

Central Bank of Nigeria Communiqué No. 66 of the Monetary Policy Committee Meeting, November 03, 2009

The Monetary Policy Committee (MPC) at its meeting today reviewed the domestic and external economic and financial developments for the year so far. The international economic scene, in the Committee's view, has turned out to be better than was projected about six months ago. Developed countries that were most adversely affected by the severe economic and financial crises have shown some signs of improvement in terms of output. However, questions remain on the durability and sustainability of the recovery. There are also concerns over the high unemployment rates in these economies, although the stock and housing markets showed some evidence of picking up. The financial sector has been stabilized and measures are set to closely monitor and regulate it. The prices of primary commodities including crude oil have risen largely due to the fiscal and monetary stimulus and on news of recovery. The rise in commodity prices however has given rise to concerns about resurgence of inflation in the near future. Emerging countries on their part have registered fairly good growth rates and are poised to make further gains in 2010. The main concerns in the international economy relate to the robustness of the recovery and the possibility of incipient inflationary tendencies. It is against this background that the question of timing and dimension of fiscal and monetary tightening is being debated.

The Committee reviewed the domestic economic developments bearing in mind the evolving international economic and financial situation. The review underscored the need for strengthening the on-going efforts at working out economic policies with reference to a desirable medium term path of economic growth along with price and financial stability. Monetary policy, the Committee emphasized, has to play an active role in the fulfillment of this task.

In the short run, however, the space available for monetary policy is somewhat limited by the uncertainty about the sustainability and robustness of economic recovery in most major trading partner countries, the fiscal constraints largely brought about by the

growing gap between the rising expenditure demands and revenue receipts and the overall deceleration in domestic economic activities. The Committee noted with satisfaction that there has been a gradual downward movement in inflation in recent months but observed that this has mirrored essentially the slack demand. The Committee also noted that structural measures currently being undertaken to strengthen the banking sector and to foster financial stability would pave the way for improved effectiveness of monetary policy in the short to medium term. The Committee welcomed the recent upward movement in the prices of crude oil in international markets and hoped that it will be sustained in the near future. It considered the external payments situation to be manageable. In the Committee's view, the behavior of short term money market interest rates and exchange rates is in general consistent with the market fundamentals.

Key Macro-economic and Financial Developments

Output and Prices: Data on real GDP growth for Quarter 3 of 2009 is not yet firm but the provisional estimate of the National Bureau of Statistics (NBS) is 7.58 per cent. The NBS reported that in Quarters I and II, output grew by 4.50 per cent and 7.22 per cent, respectively. The Committee felt that on the basis of the output growth recorded thus far and other indicators, growth in 2009 would remain robust.

The inflation rate as measured by the year-on-year increase in 'all items' consumer price index was 10.4 per cent in September 2009. This outcome is lower than the headline inflation of 15.1 per cent in December 2008 and lower than the average headline inflation of 12.6 per cent for the first 9 months of the year. Food inflation has been between 12.5 and 13.0 per cent in Q III of the year.

Monetary and Financial Market Developments: Broad money (M2) at the end of September 2009 showed an increase of 5.6 per cent on a year-on-year basis. The year-on-year movement in narrow money (M1) was negative 4.2 per cent as at end-September 2009 mainly on account of the decline in demand deposits. The trends in money supply movement reflect the fall in net foreign assets and slowdown in credit to private sector.

This implied that the aggregate demand is not adequate, suggesting the need for the continuation of an accommodative monetary policy.

Notwithstanding the low monetary growth, money market rates, reflected market realities. With the inter-bank money market guarantees in place and the measures to strengthen the banking sector, confidence in the money market has improved. This is reflected in the downward movement in the daily unsecured call rates. The average call rate for September 2009 was 9.98 per cent compared with 10.38 per cent in August and 17.64 per cent in July. The secured open buy-back (OBB) rate was 6.71 per cent for September, 2009, a shade higher than the 6.67 per cent in August but lower than the 7.47 per cent in July. The spread representing the counterparty credit risk thus narrowed to 327 basis points in September as against 365 basis points in August and 1017 basis points in July. In October, the call rate averaged 6.95 per cent while the average OBB rate was 6.08 per cent, the spread being mere 87 basis points.

The Committee noted that in October excess reserves of banks with the CBN were high with the average daily excess reserves exceeding the average in any of the preceding four months of the year. Some banks took recourse to standing deposit facilities with sharp increase since the middle of the month. No bank accessed the standing lending facilities during the same period. While this could be considered a structural phenomenon in view of the mid-month Federation Accounts Allocations, the sharp recourse to standing deposit facility and non-use of the standing lending facility in the latter-half of the month seem to suggest that there is scope to reset the rates on standing facilities so as to eliminate perverse incentives and encourage banks to enlarge their asset portfolios in a prudent manner.

Stock market developments continued to be marked by caution. In October 2009, the year-on-year declines in the average share price index and market capitalization were 47.0 per cent and 42.4 per cent respectively. The declines, however, are an improvement over the average declines of 57.6 per cent in the share prices and 50.7 per cent in market capitalization in the first nine months of the year. This may be attributable to the

emerging news that the financial conditions of the domestic banking sector has been strengthened by the injection of funds by the CBN and the major stock markets of the world have shown improved investor sentiments following reports of imminent recovery in the medium term.

External Sector Developments: The foreign exchange market has been stable. The official exchange rate stood at an average of N149.3578 per US dollar in October 2009. The inter-bank market rate averaged N150.1252/\$US. There was thus a slight appreciation of the Naira during the month. The spread between the rates has continued to be insignificant.

Foreign exchange reserves stood at US\$43.34 billion as at end September 2009, an improvement of about US\$ 1.64 billion over August, mainly owing to the receipt of the SDR allocation. As at October 30, 2009, foreign exchange reserves are provisionally estimated to be US\$43.05 billion. Crude oil prices in the international markets have edged upward in recent weeks. If the current oil price trend is sustained and if the expected recovery in both developed and emerging countries is realized, there will be further improvement in the level of foreign exchange reserves, with implications for liquidity and exchange rate management. The Committee will continue to ensure stable exchange rates determined by market forces.

The Committee's Considerations

The Committee observed that while inflation has decelerated, it is important to recognize that seasonal factors and the planned deregulation of the prices of petroleum products pose a major risk to inflation outlook in the near to medium term. It is this context that heightens the criticality of the policy dilemma now being faced by the Central Bank of Nigeria (CBN). Providing further impetus to the current accommodative monetary policy could be inflationary in the short to medium term whereas the gap between the likely output growth and the trend rate of growth as well as the fragility of economic recovery in many of the systemically important countries point to the need for maintaining

monetary accommodation along with reasonable fiscal stimulus. The Committee also noted the existing paradox of the co-existence of system-wide liquidity shortages as reflