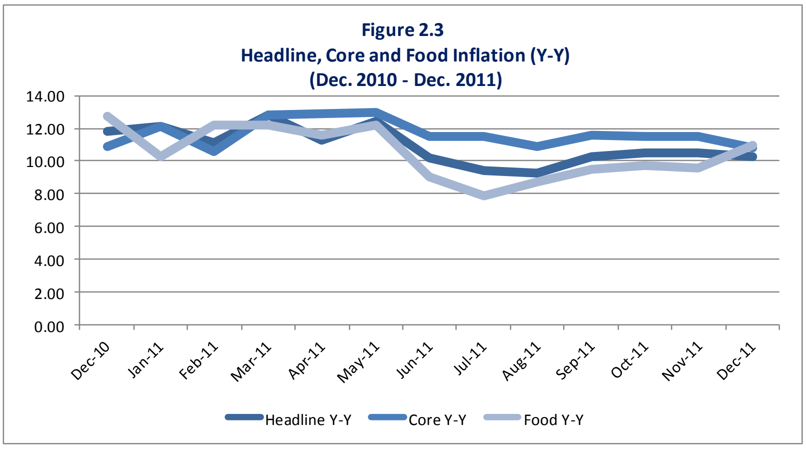
Source: National Bureau of Statistics (NBS)

Analysis of Consumer Price Index (CPI) showed that housing, water, electricity, gas and other fuels and transport, contributed most to the overall change in prices in the second half of 2011(See Table 2.2).

Table 2.3
Quarterly Consumer Price Developments in 2011 (November 2009=100)

	Mar-11		Jun-11		Sep-11		Dec-11	
	Y-Y	12-MMA	Y-Y	12-MMA	Y-Y	12-MMA	Y-Y	12-MMA
Headline	12.8	13.0	10.2	12.3	10.3	11.4	10.3	10.8
Core	12.80	12.10	11.50	12.10	11.60	11.90	10.80	11.70
Food	12.2	13.6	9.2	12.7	9.5	11.2	11.0	10.3

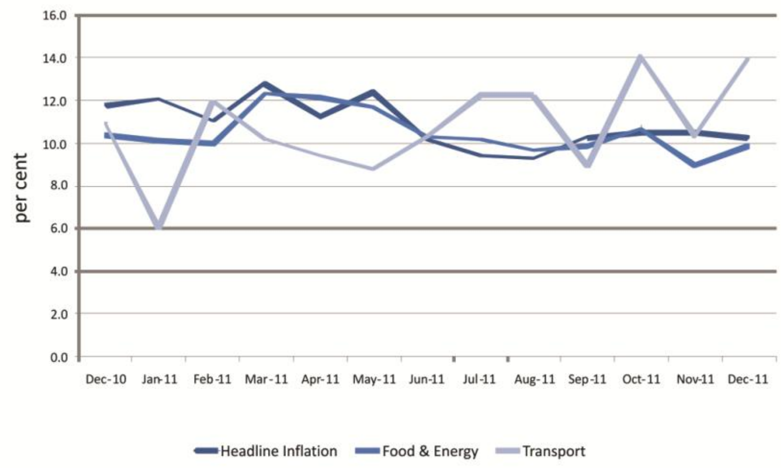
Source: National Bureau of Statistics (NBS)



Source: National Bureau of Statistics (NBS)

The contributions of transport and food components increased from 10.3 and 9.2 per cent in June to 14.0 and 11.0 per cent in December 2011, respectively. The index of food and non-alcoholic beverages increased from 8.5 per cent in June to 10.7 per cent in December 2011. Overall, the all items CPI grew by 10.3 per cent at end-December 2011 compared with the growth of 10.2 per cent at end-June 2011.

Figure 2.4
Headline Inflation (YY): Selected Items 2011



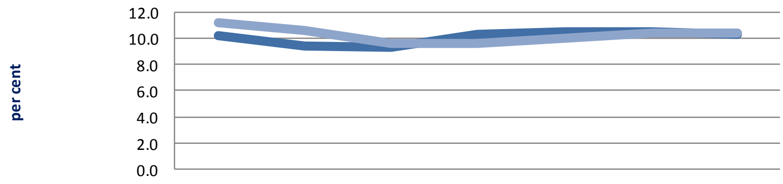
Source: National Bureau of Statistics (NBS)

In the latter period, however, the effect of seasonality, though less severe, reflected in higher actual inflation.

2.3 Actual and Seasonally Adjusted Headline Inflation

Analysis of inflation development during the review period indicated evidence of seasonality, first between June and August 2011 and between September and November. Over the former, seasonal factors including early harvests helped to moderate headline inflation. In the latter period, however, the effect of seasonality, though less severe, reflected in higher actual inflation.

Figure 2.5
Actual and Seasonally Adjusted Headline Inflation
(Jun. - Jul. 2011)



	Jun-11	Jul-11	Aug-11	Sep-11	Oct-11	Nov-11	Dec-11
Headline Inflation	10.2	9.4	9.3	10.3	10.5	10.5	10.3
Seasonal Adjusted	11.23	10.6	9.63	9.67	10.03	10.43	10.43

Source: National Bureau of Statistics (NBS)

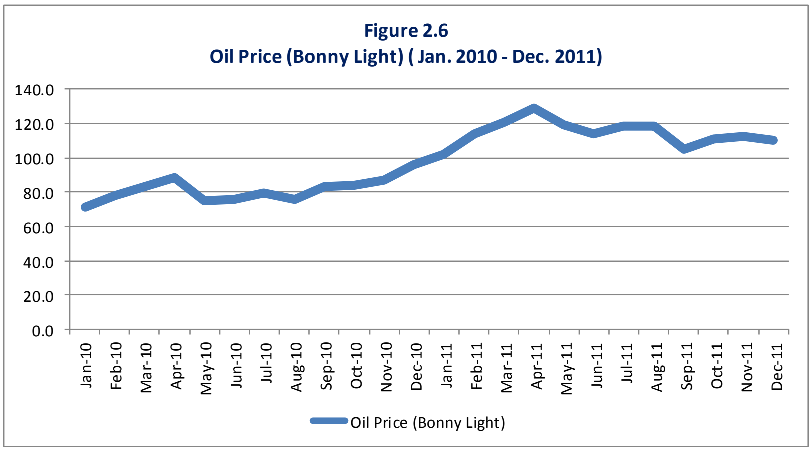
2.4 Key Factors That Influenced the Domestic Price Level

The major factors that influenced inflation in Nigeria during the review period may be categorized into demand-pull and cost-push. They formed the basis for monetary policy decisions by the Bank during the second half of 2011.

2.4.1 Pull and Push Factors

- Fiscal expansion contributed to inflation during the second half of 2011. Government fiscal operations, both at state and federal government levels exerted significant pressure on inflation. With a Federal Government of Nigeria (FGN) budget of N4.5 trillion for 2011with recurrent expenditure accounting for over 70 per cent and a deficit of 2.85 per cent of GDP, the fiscal operations of government exerted substantial pressure on domestic liquidity and consequently inflation during the period.

- High oil prices, following the crisis in the Middle East and increased quota allocation to Nigeria by OPEC, boosted overall federation revenues which supported higher levels of public expenditure across the tiers of government. By mid-October, the price of Bonny Light crude had risen to US$115.0 per barrel.



Source: Bloomberg

..depreciation of the naira exchange rate during the period impacted negatively on the domestic price level due to exchange rate pass-through effect.

- High rainfall in the western and southern parts of the country destroyed some farmlands coupled with increased desertification in the northern parts of the country, accounted substantially for the decline in the availability of food items during the period. Also, security challenges in some parts of the country hampered effective distribution of agricultural products and locally produced items across the country, thereby putting pressure on food prices, especially in urban areas.

- Imported inflation contributed to rising domestic prices. For instance, imported food prices rose from 2.0 per cent in November to 2.2 per cent in December, 2011. Similarly, prices of energy products like diesel and kerosene which were imported rose from 4.6 per cent in November to 5.4 per cent in December, 2011.

..the Bank made deliberate efforts to contain speculative demand in order to stabilize the exchange rate.

- The depreciation of the naira during the period impacted negatively on the domestic price level due to exchange rate pass-through effect. The official exchange rate of the naira during the review period (July - December 2011) opened at N152.27/US$ and closed at N158.27/US$, resulting in an average exchange rate of N155.11/US$, and a depreciation of N6.00 or 3.79 per cent.

- The implementation of the National Minimum wage legislation in most states of the federation contributed to rising prices of final goods and services during the period. In addition, large-scale household expenditures during year-end festivities also put further pressure on inflation.

- Sustained Infrastructural deficit continued to put pressure on cost of transportation, thereby, creating supply bottlenecks, especially in the agricultural sector.

2.4.2 Moderating Factors

- In the second half of 2011, the CBN tightened monetary policy to control excessive liquidity and thus tame inflation expectations. For instance, the CRR and MPR were raised from 4.0 and 8.0 per cent in June, to 8.0 and 12.0 per cent, respectively. Furthermore, attention was paid to administrative measures aimed at minimizing the speculative components of the growing demand for foreign exchange with a view to reducing the pressure it exerted on the value of the naira as well as the rate of inflation.

- The Bank also made deliberate efforts to contain speculative demand in order to stabilize the exchange rate. Some of the measures were: special intervention at the interbank foreign exchange market; downward review of net open position of authorized dealers; restriction of the petroleum marketers from wDAS market and increased supply of foreign exchange at the wDAS; prohibition of DMBs from accessing the standing lending facility (SLF) and wDAS window on the same day.

- Steady supply of petroleum products during the review period aided the smooth running of economic activities and enhanced the distribution of goods and services and the movement of economic agents across the country.

- Other factors included the release of grains from the Strategic Grains Reserve to augment supply from current harvest assisted in lowering inflation expectations during the second half of 2011.

Box 2.1
Excess Crude Account (ECA) and the Sovereign Wealth Fund (SWF)

The Excess Crude Account (ECA) was established in 2004 with the primary objective of protecting government budgets against shortfalls arising from volatile crude oil price. It is an inter-generational fund aimed at discouraging total consumption of current earnings.

The ECA was primarily funded from revenue derived from Crude Oil Sales, Petroleum Profit Tax (PPT) and Royalties above the budgeted benchmark of the FGN for each year. There are two types of excess revenue accounts; the Foreign Excess Revenue Account, which is maintained in U.S dollar, and the Domestic Excess Revenue Account, which is naira denominated. Surging crude oil prices led to the ECA increasing almost four-fold; from US$5.10 billion in 2005 to over US$20.00 billion by November 2008, which accounted for more than one-third of Nigeria's external reserves at that time. By June 2010, the account had been drawn down to less than US$4.00 billion due to budget deficits at all levels of government and the steep drop in oil prices.

In 2010, Nigeria's National Economic Council approved a plan to replace the ECA with a national Sovereign Wealth Fund (SWF) since the ECA had no legal backing. In May 2011, the National Assembly passed the Nigeria Sovereign Investment Authority (NSIA) Bill, 2010, which sought to establish a SWF to manage excess earnings from the country's crude oil sales. It was later signed into law by the President.

The SWF became operational in October 2011 with US$1.00 billion drawn from US$6.00 billion in the ECA. The Fund is designed to ensure that some of Nigeria's oil wealth is saved and could be tapped on a regular basis to finance the government's running costs. The fund would help the country to save for the future and invest in strategic infrastructural projects as well as act as a buffer against volatile oil prices.

The NSIA will receive monthly allocation of a portion of oil and gas revenue above the budgeted revenue as approved by the National Assembly. The NSIA will manage the SWF comprising the following:

- Future Generations Fund,
- Stabilization Fund, and
- Nigeria Infrastructure Fund.

Future Generations Fund

Saving for future generations is a bold attempt to discourage the total consumption of current earnings. The guiding principle is that earnings above budget projections need not be spent but saved and invested to earn more income for the present and future generations. It is anticipated that a significant proportion of the Fund will be used for long-term investment assets.

Stabilization Fund

Nigeria's heavy dependence on crude oil revenue for the funding of annual budgets and development plans exposes its economy to the vagaries of oil price fluctuations. Oil revenue projections are based on oil price and output assumptions. When price and output projections do not tally with reality, the result is that planned economic objectives are not realised.

The objective of economic stabilization fund was an attempt to shield the economy from the volatile nature of international crude oil prices and uncertainties associated with daily crude output production. For instance, crude oil output is occasionally affected by disturbances within the oil-producing region. The economic stabilization fund would help in smoothing the process of budget implementation since revenue shortages can be augmented from the Fund.

Nigeria Infrastructure Fund

The Infrastructure Fund, the largest of the three components, is designed to complement the overall development efforts of governments at all levels. Projects that are expected to be financed from the Fund should have the capacity to impact directly and positively on the lives of the people.

CHAPTER 3
MONETARY POLICY

...monetary policy in the second half of 2011 focused on the achievement of price and exchange rate stability…….

The conduct of monetary policy during the second half of 2011 focused on the achievement of price and exchange rate stability, following the significant progress made in the resolution of the banking sector crisis. In order to mitigate the impact of huge injections of liquidity in the first three quarters of 2011, the Bank maintained a tight monetary policy stance in the review period. In addition to the statutory meetings, the Bank convened an extraordinary meeting of the Monetary Policy Committee (MPC) in October 2011, specifically to address the challenge of the rising system liquidity and the attendant demand pressure in the foreign exchange market.

3.1 Highlight of Monetary Policy Measures

MPR was raised three times in the second half of 2011;…

In the period under review, the Bank tightened further its stance of monetary policy that commenced in September 2010. The MPR was raised three times in the second half of 2011; from 8.00 to 8.75 per cent in July, 9.25 per cent in September and 12.00 per cent in October. In addition, the Cash Reserve Requirement (CRR) which was raised to 4.00 per cent in May was again increased to 8.00 per cent in October. Other measures included a reduction of the foreign exchange net open position of banks from 5.0 per cent to 1.0 per cent in October later increased to 3.0 per cent in the same month.

At the MPC Meeting of November 2011, both the MPR and CRR were left unchanged because it was considered that the earlier restrictive measures needed to be allowed to work through to moderate the inflationary impulses on a more sustained basis. However, in order to ensure exchange rate stability in the face of declining external reserves, the foreign exchange mid-point was adjusted from N150.00/US$1.00 to N155.00/US$1.00 while the band of +/- 3.00 per cent was retained.

3.2 Decisions of Monetary Policy Committee (MPC)

The MPC at its July meeting noted the decline in inflation, negative real interest rate and uncertain outlook for economic activity. The Committee recognized the need to attract more capital inflow to ease pressure on external reserves. It therefore voted to tighten monetary policy. Consequently, the benchmark rate (MPR) was raised by 75 basis points to 8.75 per cent by a majority vote of 8 members. The interest rate corridor of +/-200 basis points around the MPR was, however, retained.

At the meeting of September 2011, the Committee noted the expansionary fiscal stance as shown by high recurrent expenditure component of the federal budget as well as the anticipated liquidity injection from AMCON interventions. In addition, month-on-month headline inflation had risen accompanied by increased demand pressure in the foreign exchange market. To address inflationary pressures and achieve positive real interest rates, the MPC raised the MPR from 8.75 per cent to 9.25 per cent in September 2011.

At the Extraordinary meeting of October 10, 2011, the MPC …….took a more aggressive tightening stance by raising MPR from 9.25 per cent to 12.00 per cent and CRR from 4.0 per cent to 8.0 per cent..

At the Extraordinary meeting of October 10, 2011, the MPC recognized the need to focus clearly on the Bank's primary mandate and maintain its credibility by sending strong signals of consistent commitment to price and exchange rate stability. In this context, the MPC took a more aggressive tightening stance by raising the MPR from 9.25 to 12.00 per cent and the CRR from 4.0 to 8.0 per cent. Besides, the foreign exchange net open position (NOP) was reduced from 5.0 per cent to 1.0 per cent of shareholders' fund unimpaired by losses with effect from Friday, October 14, 2011. It was further agreed that the reserve averaging method of computation be suspended in favour of daily maintenance until further notice.

At the MPC meeting of November 21, 2011, the Committee observed persisting demand pressure in the foreign exchange market and sluggish external reserve accretion signaling the need to tighten system liquidity. However, it was noted that real lending rates were already high with negative impact on the real activities. The MPC observed that December being a festive period with high level of economic activities retained existing measures to allow the full impact of the previous tightening to run out. Consequently, the MPC retained the MPR at 12.0 per cent and the symmetric interest rate corridor of +/- 200 basis points. Similarly, the CRR was retained at 8.0 per cent.

Table:3.1
MPC Decisions, July – December, 2011

Items	July	September	October	November
MPR	Raised by 75 basis points from 8.00 to 8.75 per cent	Raised by 50 basis points from 8.75 to 9.25 per cent	Raised by 275 basis points from 9.25 to 12.00 per cent	Retained the MPR at 12.00 per cent
MPR Corridor	No Change	No Change	No Change	No Change
SDF Rate	Raised to 6.75%	Raised to 7.25 per cent	Raised to 10.00 per cent	No Change
SLF Rate	Raised to 10.75%	Raised to 11.25 per cent	Raised to 14.00 per cent	No Change
CRR	No Change	No Change	Raised CRR from 4% to 8% and Suspended Reserve Averaging	No Change
LR	No Change	No Change	No Change	No Change
NOP	No Change	No Change	Reduced from 5.0 to 1.0 per cent; later raised to 3.0 per cent	No Change
FX Rate Mid – Point	No Change	No Change	No Change	Adjusted from N150.00/US$1.00 toN155.00/US$1.00 with a band of +/- 3%
FX Band	No Change	No Change	No Change	No Change

3.3 Monetary Policy Instruments

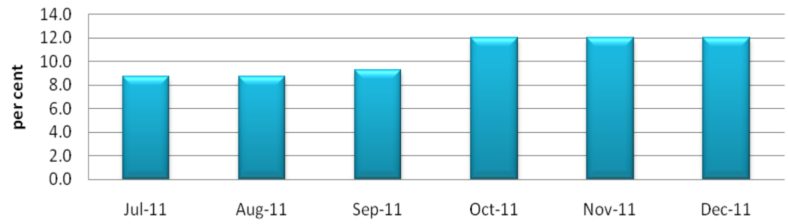
During the second half of 2011, the Bank employed a number of monetary policy instruments to achieve monetary and price stability against the challenges in the domestic and international financial and economic environment. The overriding consideration of the Bank during the period was to promptly respond to threats to price and exchange rate stability as well as maintain financial system safety and soundness.

3.3.1 Monetary Policy Rate (MPR)

The MPR served as the benchmark policy rate, supported by the SLF.

The Monetary Policy Rate remained the major signaling instrument in the second half of 2011 as it served as the benchmark policy rate, supported by the SLF. The Bank adjusted the MPR thrice; first from 8.00 to 8.75 per cent in July, 9.25 per cent in September and further to 12.0 per cent in October. These actions were aimed at attracting capital inflows and addressing negative real interest rate pressure on the exchange rate and the negative impact of huge injection of liquidity.

Figure 3.1
Monetary Policy Rate
July - Dec. 2011



	Jul-11	Aug-11	Sep-11	Oct-11	Nov-11	Dec-11
MPR	8.75	8.75	9.25	12.00	12.00	12.00

3.3.2 Reserve Requirements

The Bank retained the use of reserve requirements (cash reserve requirement and liquidity ratio) during the period under review to compliment the MPR and other instruments in moderating pressures on consumer prices and the exchange rate. The cash reserve requirement (CRR) was changed once in the review period, from 4.00 to 8.00 per cent in October

2011, and maintained at that level for the rest of the year. Over the same period, the Bank replaced reserve averaging method of computing CRR with daily maintenance to enhance liquidity management. The liquidity ratio, however, was left unchanged at 30.00 per cent throughout the second half of 2011.

3.3.3 Open Market Operations (OMO)

Total subscription to NTBs in the second half of 2011 stood at N1, 582.01 billion compared with N1, 466.48 billion in the first half……..

The Bank continued to use open market operations (OMO) as a major medium of monetary policy implementation in the second half of 2011. Nigeria Treasury Bills (NTBs) were the main securities for OMO operations during the period. Total subscription to NTBs in the second half of 2011 stood at N1,582.01 billion compared with N1,466.48 billion in the first half of 2011 and N1,269.40 billion in the corresponding period of 2010, representing an increase of 7.88 per cent and 24.62 per cent, respectively. For fiscal 2011, total subscription to NTBs stood at N3,048.48 billion compared with N2,003.95 billion for 2010, representing an increase of 52.12 per cent. The increase in 2011 was 8.02 percentage points higher than the increase of 43.92 per cent recorded in 2010, reflecting aggressive tightening measures applied in 2011.

Table 3.2 Nigerian Treasury Bills Auction (N'million) (January 2009-December 2011)				
Date	**2009**	**2010**	**2011**	**% Change over the Previous Year**
Jan	115,466.62	149,834.17	205,585.55	
Feb	80,106.56	100,217.01	216,924.18	
Mar	80,000.00	65,000.00	284,056.99	
Apr	101,356.24	160,494.88	215,067.41	
May	120,217.01	100,217.01	204,607.78	
Jun	120,000.00	158,700.00	340,233.10	
1st Half	**617,146.43**	**734,463.07**	**1,466,475.01**	**7.88**
Jul	125,356.17	250,912.17	209,740.15	
Aug	105,217.01	141,157.45	218,924.18	
Sep	91,648.64	206,567.24	280,557.25	
Oct	170,260.38	167,012.31	309,951.29	
Nov	120,217.01	205,930.87	242,930.87	
Dec	162,557.83	297,909.82	319,906.69	
2nd Half	**775,257.04**	**1,269,489.86**	**1,582,010.43**	**24.62**
Cumulative Figure	**1,392,403.47**	**2,003,952.93**	**3,048,485.44**	**52.12**

3.4 Standing Lending/Deposit Facilities

..the Bank retained the use of the standing facilities to provide liquidity cover for DMBs …….

The Bank retained the use of the standing facilities to provide liquidity cover for DMBs and also, make the MPR more effective as an anchor for interbank interest rates. The volume of SLF in the second half of 2011 stood at ₦25,047.27 billion compared with ₦17,628.64 billion in the first half of 2011 and ₦3,340.60 billion in the corresponding period of 2010; the cumulative value of SLF in the period translated to 42.08 and 649.78 per cent increases, respectively. The breakdown of the total facilities for the second half showed demand for SLF rising from N3,341.91 billion in July to N7,698.83 billion in September. Following the monetary policy actions in October, demand for the facility moderated to N2,057.10 billion in December 2011 (see Table 3.3).

Table 3.3
CBN Standing Lending Facility (N'billion)
(January 2009- December 2011)

Date	2009	2010	2011	Percentage change over the preceding year
Jan	846.18	135.50	565.51	
Feb	3,457.57	-	1,369.60	
Mar	4,592.69	-	3,425.47	
Apr	3,875.48	-	3,328.35	
May	2,581.43	270.97	3,722.41	
Jun	3,691.75	21.70	5,217.30	
1st Half	19,045.11	428.17	17,628.64	42.08
Jul	4,675.02	55.76	3,334.91	
Aug	3,733.78	0.00	2,714.70	
Sep	2,287.90	73.10	7,698.83	
Oct	1,231.61	983.44	6,675.79	
Nov	537.58	1,374.80	2,592.94	
Dec	1,022.60	853.50	2,057.10	
2nd Half	13,488.49	3,340.60	25,047.27	649.78
Total	32,533.60	3,768.77	42,702.91	1,033.07

Following the suspension of reserve averaging in October 2011, the standing deposit facility (SDF) became more active.

Following the suspension of reserve averaging in October 2011, the standing deposit facility (SDF) became active as opposed to low and no activity in the second and third quarters of 2011 when reserve averaging was practiced. Meanwhile, all excess reserves of DMBs were remunerated at the SDF rate while reserve averaging lasted. At N1,435.82 billion, SDF in the second half of 2011 was lower than the N3,132.04 billion recorded in the first half of 2011and N17,882.89 billion in the corresponding period of 2010 when monetary easing policy was in place (see Table 3.4).

Table 3.4 CBN Standing Deposit Facility (N'billion) (January 2009-June 2011)				
Date	**2009**	**2010**	**2011***	**% Change over the preceding year**
Jan	-	5,622.63	1,864.84	
Feb	-	6,101.90	721.62	
Mar	-	9,413.45	325.75	
Apr	-	6,853.06	49.65	
May	-	1,735.45	73.00	
Jun	-	5,563.64	97.18	
1st Half	-	**35,290.13**	**3,132.04**	**(54.15)**
Jul	162.00	4,055.52	-	
Aug	1,453.38	6,849.71	-	
Sep	1,058.75	4,224.80	-	
Oct	3,106.30	1,117.30	422.50	
Nov	1,050.59	443.78	436.47	
Dec	1,797.92	1,191.78	576.85	
2nd Half	**8,628.94**	**17,882.89**	**1,435.82**	**(91.97)**
Cumulative Figure	**8,628.94**	**53,173.02**	**4,567.86**	

3.5 Foreign Exchange Intervention

..the Bank intervened in the foreign exchange market primarily to sustain the stability of the naira exchange rate.

During the review period, the Bank intervened in the foreign exchange market primarily to sustain the stability of the naira. The Bank increased its supply of foreign exchange to the market in response to higher demand. Total supply by the Bank during the review period stood at US$23,458.00 million compared with US$17,002.68 million and US$16,025.95 million in the first half 2011 and the corresponding period of 2010, respectively (Table3.5). This represents an increase of 37.97 and 46.38 per cent over the levels in first half of 2011 and the corresponding period of 2010, respectively. By increasing supply, the Bank effectively restored confidence in the market which was already facing rising speculative pressures. In addition to the regular intervention at the wDAS and BDC segments, the Bank made special sales amounting to

US$2,776.88 million at the interbank market in order to calm the market.

Table 3.5
Foreign Exchange Supply by the CBN (US Dollar Million)

YEAR	2010			2011		
	Sales to wDAS	**Sales to BDC**	**Total Supply (wDAS + BDC)**	**Total wDAS sales**	**Sales to BDC**	**Total Supply (Total wDAS + BDC)**
Jan	1,461.75	429.17	1,890.92	2,000.00	135.54	2,135.54
Feb	1,838.85	279	2,117.85	1,794.85	300.04	2,094.89
Mar	1,582.02	482.19	2,064.21	3,274.38	330.53	3,604.91
Apr	1,841.07	306.05	2,147.12	2,385.58	322.26	2,707.84
May	2,707.47	277.34	2,984.81	2,825.19	392.03	3,217.22
Jun	2,283.95	657.49	2,941.44	2,894.96	347.32	3,242.28
1st Half	**11,715.11**	**2,431.24**	**14,146.35**	**15,174.96**	**1,827.72**	**17,002.68**
Jul	1,835.20	741.16	2,576.36	2,895.51	398.15	3,293.66
Aug	1,948.52	450.84	2,399.36	3,172.69	504.28	3,676.97
Sep	3,593.54	613.77	4,207.31	4,161.90	995.65	5,157.55
Oct	2,342.08	478.71	2,820.79	3,406.03	716.76	4,122.79
Nov	1,561.68	280.21	1,841.89	3,260.91	795.37	4,056.28
Dec	**1,839.13**	**341.11**	**2,180.24**	**2,475.80**	**675.65**	**3,151.45**
2nd Half	**13,120.15**	**2,905.80**	**16,025.95**	**19,372.84**	**4,085.86**	**23,458.70**
Total	**24,835.26**	**5,337.04**	**30,172.30**	**34,547.80**	**5,913.58**	**40,461.38**

3.6 Performance of Monetary Aggregates

Broad money witnessed significant increase in the second half of 2011.

Broad money (M2) witnessed significant increase in the second half of 2011. It grew by N1, 122.95 billion or 9.22 per cent as against N651.86 billion or 5.66 per cent in the first half of the year (Table 3.6). The overall growth of 15.40 per cent in 2011 exceeded the annual target of 13.75 per cent by 1.65percentage points. Narrow money (M1) increased by N1,125.86 billion or 19.95 per cent as against N71.29 billion or 1.28 per cent in the first half of the year. On the whole, M1 grew by 21.49 per cent for fiscal 2011 as against the target of

..inflation expectation arising from the planned removal of subsidy on PMS in early 2012 contributed to the accumulation of inventories… hence, an increase in narrow money.

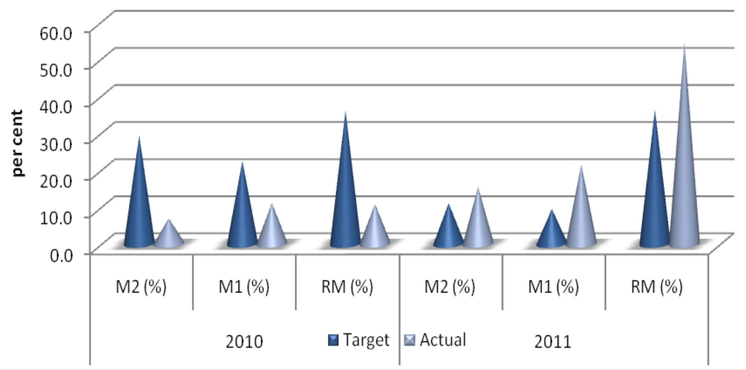
9.41 per cent, thereby exceeding the target by 12.08 percentage points.

The huge growth in M1 was partially driven by the number of festivals during the period, which increased transactional demand for money. In addition, inflation expectation arising from the planned removal of subsidy on PMS in early 2012 contributed to the accumulation of inventories by some economic agents, hence, an increase in narrow money.

Table 3.6
Performance of Monetary Aggregates

	2010			2011			Change in 2011:H1	Change in 2011:H2
	Target	Actual	Deviation	Target	Actual	Deviation	Actual	Actual
M2 (N'b)	13,916.83	11,525.53	2,391.30	12,790.88	13,300.34	-509.46	651.86	1,122.95
M2 (%)	29.25	6.91	-22.34	610.98	15.4	4.42	5.66	9.22
M1(N'b)	6,122.72	5,571.27	-551.45	6,095.31	6,768.42	673.11	71.29	1,125.86
M1 (%)	22.36	11.05	-11.31	9.41	21.49	12.08	1.28	19.95
RM (N'b)	2,232.44	1,845.71	-386.73	2,515.28	2,784.27	268.99	219.39	719.17
RM (%)	35.98	10.76	-16.15	36.28	54.34	18.06	11.88	34.82
NDC (N'b)	11,968.71	8,708.54	-3,005.74	11,715.59	12,403.17	687.58	199.92	3,494.71
NDC (%)	51.43	10.0	-41.43	34.53	42.43	7.9	2.3	39.22
Cg (N'b)	-1,710.60	-1,121.79	588.21	-974.07	-531.16	-442.91	57.04	533.59
Cg (%)	25.1	51.27	26.17	13.17	52.65	39.48	5.09	50.11
Cp (N'b)	13,425.08	9,830.34	-3,594.74	12,689.65	12,934.34	244.69	-57.13	3,161.13
Cp (%)	31.54	-3.81	35.35	29.09	31.58	2.49	-0.05	32.34
NFA (N'b)	8,132.44	6,506.62	-1,625.82	6,940.58	7,180.63	240.05	-52.93	726.94
NFA (%)	7.01	-14.31	21.32	6.67	10.36	3.69	-0.81	11.26

Figure 3.2:
The Performance of M2,M1 and RM (2010 and 2011)

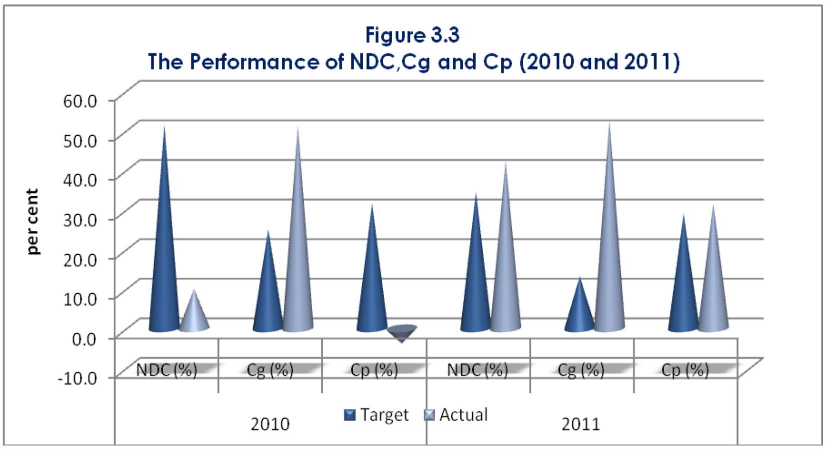


Reserve Money (Base money) also increased significantly during the review period. It grew by N719.17 billion or 34.82 per cent as against N219.39 billion or 11.88 per cent in the first half of the year. Overall, reserve money was N2, 784.27 billion at the end of fiscal 2011 which was above the indicative benchmark of N2, 515.28 for the year by N268.99 billion or 10.69 per cent. The upward review of the CRR of DMBs liquidity injection by fiscal and AMCON operations contributed largely to the growth of reserve money during the period.

..growth in aggregate credit during the period was driven by increases in both credit to government and the private sector.

Aggregate domestic credit increased by N3,494.71 billion or 39.22 per cent during the period compared with N199.92 billion or 2.30 per cent in the first half of the year. In relation to the corresponding period of 2010, aggregate credit grew by 4.07 per cent. The growth in aggregate credit during the review period was driven by increases in both credits to government and the private sector. Credit to government increased by N533.59 billion or 50.11 per cent in the second half of the year compared with N57.04 billion or 5.09 per cent in the first half. The sharp increase in the second half of the year was partly attributable to the need to meet government's fiscal commitments in the second half of the year.

For fiscal 2011, aggregate credit increased by 42.43 per cent, exceeding the annual target of 36.61 per cent by 5.8 percentage points. Credit to government increased by 52.65 per cent against the annual target of 29.29 per cent. Despite the surge in credit to government, the public sector remained a net creditor to the banking system at the end of 2011.



Credit to the private sector increased by ……. 32.34 per cent in the second half of the year as against a decline of …… 0.05 per cent in the first half…..

Credit to the private sector increased by N3,161.13 billion or 32.34 per cent in the second as against a decline of N57.13 billion or 0.05 per cent in the first half of the year. Similarly, credit to the private sector improved significantly compared with the level in the corresponding period of 2010, when it declined by N399.11 billion or 3.95 per cent. At 31.58 per cent, growth in private sector credit exceeded the annual target of 29.09 per cent by 2.49 percentage points. The increasing trend in the second half of 2011 could largely be attributed to the improvement in financial conditions of the DMBs resulting from significant sale of their non-performing loans (NPLs) to AMCON. Net Foreign Assets (NFA) of the banking system rose by N726.94 billion or 11.26 per cent compared with a decline of N52.93 billion or 0.81 per cent in the first half of 2011. The improvement in the second half of 2011 was largely attributed to the high price of crude oil. In addition, the increased interest rates led to more capital inflows in the second half of 2011 as investment in fixed income securities became more attractive. For fiscal 2011, NFA increased by 10.36 per cent, exceeding the annual target of 6.67 per cent.

Box 3.1

Euro Zone Sovereign Debt Crisis and the Nigerian Economy

Economic activities in some Euro area countries like Portugal, Ireland, Italy, Greece and Spain (PIIGS) were largely constrained due to rising sovereign debt crisis and domestic unemployment. Inflationary pressures and suppressed aggregate demand also persisted in some of these countries. With public debt at unsustainable levels, these countries have continued to struggle to limit government spending. Credit conditions remained generally tight accompanied by high commodity prices. As a consequence, economic activity in the euro area slowed sharply in the second half of 2011.

Deteriorating sovereign creditworthiness and high economic uncertainty weakened lender credit profiles, while European banks continued to be vulnerable to the debt crisis. Identified risk factors included; elevated economic uncertainty, high funding spreads and reduced market access at a time banks faced large debt maturities. The downgrade of France, the Eurozone's second-largest economy, made it even harder and, potentially, more expensive for the euro-zone's bailout fund to help troubled states. Europe's debt crisis has effectively increased the risk of government and bank defaults, making financial institutions across the world wary of lending to each other, thus further driving up the cost of credit. These developments had implications for developing countries, including Nigeria, with large savings-investment gaps.

One of the channels through which the foregoing developments impacted on the Nigerian economy is in reduction in the size of credit lines, especially to local financial institutions and non-financial corporations. In the circumstance, terms and conditions of credit could become more stringent. This has implications for liquidity conditions in the domestic money market. Economic slowdown in Europe would reduce global demand for crude oil, depress price and eventually weaken Nigeria's fiscal position. Trade, particularly non-oil exports to Europe is likely to be affected negatively in the event of a prolonged crisis. All of these suggest significant downside risk to domestic output and financial stability. Monetary policy would be expected to play a major stabilizing role in the short to medium-term; first, by proactively ensuring that system liquidity was maintained at optimal levels; second, that key prices (interest and exchange rates) were stable; third, ensuring effective coordination with the fiscal authorities; and finally, monetary policy must aim at cultivating confidence through effective communication.

CHAPTER 4
DOMESTIC FINANCIAL MARKETS

4.1 Money Market

Activities in the money market during the second half of 2011 were influenced, largely by rising inflation and structural factors…..

Activities in the money market during the second half of 2011 were influenced, largely by rising inflation and structural factors on the one hand, and the significant increase in government spending, especially in the fourth quarter of 2011. The interbank placement guarantee which was extended from May 2010 to end-June 2011 and further to end-December 2011, terminated in the review period. The guarantee helped to impart confidence to participants in the money market (Box 4.1). Also, key interbank rates moved in tandem with the upward review of the Monetary Policy Rate (MPR) especially following the Special MPC meeting of October 2011 that raised the rate from 9.25 to 12.00 per cent. However, the sharp rise in the MPR has had the effect of pushing up retail lending rates and widening further the spread between average lending rates and consolidated deposit rates.

Following the upward reviews of the MPR, the increase in money market rates improved real returns on asset holding and provided incentive for portfolio reallocation in favor of naira-denominated assets

The money market remained the most active segment of the financial market in providing the mechanism for trading in short-term financial assets. The reforms of the banking sector bolstered liquidity in the market and improved the creation of credit by the banks. Transactions in the money market were largely done using government securities for OMO, Repurchase Agreements (Repos) and Discount Window (DW) operations.

Following the upward reviews of MPR, the increase in money market rates improved real returns on asset holding and provided incentive for portfolio reallocation in favour of naira-denominated assets. In addition, it increased the cost of holding foreign currency for speculative purposes and reduced significantly the tendency to pre-pay dollar obligations.

However, the rise in interest rates carried the risk of possible losses on fixed income positions and slowing the recovery of the equities market. Furthermore, high interest rates were a disincentive to credit growth. However, the need to promptly contain the risks to inflation arising from fiscal expansion and rising global prices of food and energy, dominated considerations by the MPC in setting policy in the review period.

Box 4.1
Performance of Interbank Guarantee

In July 2009, the CBN introduced the Interbank Guarantee mechanism through which the Bank guaranteed all interbank placements including pension funds and foreign credit lines. The guarantee, which replaced the expanded discount window operations (EDWs), remained in place until December 31, 2011. Before the guarantee, DMBs with surplus funds preferred to place them at the Standing Deposit Facility of the CBN rather than lend to other DMBs that were in deficit position because of perceived high counter-party risks. The Interbank guarantee scheme produced desired results as transactions in the interbank market were devoid of discrimination on account of perceived high counter-party risks while the guarantee lasted.

The guarantee succeeded in lowering the interbank lending rates. Between July 2009 when the guarantee was introduced and December 2011, the interbank rates ranged between 2.0 and 15.7 per cent, compared to 8.0 and 20.0 per cent between July 2008 and July 2009. In addition, the guarantee helped to moderate high volatility of rates in the market.

The guarantee, nevertheless, had some downsides. For instance, the interbank rates fell most of the time significantly below the MPR rendering it partially ineffective and also reflecting in operators' perceived distortions in the pricing of credit in the interbank money market. More fundamentally, the guarantee obscured some vital signals from the market thereby constraining appropriate policy actions. In response to these, and considering that the objectives of the guarantee including the resolution of banking sector crisis were fully achieved, the Bank discontinued the interbank guarantee at the expiration of its tenure on December 31, 2011.

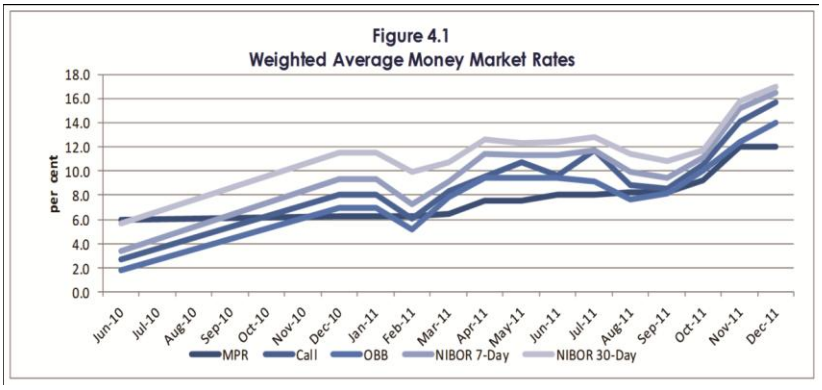
4.1.1 Developments in Short-Term Interest Rates

One of the challenges of monetary management during the second half of 2011 was to contain and stabilize short-term money market interest rates which were rising and volatile…..

One of the challenges of monetary management during the second half of 2011 was how the containment and stabilization of short-term money market interest rates which were volatile and trended upwards. Movements in call and OBB rates were largely dictated by the level of liquidity, which in turn, was influenced by the fiscal operations of the three tiers of government and the lag impact of CBN quantitative easing measures in the previous period.

Table 4.1
Weighted Average Money Market Interest Rates (%)
(Dec 2010 – Dec 2011)

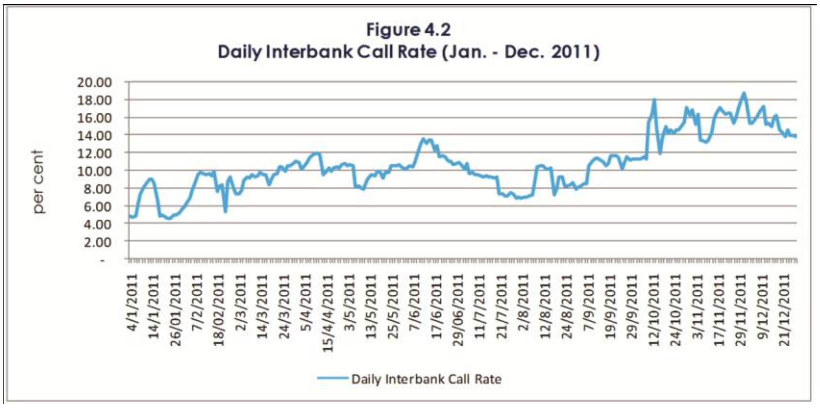
Month	Monetary Policy Rate	Overnight Interest Rates		NIBOR	
		Call Rate	Open-Buy-Back	7-Day	30-Day
Dec-10	6.25	8.03	6.93	9.31	11.50
Jan-11	6.25	6.10	5.17	7.21	9.92
Feb-11	6.50	8.30	7.80	9.13	10.75
Mar-11	7.50	9.50	9.39	11.44	12.63
Apr-11	7.50	10.70	9.44	11.29	12.29
May-11	8.00	9.60	9.47	11.33	12.40
Jun-11	8.00	11.70	9.11	11.75	12.83
Jul-11	8.25	8.87	7.61	9.91	11.45
Aug-11	8.25	8.55	8.18	9.47	10.79
Sep-11	9.25	10.50	10.06	11.07	11.74
Oct-11	12.00	14.10	12.38	15.21	15.74
Nov-11	12.00	15.72	14.04	16.47	17.00
Dec-11	12.00	15.50	14.06	16.30	16.74



Interbank Call Interest Rates

..steep rise in the average interest rate was largely a response to policy measures that were implemented in the review period …..

During the review period, the weighted average interbank rate which was 11.70 per cent in June 2011 moderated to 10.50 per cent in September, 2011. The rates rose further to 14.10 per cent in October before closing at 15.50 per cent by December 2011. When compared with the 8.03 per cent recorded in December 2010, the interbank rate rose by 7.47 percentage points. The steep rise in the average interest rate was largely a response to policy measures that were implemented in the review period to cope the threat to inflation (figure 4.1).



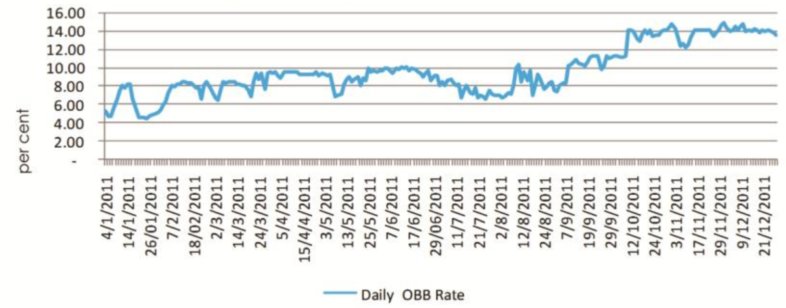
(ii) Open Buy-back Rate

The average weighted open buy-back (OBB) rate, which was 9.59 per cent in June 2011, increased to 12.38 per cent in October and further to 14.06 per cent in December, 2011. The figures showed a significant leap in the OBB rates when compared with the values of 1.80, 7.53 and 6.86 per cent recorded in the corresponding period of 2010, respectively.

...average weighted OBB rate, which was 9.59 per cent in June 2011, increased to 12.38 per cent in October and further to 14.06 per cent in December, 2011.

The upward trend in OBB rate was in tandem with the movement in the MPR and other interbank rates. When compared with the December 2010 rate of 6.86 per cent, the OBB rates in December 2011 grew by 7.20 percentage points over the twelve months period (Figure 4.1).

Figure 4.3
Daily Open - Buy - Back (Jan - Dec. 2011)



A major explanation for the observed upward trend in OBB rates was the steady rise in the monetary policy rate in the review period as the Bank increased the MPR three times to address inflationary concerns and exchange rate pressures. OBB rates, however, were within the +/-200 basis points band around the policy rate indicating that it tracked the movement in the MPR as well as reflecting that market sentiments were consistent with the policy stance.

iii Nigeria Interbank Offered Rate

Generally, the short -term interest rates were relatively higher during the second half of 2011.

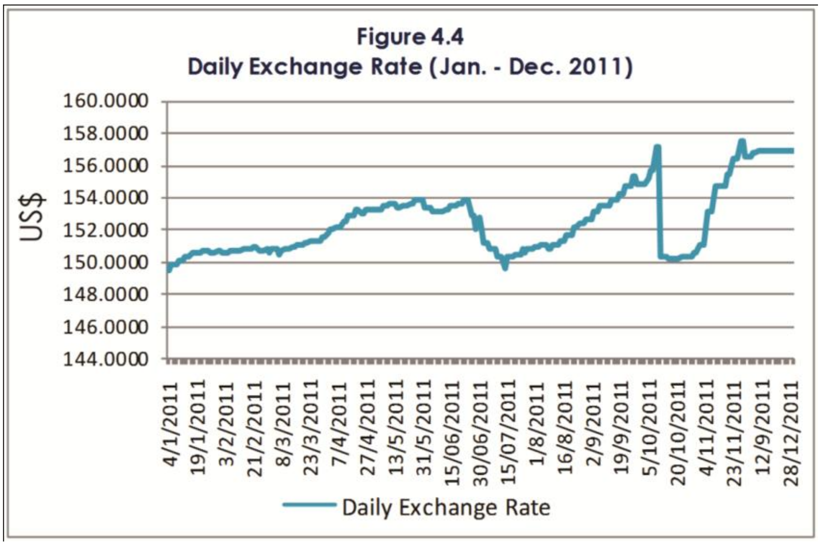
During the review period, the Nigeria Interbank Offered Rate (NIBOR) remained the traditional market reference rate as in other jurisdictions. The NIBOR for 7-day and 30-day tenors moved in tandem with interbank call and OBB interest rate in the second half of 2011(Figure 4.1). The NIBOR for 7-days and 30-days tenors which at end-June 2011 stood at 11.75 and 12.83 per cent, respectively, rose to 16.30 and 16.74 per cent in December 2011. Compared with the rates in the corresponding period of 2010, NIBOR was 9.31 and 11.50 per cent for 7-day and 30-day tenors, respectively in the corresponding period of 2010. The high rates recorded during the second half were expected given the tight posture of monetary policy.

The relatively high short-term rates during the second half of 2011translated to higher lending rates and lower credit to the real sector, as DMBs maintained a cautious approach to lending. Lending rates remained substantially high throughout the review period partly also because of the more stringent regulatory framework in which risk management principles were strongly enforced.

The Bank, however, responded to persistent foreign exchange demand pressures by reviewing upward the target mid-point….

4.2 The Foreign Exchange Market

The overall policy thrust of the CBN remained the need to engender a stable exchange rate around the mid-point of N150/US$ with a band of +/- 300 basis points. The Bank, however, responded to persistent foreign exchange demand pressures by reviewing upward, the target mid-point to N155/US$ in October, 2011with the band of +/- 300 basis points retained.



..depreciation in the spot rates across all segments of the foreign exchange market was attributed to demand pressures …….

4.2.1 Spot Rates

The spot rate at the official window of the foreign exchange market, the wDAS averaged ₦154.99/US$ in the second half of 2011 compared with the average of ₦153.31/US$ in the first half of 2011 and ₦150.52/US$ in the corresponding period of 2010, representing a depreciation of 1.08 and 2.88 per cent, respectively.

In the interbank foreign exchange market (IFEM), the spot rate averaged ₦157.98/US$ during the review period compared with ₦154.07/US$ in the first half of 2011 and ₦151.72/US$ in the corresponding period of 2010. The movement in rates showed a depreciation of 2.47 and 3.96 per cent in both periods, respectively. Similarly, spot rates at the BDC segment averaged ₦161.17/US$ in the second half of 2011 compared with ₦157.25/US$ in the first half of 2011 and ₦153.67/US$ in the corresponding period of 2010, representing a depreciation of 2.43 and 4.65 per cent, respectively.

The depreciation in the spot rates across all segments of the foreign exchange market was attributed to demand pressure emanating mainly from high liquidity in the banking system and the financing of refined petroleum product imports. The spread between the wDAS and BDC rates peaked at N11.92 in July 2011 before narrowing to N5.09 in December 2011due to the impact of tight monetary policy (Table 4.2).

Table 4.2
Average Monthly Spot Exchange Rates (N/US$): Jul. 2010 – Dec. 2011

	CBN	IFEM	BDC
Jul-10	150.09	150.20	152.50
Aug-10	150.78	151.85	153.00
Sep-10	151.35	154.50	155.00
Oct-10	149.99	150.85	153.00
Nov-10	150.24	150.90	152.50
Dec-10	150.66	152.00	156.00
2010: H2 Average	**150.52**	**151.72**	**153.67**
Jan-11	151.85	152.20	155.00
Feb-11	152.07	153.35	156.00
Mar-11	153.04	155.22	157.50
Apr-11	154.45	154.72	157.00
May-11	155.13	156.40	159.00
Jun-11	153.31	152.52	159.00
2011: H1 Average	**153.31**	**154.07**	**157.25**
Jul-11	151.96	153.00	164.00
Aug-11	153.92	155.00	157.00
Sep-11	156.15	159.60	160.00

Oct-11	151.75	159.35	160.00
Nov-11	157.87	161.20	161.00
Dec-11	158.27	159.70	165.00
2011: H2 Average	**154.99**	**157.98**	**161.17**
2011 Average	**154.15**	**156.02**	**159.21**

4.2.2 Forward Rates

1-month forward rate averaged N154.45/US$ compared with the average of N153.73/US$ in the first half of 2011.

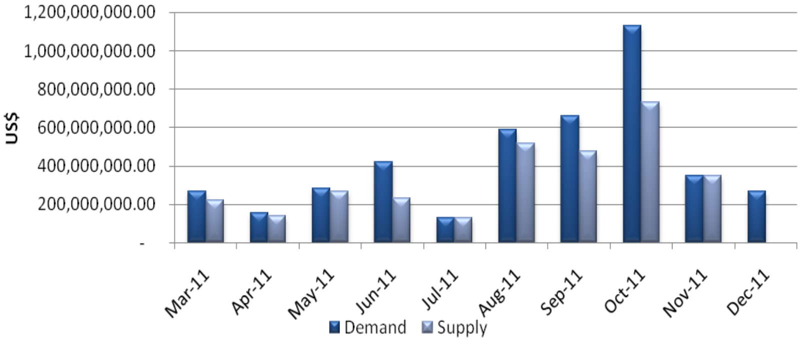
The CBN commenced foreign exchange forward transactions with authorized dealers in March 2011. The introduction of the forwards market was expected to smoothen out the demand for foreign exchange by reducing speculative demand that exerted sustained pressure on the Naira. Thus, during the second half of 2011, the 1-month forward rate averaged ₦154.45/US$ compared with the average of ₦153.73/US$ in the first half of 2011, indicating a depreciation of 0.47 per cent. The average forward rate for 2-month tenor was N155.95/US$ as against N154.95/US$ in the first half of 2011, reflecting a depreciation of 0.64 per cent. Similarly, the forward rate for 3-month tenor transactions recorded a depreciation of 2.12 per cent to an average of ₦158.17/US$ in the second half of 2011, compared with an average of ₦154.81/US$ in the first half of the year.

Table 4.3
Average Monthly Foreign Exchange Forward Rates (N/US$)
(Mar. 2011 – Dec. 2011)

	1-MONTH	2-MONTH	3-MONTH
Mar-11	152.43	153.85	154.27
Apr-11	153.75	154.30	154.46
May-11	154.47	155.52	156.71
Jun-11	154.29	155.49	153.45
2011: H1 Average	**153.73**	**154.95**	**154.81**
Jul-11	151.57	152.97	
Aug-11	152.40	153.75	154.91
Sep-11	154.47	155.54	156.47
Oct-11	155.68	156.99	158.34
Nov-11	153.75	155.48	158.06
Dec-11	158.85	160.99	163.05
2011: H2 Average	**154.45**	**155.95**	**158.17**

The average demand at the wDAS Forward Market increased by 46.08 per cent from US$280.59 million in the first half of 2011 to US$520.42 million during the review period. Also, total sales by the CBN increased by 41.42 per cent from US$215.13 million in the first half of 2011 to US$367.23 million in the second half of the year.

Figure 4.5
Demand and Sales at wDAS Forwards (Mar. - Dec. 2011)



4.2.3 End-Period Exchange Rate

The Naira depreciated in all segments of the market mainly as a result of the high demand for foreign exchange to finance imports…

The naira depreciated in all segments of the market mainly as a result of the high demand for foreign exchange, compounded by the activities of speculators. Thus, the naira depreciated at the wDAS by 3.14 and 4.81 per cent from ₦153.31/US$ at end-June 2011 and N150.66/US$ at end-December 2010,respectively, to ₦158.27/US$ at end-December 2011 (Table 4.4).

Similarly, the naira depreciated by 3.64 per cent from ₦159.70/US$ to ₦165.00/US$ at the BDC segment and 4.50 per cent from ₦152.52/US$ to ₦159.00/US$ at the interbank market, between the first and second half of 2011. When compared with end-December 2010, the naira depreciated by 5.46 and 4.82 per cent from N156.00/US$ and 152.00/US$ at the BDC and interbank market, respectively (Table 4.4).

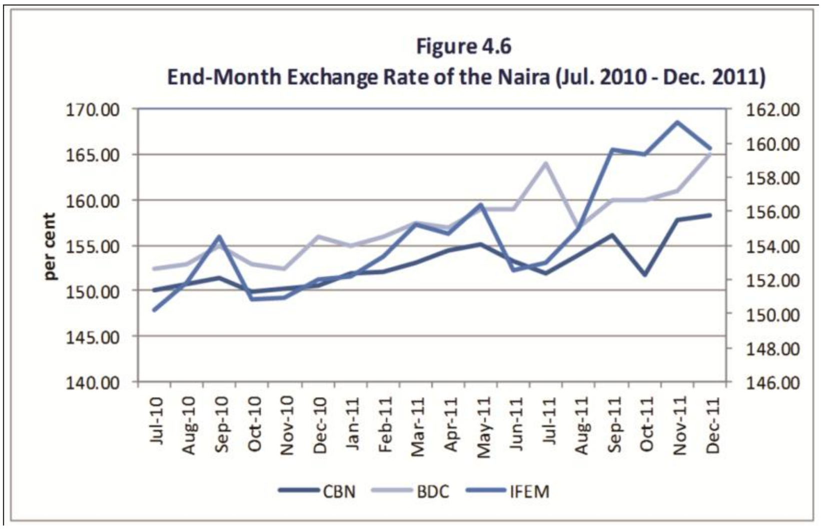


Table 4.4
End-Month Exchange Rate Movements at Various Segments of the Market
(Naira per US dollars)

	CBN	IFEM	BDC
Jun-10	149.49	150.00	152.50
Jul-10	150.09	150.20	152.50
Aug-10	150.78	151.85	153.00
Sep-10	151.35	154.50	155.00
Oct-10	149.99	150.85	153.00
Nov-10	150.24	150.90	152.50
Dec-10	150.66	152.00	156.00
Jan-11	151.85	152.20	155.00
Feb-11	152.07	153.35	156.00
Mar-11	153.04	155.22	157.50
Apr-11	154.45	154.72	157.00
May-11	155.13	156.40	159.00
Jun-11	153.31	152.52	159.00
Jul-11	151.96	153.00	164.00
Aug-11	153.92	155.00	157.00
Sep-11	156.15	159.60	160.00
Oct-11	151.75	159.35	160.00
Nov-11	157.87	161.20	161.00
Dec-11	158.27	159.70	165.00

The Nominal Effective Exchange Rate (NEER) index decreased by 2.81 to 99.73 at end-December 2011…

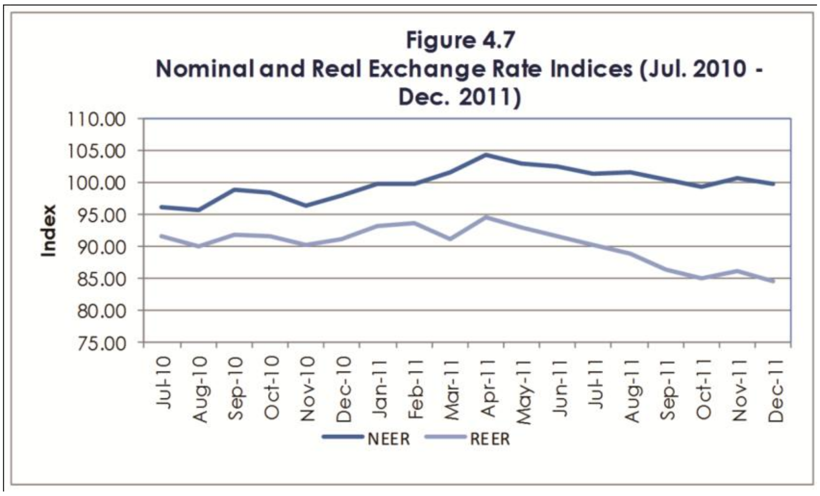
4.2.4 Nominal and Real Effective Exchange Rate Indices

The Nominal Effective Exchange Rate (NEER) index decreased by 2.81 to 99.73 at end-December 2011 from 102.54 at end-June 2011. The Real Effective Exchange Rate (REER) index also fell by 7.04 to 84.56 at end-December 2011 from 91.60 at end-June 2011. Compared with end-December 2010, the NEER increased by 1.86 while the REER decreased by 6.65 (Table 4.5 and Figure 4.7).

On the average, both the NEER and REER decreased at end-December 2011 when compared with the level at end-June 2011, reflecting a real exchange rate appreciation relative to the currencies of Nigeria's major trading partners.

Table 4.5
Nominal and Real Effective Exchange Rate Indices
(Jul. 2010 –Dec. 2011)

	NEER	REER
Jul-10	96.09	91.55
Aug-10	95.65	90.03
Sep-10	98.88	91.80
Oct-10	98.51	91.67
Nov-10	96.42	90.19
Dec-10	97.87	91.21
2010: H2 Average	97.24	91.08
Jan-11	99.72	93.31
Feb-11	99.90	93.73
Mar-11	101.55	91.20
Apr-11	104.28	94.65
May-11	102.99	93.07
Jun-11	102.54	91.60
2011: H1 Average	101.83	92.93
Jul-11	101.49	90.22
Aug-11	101.62	88.82
Sep-11	100.41	86.46
Oct-11	99.24	85.08
Nov-11	100.73	86.26
Dec-11	99.73	84.56
2011: H2 Average	100.54	86.90



4.2.5 Demand and Supply of Foreign Exchange

Total demand for foreign exchange at the wDAS during the review period increased by 15.02 per cent to US$20,020.37 million from US$17,405.43 million recorded in the first half of 2012. Compared with the US$15,368.91 million demanded in the corresponding period of 2010, the demand for foreign exchange rose by 30.27 per cent. Total supply of foreign exchange at the wDAS amounted to US$15,146.87 million in the second half of 2011, compared with US$14,627.53 million recorded in the first half, representing an increase of 3.55 per cent. It rose by 15.45 per cent from US$13,120.15 million in the second half of 2010 (Table 4.6).

The CBN responded to persistent demand pressures in the foreign exchange market by increasing supply to match genuine demand. Though, the forwards segment of the market provided some relief to the high demand on the spot market, its impact was insufficient to stave-off demand pressures.

Table 4.6
Foreign Exchange Demand and Supply
(US Dollar Million)

	wDAS Demand	wDAS Sales
Jul-10	1,795.82	1,835.20
Aug-10	2,789.10	1,948.52
Sep-10	4,391.83	3,593.54
Oct-10	2,503.67	2,342.08
Nov-10	1,853.37	1,561.68
Dec-10	2,035.12	1,839.13
2010: H2 Total	**15,368.91**	**13,120.15**
Jan-11	2,800.42	2,000.00
Feb-11	2,041.09	1,794.85
Mar-11	3,612.36	3,274.38
Apr-11	2,780.41	2,375.58
May-11	2,845.62	2,549.89
Jun-11	3,325.53	2,632.83
2011: H1 Total	**17,405.43**	**14,627.53**
Jul-11	3,065.41	2,643.34
Aug-11	4,504.49	2,899.05
Sep-11	4,076.18	3,850.00
Oct-11	3,904.58	2,607.00
Nov-11	3,054.43	1,749.62
Dec-11	1,415.28	1,397.86
2011: H2 Total	**20,020.37**	**15,146.87**

.. increase in inflow was mainly attributed to the rise in both price and output of crude oil.

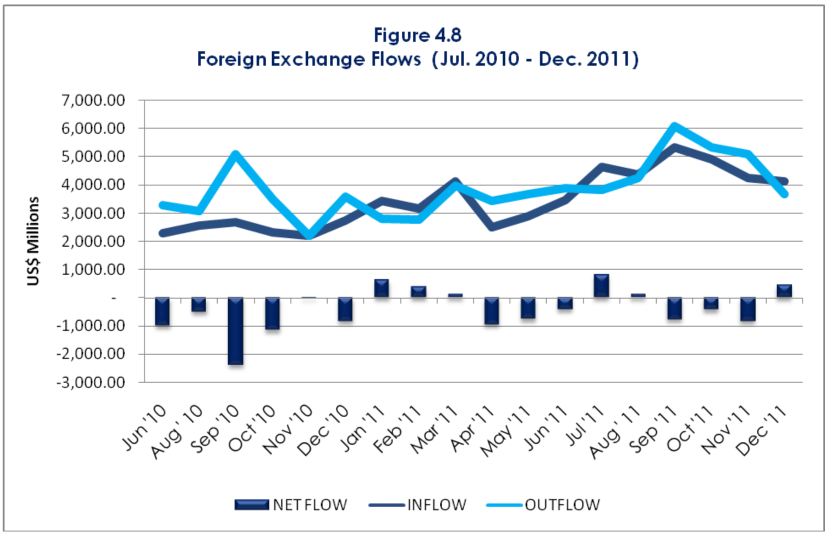
4.2.6 Foreign Exchange Flows

Gross foreign exchange inflow into the economy was US$27,631.39 million in the second half of 2011, compared with US$19,574.33 million and US$14,865.04 million in the first half and the corresponding period of 2010, representing increases of 41.16 and 85.88 per cent, respectively (Figure 4.8 and table 4.7). The increase in inflow was mainly attributed to the rise in both price and output of crude oil. Foreign exchange outflow recorded an increase of 39.46 per cent from US$20,530.92 million to US$28,244.16 million between the first half and second half of 2011. Outflow increased by 37.05 per cent compared with the total outflow of US$20,891.28 million in the second half of 2010. The high volume of foreign exchange outflow was mainly due to demand pressures to finance importation of refined petroleum products.

In the second half of 2011, foreign exchange flows resulted in a net outflow of US$612.77 million, reflecting an improvement over the net outflow of US$956.59 million in the first half of 2011 and US$6,026.24 million in the corresponding period of 2010 (Table 4.7).

Table 4.7
CBN Monthly Foreign Exchange Flows
(US Dollar Million)

	INFLOW	OUTFLOW	NET FLOW
Jul-10	2,289.00	3,282.56	-993.56
Aug-10	2,564.49	3,061.05	-496.56
Sep-10	2,701.52	5,078.74	-2,377.22
Oct-10	2,339.28	3,463.47	-1,124.19
Nov-10	2,209.35	2,169.84	39.51
Dec-10	2,761.40	3,835.62	-1,074.22
2010: H2	**14,865.04**	**20,891.28**	**-6,026.24**
Jan-11	7,062.55	969.33	6,093.23
Feb-11	7,173.18	148.45	7,024.73
Mar-11	6,333.20	32.15	6,301.05
Apr-11	4,815.10	152.36	4,662.74
May-11	7,353.66	507.50	6,846.16
Jun-11	6,807.36	123.49	6,683.88
2011: H1	**39,545.05**	**1,933.26**	**37,611.78**
Jul-11	7,815.98	212.57	7,603.40
Aug-11	8,732.50	345.83	8,386.67
Sep-11	7,516.53	448.63	7,067.90
Oct-11	7,714.71	168.99	7,545.72
Nov-11	5,953.40	142.13	5,811.27
Dec-11	4,545.97	302.15	4,243.82
2011: H2	**42,279.09**	**1,620.30**	**40,658.79**
2011 Total	**81,824.14**	**3,553.57**	**78,270.57**



4.3 Capital Market

... Nigerian stock market in the second half of 2011 remained bearish, mirroring the trend in the first half of the year.

The Nigerian stock market in the second half of 2011 remained bearish, reflecting a continuation of the trend in the first half of the year. The market recorded significant divestment and low liquidity; a development attributed mainly to low return on equity, tight monetary policy, strict regulatory control over margin lending and corporate governance issues. In addition, the protracted euro zone sovereign debt problems that led to a downgrade in credit rating of some countries, lingering U.S. limited fiscal space as well as prevailing real estate and inflation problems in key emerging market economies, posed challenges to global equities trading, including Nigeria.

4.3.1 Market Turnover

Aggregate stock market turnover during the second half of 2011 was 40.06 billion shares valued at N262.25 billion exchanged in 497,025 deals, compared with 49.52 billion shares valued at N372.70 billion exchanged in 733,762 deals in the first half of 2011, and a turnover of 38.55 billion shares valued at N360.60 billion in the second half of 2010. Relative to the first half of 2011, market turnover fell by 19.10 per cent during the review period but rose by 3.92 per cent when compared with the corresponding period of 2010.

…All-Share Index (ASI) decreased by 17.01 per cent …..at end-December 2011, from its level…….at end-June 2011.

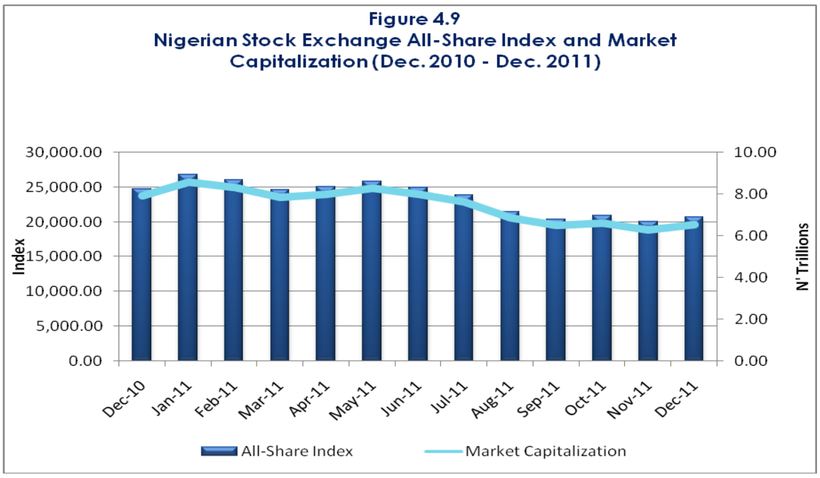
4.3.2 Equities Market

The All-Share Index (ASI) decreased by 17.01 per cent to 20,730.63 at end-December 2011, from its level of 24,980.20 at end-June 2011, compared with the 2.42 per cent decrease in the second half of 2010. On a year-on-year basis, the ASI decreased by 16.31 per cent from 24,770.52 at end-December 2010 to 20,730.63 at end-December 2011. Market Capitalization (MC) decreased by 18.27 per cent to N6.53 trillion at end-December 2011 from N7.99 trillion at end-June 2011, and 17.45 per cent when compared with the N7.91 trillion recorded at end-December 2010 (Table 4.7 and Figure 4.9).

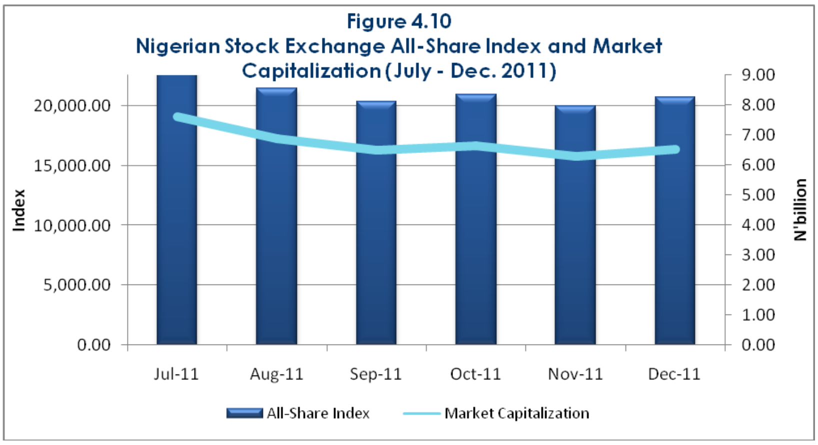
Table 4.8
NSE All Share Index (ASI) and Market Capitalization (MC)
December 2010 – December 2011

Date	All Share Index (ASI)	Market Capitalization (Equities) (N' Trillion)
Dec-10	24,770.52	7.91
Jan-11	26,830.67	8.58
Feb-11	26,016.84	8.32
Mar-11	24,621.21	7.87
Apr-11	25,041.68	8.00
May-11	25,866.62	8.27
Jun-11	24,980.20	7.99
Jul-11	23,826.99	7.62
Aug-11	21,497.61	6.88
Sep-11	20,373.00	6.50
Oct-11	20,934.96	6.63
Nov-11	20,003.36	6.29
Dec-11	20,730.63	6.53

Source: Nigerian Stock Exchange (NSE)



Source: Nigerian Stock Exchange



Source: Nigerian Stock Exchange

..real interest rates turned positive from October 2011 and remained so for the rest of the year …

The lull in performance of the Nigerian stock market in the second half of 2011 was traced to a number of global and domestic factors. On the global scene, the U.S., euro zone and major emerging market economies faced persistent fiscal challenges stoked up by sustained high energy, commodity and food prices. As a result, consumer confidence and output growth dipped, leading to adverse consequences on global equities.

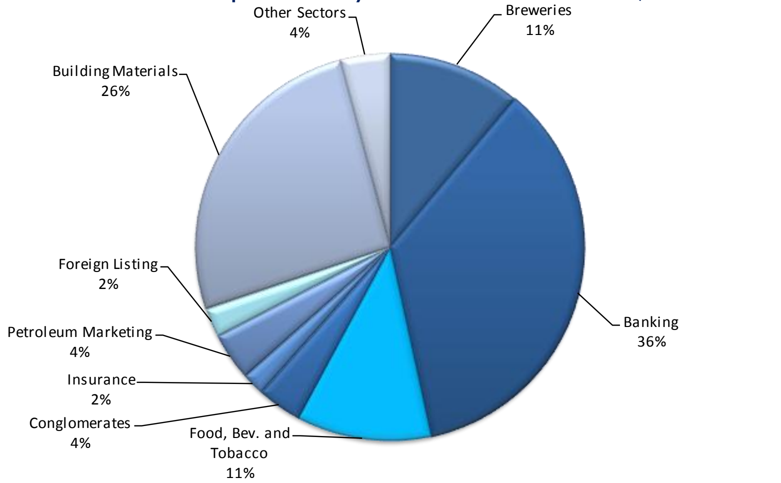
On the domestic scene, policy and money market interest rates turned positive in real terms from October 2011 and remained so for the rest of the year. Consequently, improved return on money market instruments seemed to have made investment in equities market relatively unattractive.

4.3.3 Sectoral Contribution of Equities Market Capitalization

..building materials sector was the most capitalized with its overall share of the market rising to 29.0 per cent at end-December 2011.....

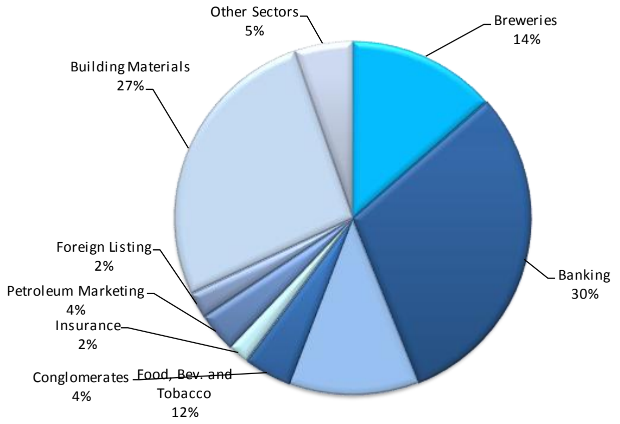
The building materials sector was the most capitalized with its overall share of the market rising to 29.0 per cent at end-December 2011, from 27.0 per cent at end-June 2011. Compared with the 26.0 per cent at end-December 2010, the sector's share of market capitalization increased by 3.0 percentage points. The banking sector was next with 28.0 per cent share of overall market capitalizationas at end-December, 2011. However, the sector's market share progressively declined from 36.0 and 30.0 per cent at end-December 2010 and end-June, 2011, respectively (Figures 4.11, 4.12 and 4.13). The development reflected the de-listing of the shares of three banks that were nationalised in August 2011 and the growth in the building and construction industry. Dangote Cement (Building Materials) maintained its lead as the most capitalized company with market capitalization of N1.72 trillion at end-December 2011. Other leading sectors were the breweries and food, beverages and tobacco with respective market shares of 17.0 and 10.0 per cent at end-December 2011.

Figure 4.11
NSE Market Capitalisation by Sector as at End-December, 2010



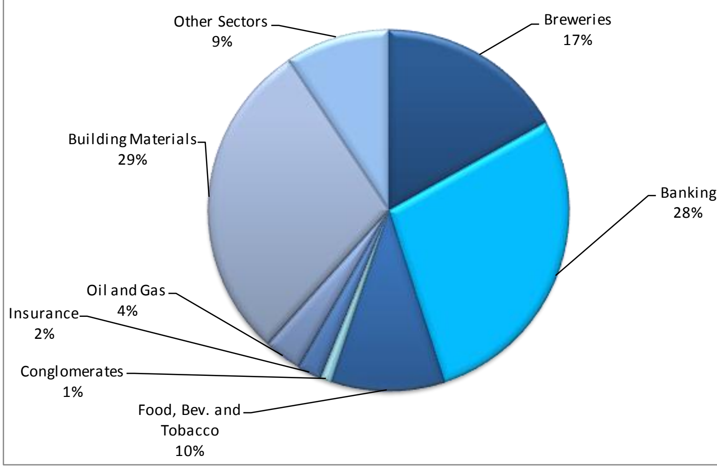
Source: Nigerian Stock Exchange

Figure 4.12
NSE Market Capitalisation by Sector as at End-June, 2011



Source: Nigerian Stock Exchange

Figure 4.13
NSE Market Capitalisation by Sector as at End-December, 2011



Source: Nigerian Stock Exchange

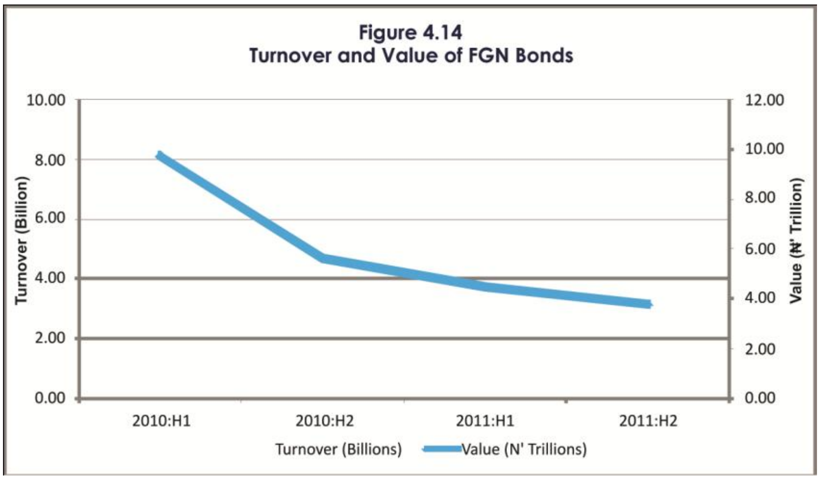
4.3.4 Bonds Market

The bonds market witnessed a slowdown in growth and activity in the second half of 2011

The FGN bonds market slowed activity in the second half of 2011. The volume and value of activities dropped by 16.4 and 15.3 per cent, respectively, from 5.01 billion and N4.44 trillion in the first half of 2011 to N4.19 billion and N3.76 trillion, respectively in the second half. However, the value of FGN bonds traded grew to N8.20 trillion at end December 2011 from N4.44 trillion at end June 2011. Some sub-national and corporate bonds were issued during the review period.

4.3.4.1 Federal Government (FGN) Bonds

Total transactions in FGN bonds in over-the-counter (OTC) market in the second half of 2011 was 4.19 billion units valued at N3.76 trillion in 29,625 deals compared with 5.01 billion units valued at N4.44 trillion in 37,053 deals during the first half and a turnover of 5.60 billion units worth N5.64 trillion in 48,682 deals recorded in the corresponding period of 2010 (Figure 4.14). The decline in OTC market was largely attributed to the fact that only six FGN bonds were actively traded out of the twenty-six issues outstanding during the review period. In addition, the inability to trade the remaining twenty FGN bonds due to lack of depth and benchmarking by the money market also impacted on trading activities in the bonds market.

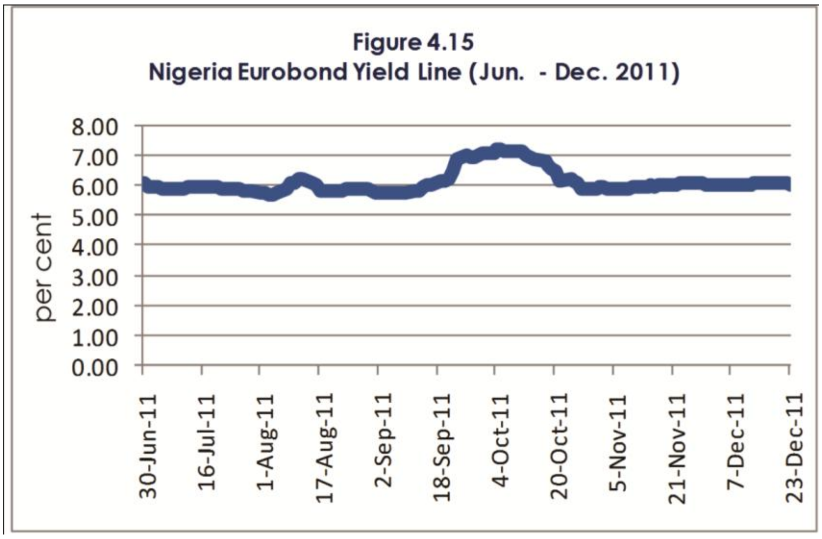


Source: Nigerian Stock Exchange

..twin challenges of trade and fiscal deficit in the US and the fragility of some internationally active banks, continued to facilitate the redirection of capital flows in favour of emerging markets…

4.3.4.2 FGN Eurobond

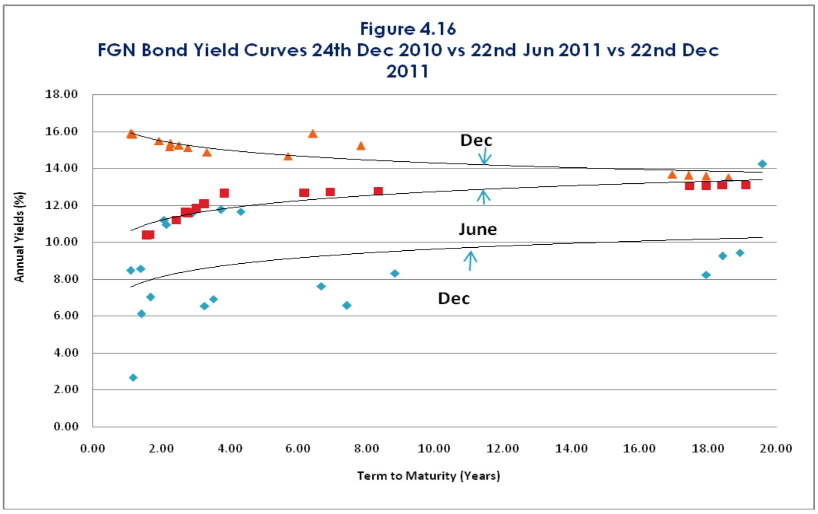
The Federal Government of Nigeria's Eurobond continued to be traded in the review period. Yield on the bond decreased by 3 basis points from 6.06 per cent at end-June 2011 to 6.03 per cent at end-December 2011. Weak global economic and financial conditions and in particular, investors' concern about the euro area sovereign debt crisis, the twin challenges of trade and fiscal deficit in the U.S. and the fragility of some internationally active banks, continued to facilitate the redirection of capital flows in favour of emerging markets and developing economies. In the domestic economy, measures taken by the Bank to stabilize the exchange rate and increase the stock of external reserves also assisted in shoring up investor confidence (figure 4.15).



Source: Bloomberg

4.3.4.3 Yields on Federal Government Bonds

The FGN bonds yield curve for December 22, 2011 shifted upwards by 607 basis points compared with that of December 24, 2010 and also by 273 basis points compared with that of June 22, 2011 (Figure 4.16). The upward shift in the yield curve is traceable to the substantial cumulative increase in the MPR in the period. Yields on all FGN bonds closed the year above the 10.3 per cent inflation rate at end December 2011.



Source: Data obtained from Financial Markets Dealers' Association

Total value of state governments bonds issued in the second half of 2011 was N84 billion, compared with the N245.5 billion issued in the first half.

4.3.5 State Government Bonds

Total value of state government bonds issued in the second half of 2011 was N84.0 billion, compared with theN245.5 billion issued in the first half. The development was accounted for by the listing of only three (3) state government bonds in the review period compared with eight (8) in the first half. The bonds were: Edo State Government N25.0 billion14.0 per cent Fixed Rate Infrastructure Development Bond 2017; Delta State Government N50.0 billion 14.0 per cent Bond due 2018 and Niger State N9.0 billion 14.0 per cent Fixed Rate Development Bond due 2018.

4.3.6 Corporate Bonds

In the second half of 2011, two private corporations namely, Nigerian Aviation Handling Company (NAHCO) and Dana Group, issued bonds. NAHCO issued N2.15 billion, (Fixed Rate Bond Series 1 2011/2016 under the N5 billion debt issuance programme), while Dana Group issued N8.01 billion Bond at MPR + 7 per cent maturing in December 2018. In the first half of 2011, five corporations from the banking sector (GTBank, UBA, First Bank, Access Bank and Diamond Bank) provided the lead in corporate bond offerings seeking to raise N1,800.0 billion from the market.

CHAPTER 5
ECONOMIC OUTLOOK

5.1 Overview

Global economic recovery during the second half of 2011 was threatened by fiscal pressures and financial system fragility in the euro area …

Global economic recovery during the second half of 2011 was threatened by fiscal pressures and financial system fragility in the euro area, trade and fiscal deficit crises in the U.S. and nascent real estate bubbles in China. In addition, concerns about fiscal sustainability widened sovereign spreads for most countries, while rising food and commodity prices weakened growth in global output in most advanced economies. The euro area crisis necessitated bailout funds from the European Central Bank (ECB), European Union (EU) and the International Monetary Fund (IMF). In contrast, commodity exporting nations, including sub-Saharan African countries, benefited from the favourable price development and registered appreciable output growth.

Overall, at 3.8 per cent, global output growth in 2011 was mainly driven by the performance of emerging and developing economies. Consequently, global output in 2012 may remain modest as downside risks persist. Some of these risks include financial sector imbalances and fiscal sustainability pressures in the euro area and tensions between Iran and some western countries, which could impact negatively on energy and commodity prices. Also, the contagious social and political unrest in the Middle East and North Africa (MENA) region could impede global financial stability and output growth in 2012.

..heightened security risk in the country poses challenge to the growth prospect for 2012…

On the domestic front, the banking sector and capital market reforms, relative peace in the Niger Delta region, the proposed deregulation in the downstream petroleum sector as well as government's resolve to improve power supply, agriculture and manufacturing sectors might boost output in 2012. However, the heightened security risk in the country poses challenge to the growth prospect for 2012, while the proposed deregulation of the downstream petroleum sector may be inflationary in the short-term.

5.1.1 Global Output[1]

Growth in global output in the second half of 2011 declined to 2.77 per cent recorded during the first half.......

Growth in global output in the second half of 2011 declined to 2.77 per cent from 4.30 per cent in the first half. Growth in the advanced economies was 1.76 per cent, down from 2.20 per cent in the first half. In the emerging and developing economies, growth was 6.63 per cent in the second half of 2011 as against 6.50 per cent in the first half. In Developing Asia, growth declined to 7.09 per cent in the second half from 9.60 per cent in the first half of 2011. Similarly, in Latin America and the Caribbean countries, output growth decelerated from 4.60 per cent in the first half of 2011 to 3.56 per cent in the second half.

Provisional data from the WEO indicates that annual output growth in 2011 for Advanced Economies was 1.6 per cent; Emerging and Developing Economies, 6.2 per cent; Developing Asia, 7.9 per cent; Latin America and the Caribbean, 4.6 per cent; MENA, 3.1 per cent and sub-Saharan Africa, 4.9 per cent (Table 5.1).

For Emerging and Developing economies, especially sub-Sahara African countries, the outlook suggests sustained recovery.

The outlook for the global economy in the first half of 2012 suggests that economic growth would moderate at 2.02 per cent, reflecting the possibility of sustained sovereign debt crisis and fiscal tightening in the euro area with dampening effect on economic activity in the rest of the advanced economies.

For Emerging and Developing economies, especially sub-Sahara African countries, the outlook suggests sustained recovery. However, the real estate bubble in China and inflation pressures in both India and Brazil may constrain economic activities in these countries. In the MENA region, the outlook is mixed (Table 5.1). While countries like Tunisia are settling down for reconstruction and rehabilitation, the political situation in Libya, Syria and Egypt are still tenuous. Also, Iran's nuclear ambition and the impending U.S./Western European's economic sanctions may depress the prospects for growth in the region.

[1] Quarterly and half year data were obtained from Bloomberg, while the annual data was from the WEO

Table 5.1
World Economic Outlook

	2009	2010	2011	2012	2013
A. World Output					
World Output	**-0.7**	**5.2**	**3.8**	**3.3**	**3.9**
Advanced Economies	**-3.7**	**3.2**	**1.6**	**1.2**	**1.9**
USA	-3.5	3.0	1.8	1.8	2.2
Euro Area	-4.3	1.9	1.6	-0.5	0.8
Japan	-6.3	4.4	-0.9	1.7	1.6
UK	-4.9	2.1	0.9	0.6	2.0
Canada	-2.8	3.2	2.3	1.7	2.0
Other Advanced Economies	-1.1	5.8	3.3	2.6	3.4
Emerging & Developing Economies	**2.8**	**7.3**	**6.2**	**5.4**	**5.9**
Central and Eastern Europe	-3.6	4.5	5.1	1.1	2.4
Commonwealth of Independent States	-6.4	4.6	4.5	3.7	3.3
Developing Asia	7.2	9.5	7.9	7.3	7.8
Latin America and the Caribbean	-1.7	6.1	4.6	3.6	3.9
Middle East and North Africa	2.6	4.3	3.1	3.2	3.6
Sub-Saharan Africa	2.8	5.3	4.9	5.5	5.3
B. Commodity Prices (US' Dollars)					
Oil	-36.3	27.9	31.9	-4.9	-3.6
Non-fuel	-15.7	26.3	17.7	-14.0	-1.7
C. Consumer Prices					
Advanced Economies	0.1	1.6	2.7	1.6	1.3
Emerging & Developing Economies	5.2	6.1	7.2	6.2	5.5

Source: IMF World Economic Update, January 2012

5.1.2 Global Inflation

Global inflation ……, projected to slow down to 2.6 per cent in the first half of 2012 as a result of declining demand and stabilizing commodity prices.

Global inflation rose to 3.88 per cent in the second half of 2011 from an average of 3.45 per cent in the first half, largely due to rising commodity and energy prices. It is, however, projected to slow down to 2.60 per cent in the first half of 2012 as a result of declining demand and stabilizing commodity prices. In the Advanced economies, inflation averaged 2.73 per cent in the second half of 2011 as against 2.60 per cent in the first half and is projected to decline to 1.86 per cent in the first half of 2012. Similarly, inflation in the U.S. averaged 3.54 per cent in the second half of 2011 as against 2.40 per cent in the first half and is predicted to ease to 2.20 per cent in the first half of 2012.

In sub-Saharan Africa, a number of factors including strong domestic and foreign exchange demand, high import prices and rising energy costs combined to put pressure on consumer prices in 2011. This situation could continue in the first half of 2012 in view of the not-too-good outlook for the global economy.

..projected decline in oil prices is largely attributed to anticipated slack in demand arising from low economic activities

5.1.3 Global Energy Prices

World crude oil prices averaged US$108.21 per barrel in the second half of 2011, down from US$116.90 per barrel in the first half, representing a decrease of 7.43 per cent. The IMF baseline oil price projection for 2012 which is US$99.00 per barrel is lower than the average price at end-December 2011. The projected decline in oil prices derives largely from the high prospects of a slower in demand in 2012.

..overall growth outlook for the domestic economy remained optimistic.

5.1.4 Domestic Output Growth

The overall growth outlook for the domestic economy in the first half of 2012 remains optimistic. Provisional data from the National Bureau of Statistics (NBS) showed that output in the second half of 2011 grew by 7.54 per cent as against 7.18 per cent in the first half of 2011. NBS's current estimates show that the domestic economy would grow at 7.2 per cent in 2012. This estimate takes into account prospects of sustained weakness in the global economy and a cautious view of domestic conditions such as security in the Niger Delta region, oil production, and implementation of Federal Government's initiatives relating to infrastructure renewal and development (including power and roads) and agriculture. The non-oil sector is expected to drive output growth in 2012. However, the major risk remains the euro area debt crisis which could adversely affect Nigeria's exports of crude oil earnings and government revenue.

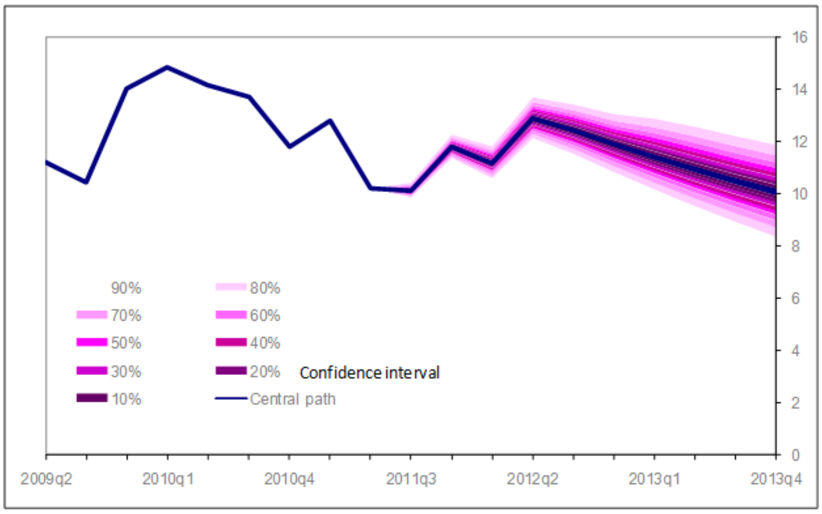
5.2 Outlook for Inflation and Monetary Policy Thrust in 2012

5.2.1 Inflation Outlook

Inflation at the end of the second half of 2011 was 10.3 per cent down from 11.8 per cent in 2010. Staff forecasts suggest that inflation would be in the region of 11.2 to 13.8 per cent in the first half of 2012. Key downside risks include; anticipated fiscal injections in relation to the proposed 2012 budget, planned deregulation of the downstream sector of petroleum industry, the proposed new tariff regimes on imported food products such as rice and flour as well as the upward review of electricity tariff. However, moderating factors would include the lag effects of tight stance of monetary policy in 2011, expected good harvest of agricultural produce and high prospects of a stable naira exchange rate.

Figure 5.1 presents inflation fan chart for the period 2011:3 – 2013:4 simulated among others, under the assumption of full deregulation of the downstream sector of the petroleum industry. The chart shows that inflation would assume an upward trend in the first half of 2012.

Figure 5.1
Fan Chart for Inflation from 2011:3 – 2013:4



Given the persisting inflationary pressures, it is expected that the current restrictive stance of monetary policy would continue in the near –term.

5.2.2 Monetary Policy Thrust in 2012

Given the persistent inflationary pressures, it is expected that the current restrictive stance of monetary policy would continue in the near-term. In addition to traditional instruments of monetary control like reserve requirements and discount window operations, the Central Bank would continue to explore other means, including administrative measures and closer coordination with the fiscal authorities to ensure price stability. The global financial crisis has brought to the fore the importance of synergy between monetary and other macroeconomic policies. In this regard, the Bank would continue to place higher premium on macro-prudential issues in 2012.

APPENDICES

Communiqués of the Monetary Policy Committee (June – December 2011)

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-December2010 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.

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 market 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 slowdown 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 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

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 N7.99 trillion to N6.73 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

Central Bank of Nigeria Communiqué No. 79 of the Monetary Policy Committee Meeting, October 10, 2011

The Monetary Policy Committee (MPC) held an extraordinary meeting on 10th October, 2011 in response to unusual developments in the global and domestic economy, with potential negative impact on domestic liquidity conditions and renewed threats to price and exchange rate stability.

The global economic horizon remains highly uncertain, with the signs getting more ominous as policy makers find it increasingly difficult to take the necessary economic decisions that may avert a new wave of recession. Three self-reinforcing negatives continue to define the global economy: the sovereign debt crisis in the Eurozone, significant undercapitalization of internationally-active banks, and negative market sentiment leading to continuing flight to cash as a safe haven and deleveraging. The first and second aspects intensify the third, and without confidence and some appetite for financial assets and credit, the debt crisis and financial solvency concerns in turn become deeper.

As a result of these concerns about the Eurozone, coupled with the US deficit problem, inflation in emerging markets, debates about a soft or hard-landing in China and other pessimistic scenarios, there is a trend towards reversal of capital flows to emerging and frontier markets. This is coupled with a recent depreciation in the national currencies of many economies in Asia and Latin America including India, Indonesia, Malaysia, South Korea, Brazil, Chile, Colombia, and Mexico, among others. In Africa, the national currencies of Kenya, South Africa, Gabon, Ghana and Nigeria have also been under pressure. Central banks have generally responded through direct intervention in the foreign exchange market to stabilize the currency and, in some cases, a significant hike in policy rates. It is worthy of note that fund managers have not been eager to exit environments with relatively high real rates of interest and benign inflation outlook.

The Domestic Economy and Committee's Deliberations

The growth outlook for the economy does not appear to have changed much, driven largely by the positive forecasts for the non-oil sector as noted in the last MPC communiqué. Inflation had come down to 9.3 per cent in August but, as indicated in the same communiqué, a combination of monetary, fiscal and structural factors continue to advise against complacency.

The naira has come under increasing pressure, and has recently traded outside the band of N150 +/- 3.0 per cent. In the Committee's view, the increasing pressure on the domestic currency has been emanating from a number of sources not all of which can be addressed by purely monetary interventions. First, there are concerns about the likely impact of a double dip recession on oil prices and already declining foreign reserves. Second, there are also concerns about the delay in implementing fundamental economic decisions that will shore up reserves. Specifically, it is estimated that simply passing the Petroleum Industry Bill (PIB) and removing subsidies on Premium Motor Spirit (PMS) will add at least US$10 billion to national reserves annually. The petroleum subsidy for 2011 alone is estimated to be about US$6 billion. A substantial part of oil production (about 40 per cent) is currently in deep offshore wells. Based on the terms agreed in the 1990s when oil price was under US$30, royalty from oil wells deeper than 1,000 metres is zero per cent and the nation is paid only 20 per cent of the profit by oil companies after deducting their expenses. As a result, the country has had limited benefits from high oil prices and increasing output, with most of the gains going to multinational oil companies under an inequitable fiscal arrangement.

Similarly, the Committee expressed concerns about the genuineness of demand for petroleum imports. This year alone, oil importers have bought over US$7.0 billion from wDAS, thereby, depleting the Nation's external reserves. This demand, in the Committee's view, might have been fuelled by rent-seeking and subsidies.

It is imperative that the enabling legislation for correcting fiscal terms be put in place under a Petroleum Industry Bill (PIB) that reflects international best practice. Unfortunately, discordant voices are delaying these processes to the long-term detriment of the economy. Whereas the labour unions have genuine concerns about the impact of subsidy removal on the poorer segments of society, the stark reality is that the country is living above its means.

The Greek government recently passed a budget in which 33,000 public sector workers had to be retrenched as a result of failure to take difficult but necessary economic decisions in the past. Nigeria cannot afford to delay, any further, the reforms of the petroleum industry.

Third, the draft 2012 budget and the underlying assumptions are based on an oil price of US$75 per barrel and an output of 2.4 million barrels per day. This makes the 2012 budget even more expansionary than the 2011 budget and further dampens any hope for an early fiscal retrenchment. The fiscal authorities have clearly signaled a commitment to medium-term consolidation and indeed the projected deficit in 2012 is lower than the deficit in the 2011 budget. This notwithstanding, the projected increase in spending, particularly the high levels of recurrent expenditure, would suggest increasing pressure on prices in general.

Fourth, structural bottlenecks in the Nigerian economy that perpetuate import dependence make import-demand highly inelastic.

Finally, real interest rates have been low, partly driven by a cautious approach to monetary tightening at a time of financial system instability. Although the MPC recognized inflationary pressures and has consistently acted prudently in policy tightening based on expectations, a gradualist approach has been the pattern thus far, given the situation with the banking system and equity markets.

Policy Issues and Dilemmas

In the face of the spectre of declining oil prices, declining foreign reserves, increased demand for foreign exchange, fiscal dominance and capital flow reversals, monetary policy must bear a larger burden of economic adjustment. The MPC has, therefore, to make difficult choices, each of which has clear costs and benefits.

One option is protecting reserves by reducing the supply of dollars at the wDAS. This will lead to a rapid depreciation of the currency and the emergence of a parallel market, leading to further pressures on the Naira, imported inflation and a general loss of confidence on the part of investors.

Indeed, the impact on price and exchange rate stability will be such as to undermine the key mandates of the Central Bank. Given the highly inelastic demand for imports, it is doubtful that increasing the cost of dollars will significantly reduce quantity demanded. Indeed, genuine demand will be compounded by high levels of speculative demand.

A second option is to address monetary and liquidity conditions more aggressively. By tightening liquidity and raising domestic interest rates, a number of advantages follow. First, this is the logical response to fiscal expansion, especially with the anticipated capital releases in the fourth quarter as well as repayment of backlog of Nigeria National Petroleum Corporation (NNPC) debt to the Federation account. Second, it provides an incentive for reallocation of portfolios by improving real returns of holding the naira as a store of value. Third, it increases, after a lag, the rates paid on deposits and savings, thus reversing any tendency towards disintermediation and capital flight. Finally, it increases the cost of foreign currency positions held for speculative purposes, and reduces the tendency to pre-pay dollar obligations with naira liabilities.

The option has disadvantages in the form of high lending rates, financial cost to the banking system and possible losses on fixed income instruments due to capital losses. Besides, tightening of liquidity would run the risk of slowdown in credit growth. Having considered the pros and cons of each option (and combinations of options), the Committee is of the view that given the completion of shareholder meetings on all banks and approvals from the courts for many, the risks to the banking system of tighter liquidity conditions have been significantly reduced, as the banks are in the process of receiving all approvals and fresh capital including AMCON bonds. Now that the banking system recapitalization is complete, monetary policy can be freed from concerns about its impact on financial system stability.

The Committee reaffirmed its belief that maintaining exchange rate stability, especially in times of global uncertainty, is crucial to the mandate of price stability. Moreover, the interest of the economy is best served, by maintaining an unequivocal stance of non-accommodative monetary policy, given the existing fiscal conditions.

The Committee also reaffirmed its commitment to improving returns on naira assets and protecting the capital of investors against erosion due to huge exchange rate losses, in order to encourage appropriate asset allocation decisions.

The Committee recognized the need to remain very clear on the Bank's primary mandate and maintain the credibility it has established so far by sending strong signals of continuing commitment to price and exchange rate stability. Finally, the Committee noted that the Committee of Governors has already commenced full investigation of compliance with rules governing foreign exchange transactions by authorized dealers and endorsed the declared commitment to sanction all infractions and improve the level of supervision and compliance in the market.

Decisions:

1. The monetary policy rate (MPR) is raised by 275 basis points from 9.25 per cent to 12.0 per cent (by a vote of 8 in favor and 1 in favor of status quo);

2. Maintain the current symmetric corridor of +/-200 basis points around the MPR (by unanimous vote);

3. The cash reserve ratio(CRR) is increased from 4.0 per cent to 8.0 per cent from the maintenance period beginning October 11, 2011 by a vote of 7 to 2 (2 members voted for a 6.0 per cent CRR);

4. The net open position (NOP) is reduced from 5.0 per cent to 1.0 per cent of share-holders funds with immediate effect and with full compliance by Friday, October 14, 2011 (by unanimous vote); and

5. It was further agreed that the reserve averaging method of computation be suspended in favour of daily maintenance until further notice.

Sanusi Lamido Sanusi, CON
Governor
Central Bank of Nigeria
October 10, 2011

Central Bank of Nigeria Communiqué No. 80 of the Monetary Policy Committee Meeting, Monday, November 21, 2011

The Monetary Policy Committee (MPC) met with 11 out of the 12 members present on 21st November, 2011 to review domestic economic conditions up to the early part of Q4 2011 and the challenges facing the Nigerian economy against the background of developments in the international economic and financial environment in order to reassess the options for monetary policy for the remaining part of the year and Q1 2012.

The Committee noted that international economic and financial conditions had deteriorated with possible threats of financial shocks from Europe, making it very difficult to correct the serious imbalances that have developed in the international economy since the peak of the global economic and financial crises. Most of the major industrial economies are at present economically weak and are expected to remain in recession with high unemployment rates and large unsustainable fiscal imbalances for an extended period, going by the recent forecasts of most international institutions. Inflation rates, with the exception of Japan, are expected to be higher than in 2010. It is projected at around 3.0 per cent in 2011 in the US, the Euro-area and the UK compared with 1.9 per cent in 2010. The ratio of government debt to GDP for the European Union remains high and has led to a change of governments in Greece and Italy and a likely election of conservative government in Spain. It has also led to the adoption of tougher austerity measures including staff rationalization and privatization. In the case of some countries of the Euro area, the markets are still not certain that the risk of sovereign default will be addressed expeditiously and in an efficient manner. These concerns have opened up issues relating to financial stability, given the considerable exposures of banks and other financial institutions to government securities across countries. Consequently, financial markets have become nervous with their uncertainties reflected in the volatility of stock, bond and foreign exchange markets. Current account imbalances are also projected to be high in 2011 in both the US and the Euro area.

The Committee noted that, with the limited available fiscal space, the burden of economic adjustment has fallen on central banks in the industrial economies. However, as the policy rates are close to zero, the only recourse available to central banks to promote recovery is through quantitative easing. In resorting to quantitative easing, the Committee is concerned that central banks, particularly, in the US and UK, are failing to recognize the limitations of monetary policy and delaying the difficult but inevitable structural adjustment required by the developed world to avoid a recession. A significant amount of sovereign debt needs to be written off, systemically important banks need to be recapitalized (and if necessary nationalized) and stronger austerity measures need to be put in place in the US and the Europe. Concerns over elections in 2012 in the US, Germany and France seem to be getting in the way of these tough decisions. Failure to act quickly may lead Europe into a prolonged recession that could lead to a permanent loss of competitiveness and economic vibrancy.

Emerging countries are also projected to record lower growth rates in 2011 than in 2010. Given the high degree of real and financial integration with the industrial economies, a quick rebound in growth in 2012 does not seem to be realistic at this point in time. In many emerging countries, inflation rates are relatively high. There are also concerns about financial asset prices and the growing nonperforming loans of banks. In China, early signals of a collapse in property prices have emerged and should the real estate bubble burst, this will have an impact on China's growth prospects. Fiscal imbalances have also been high in many countries.

Growth performance of industrial and emerging economies in 2012 is vital for Nigeria's economic performance. Oil demand, in the Committee's view, would soften as a consequence of slow global growth and would necessitate comprehensive and sound policy actions to help diversify the domestic economy away from oil. The impact of external developments on the domestic economy working through the channels of trade, finance and confidence has, in the Committee's view, been strong and would need to be addressed efficiently and expeditiously.

On the domestic front, the Committee observed a mild resurgence of inflationary pressures at the end of the third quarter and beginning of the fourth quarter of the year, after they had moderated following a series of monetary policy tightening measures. The inflation outlook, however appears mixed, and is complicated by the fact that the full effects of the recent aggressive monetary tightening measures are yet to be felt. Latest output growth projections remained robust, even though lower than earlier projected. The Committee observed no major threats to financial system stability and welcomed the conclusion of the banking sector recapitalization exercise, which places the banks in a strong position to weather external shocks and also lays the foundation for strong earnings and credit growth.

Key Domestic Macroeconomic and Financial Developments

Output and Prices:

The Committee observed that the robust output growth recorded since the beginning of the year has been sustained. Real output growth was estimated at 7.40 per cent in Q III of 2011 as against 7.86per cent in the corresponding quarter of 2010, according to the latest estimates of the National Bureau of Statistics (NBS). Non-oil GDP was estimated to grow sharply by 8.81 per cent in Q III of the current year as compared with 8.38 per cent recorded in Q III of the previous year. For the year as a whole, real GDP growth was projected at 7.69 per cent, slightly lower than the 7.87 per cent attained in 2010.

The Committee noted with satisfaction that the expected output performance in 2011 was higher than the average growth of 6.63 per cent recorded since 2004. As investments increase and productivity improves, real GDP could double in less than ten years from now if the potential growth is elevated slightly over the average growth recorded in the last seven years.

The year-on-year headline inflation rate rose to 10.5 per cent in October 2011 from 10.3 per cent in September. Similarly, food inflation rose to 9.7 per cent in October 2011 from 9.5 per cent in September. However, core inflation declined marginally to 11.5 from 11.6 per cent in September.

Coming on the heels of a series of monetary policy measures, and at a time of global uncertainty, the numbers send mixed signals for inflationary expectations in spite of the uptick in year-on-year headline inflation. For instance, all broad measures declined on a month-on-month basis. Headline inflation declined by 0.9 per cent in October compared to an increase of 1.4 per cent in September. This was a result of a month-on-month decline of 0.8 and 0.7 per cent in food and non-food inflation compared to increases of 1.9 and 0.9 per cent, respectively, in the preceding month.

On the fiscal front, the Ministry of Finance continued to stress its commitment to a tighter fiscal stance and has already indicated a reduction in the benchmark price of oil from US$75.0 per barrel to US$70.0 per barrel. It has also adopted an exchange rate assumption consistent with the current stance of monetary authorities. Although, the Sovereign Wealth Fund is subject to continuing political negotiations between States and Federal Governments, it would appear from public statements on both sides that a positive resolution would be reached very soon. The risk to inflation from removal of fuel subsidy is ever-present. However, whenever the policy becomes effective, the Central Bank stands ready to react to any second round effects of a price adjustment. As a matter of policy, the Central Bank will not respond to first-round shocks, as tightening money supply in such a circumstance will be pro-cyclical. Finally, in view of the external developments above, any softening in oil prices will impact negatively on government revenue receipts. Given the concerns over the budget deficit, such a development would lead to a forced adoption of belt-tightening measures, thus, providing the much-needed fiscal support in the effort to rein in inflation. In such a circumstance, further tightening may also turn out to be pro-cyclical, especially, as the full effects of recent measures are still working their way through the system. Given the cost of borrowing in current tight monetary conditions, the Committee projects that in the face of revenue shocks, the likely reaction of the authorities will be a reduction in non-essential spending, rather than an increase in public debt.

Monetary, Credit and Financial Market Developments

Provisional data indicate that aggregate domestic credit (net) grew by 24.57 per cent in October 2011 over the end-December 2010 level, and by 29.48 per cent when annualized, which was below the indicative benchmark of 32.58 per cent for 2011. The growth in aggregate credit (net) in October 2011 was due to increases in credit to the private sector as well as State and Local governments. Credit to the private sector grew by 24.24 per cent (29.09 per cent on annualized basis) which was higher than the indicative benchmark of 23.34 per cent for 2011. However, credit to the Federal Government which fell by 21.65 per cent (25.98 per cent on annualized basis), was below the indicative benchmark growth rate of 29.29 per cent for 2011. This was due to the fiscal surplus of N307.84 billion in July 2011 following the sharing of the arrears of budget augmentation (January-April, 2011) which reduced the need for government borrowing.

Rates at the interbank money market moved in tandem with the upward reviews of the MPR at the MPC meetings during the period. The average interbank call and Open buy back (OBB) rates rose from 11.38 and 11.16 per cent before the extra-ordinary MPC meeting, held in October 2011, to 15.00 and 13.70 per cent, respectively, after the meeting, reflecting the spike in the MPR. In addition, the upward review of the CRR and the sterilization of the funds helped to push up inter-bank rates to a high of 18.06 per cent on October 14, 2011. The Interbank and OBB rates, which opened at 10.74 and 10.63 per cent on September 19, 2011 rose to 17.09 and 14.00 per cent on October 31, and closed at 14.30 and 13.26 per cent, respectively, on November 15, 2011. Other factors responsible for the upward movement in rates included the various OMO auctions conducted to mop-up excess liquidity, as well as the low level of liquidity in the banking system following the deadlock at the Federation Accounts Allocation Committee meeting which culminated in the late release of statutory revenue to the three tiersof government. However, the purchase of AMCON bonds by the Bank and the injection of funds, moderated rates in the market.

The Committee also noted that deposit money banks have improved the rates on fixed-term deposits. Thus, the average weighted three-month deposit rate has gone up to 7.06 per cent in October from 5.49 per cent in September. Also, the rates on deposits for 12 months increased from 4.47 per cent in September to 4.90 per cent in October, 2011. The average weighted interest bearing deposit rate stood at 4.93 per cent in October compared with 4.02 per cent in September. This increase in rates had been anticipated by the Committee and is likely to continue especially as we approach the December 31, 2011 deadline for the removal of the CBN guarantee on the interbank market. Lending rates have also gone up in response to tighter conditions in the money market.

The Committee observed that the bearish performance of the Nigerian capital market continued for most of the year. The All-Share Index (ASI) decreased by 18.0 per cent on a year-to-date basis from 24,770.52 at end-December 2010 to 20,311.51 on November 18, 2011. Market Capitalization (MC) also declined, by 19.2 per cent, from N7.91 trillion to N6.39 trillion over the same period due partly to the delisting of acquired banks. The bearish market is consistent with the trends globally in a very uncertain world where fund managers have resorted to a flight to safety. High yields on fixed income securities and subdued activity from investors in the wake of the Euro Zone crisis should advise against undue optimism for a rally in stocks in the short-term. However, strong earnings and fundamentals mean that the market is at present very attractive to long-term investors but not speculators.

External Sector Developments.

The Committee observed some restoration of stability in the Foreign exchange market since the last MPC meeting. The average exchange rate appreciated at all three segments of the market during the period. At the wDAS market, the exchange rate opened at N158.48/US$ (including 1% commission) on October 11, 2011 and closed at N156.05/US$ on November 18, 2011, representing an appreciation of N2.43k or 1.53 per cent within the period. At the inter-bank segment, the selling rate opened at N158.90/US$ and closed at N158.62/US$, representing an appreciation of N 0.28k or 0.17 per cent. At the BDC segment, the selling rate opened at N165.00/US$ and closed at N160.00/US$, representing an appreciation of N5.00k or 3.03 per cent for the period. The external reserves position has continued to improve, closing at US$34.38 billion of international reserves as at November 17, 2011.

The Committee felt that external developments have in general responded favorably to monetary policy stance adopted in the last MPC meeting in October. It urged the Central Bank to be vigilant with respect to the developments in the foreign exchange market and maintain its stance in favour of stable exchange rates, and send clear signals that will help anchor the expectations of investors, manufacturers, and policy makers in the short-to-medium term.

The Committee's Considerations

The Committee reviewed its decisions over the course of 2011 and their impact on the Bank's core mandate of maintaining price stability. It noted that Nigeria had been ahead of all other African countries in anticipating the impending danger of inflation and started its monetary tightening cycle at a time other African Central Banks were still holding or reducing policy rates. It noted that these decisions have helped in controlling pressures on the general price level and in maintaining a relatively stable equilibrium in the foreign exchange markets. Where this equilibrium is disturbed by external factors, the ability to respond rapidly has succeeded in quickly restoring stability.

The Committee also noted the mixed signals sent by inflation numbers for October 2011. The slight uptick in headline inflation year-on-year represents only a 20 basis-point increase from a high base of 10.3 per cent, and it is important not to exaggerate its significance. The index of all items except food declined marginally year-on-year, and all three broad indices (headline, food and core) showed a month-on-month decline in October, against month-on-month increases in the previous month.

On the fiscal side, a moderated oil benchmark price coupled with very strong public statements of commitment to fiscal consolidation by the fiscal authorities, give rise to optimism about long-awaited support on the fiscal side. Global headwinds may lead to a softening of commodity markets, thus reducing the resources available to fiscal authorities and contributing to a disinflationary process. The Committee noted the continuing demand pressures in the foreign exchange market and the slow rate of reserve accretion as indicators that liquidity conditions may still need further tightening.

On the other hand, lending rates are already high and having impact on the real sector, and global headwinds may make further tightening counter-productive and pro-cyclical should oil price fall significantly. Also, a combination of small fiscal adjustments and moderate depreciation in the exchange rate of the naira should compensate for maintaining current interest rate stance. Finally, the Committee noted that December is usually a period of muted economic activity, and an appropriate time to pause and assess the full impact of the recent tightening decisions after a lag.

Decision

The Committee decided as follows:

1. By a unanimous vote to retain the MPR at 12.0 per cent and the symmetric band at +/-200 basis points.

2. To retain the CRR at 8.0 per cent.

3. To adjust the mid-point of target official exchange rate from N150.00/US$1.00 to N155.00/US$1.00 and maintain the band of +/-3.0 per cent. This means that the naira should float roughly within a range of N150.00/US$1.00–N160.00/US$1.00, unless extraordinary shocks necessitate a change in stance.

4. To encourage the CBN to continue to seek convergence between wDAS and interbank rates to reduce arbitrage opportunities, avoid speculative attacks, and the emergence of a multiple-exchange rate environment.

Sanusi Lamido Sanusi, CON
Governor
Central Bank of Nigeria
November 21, 2011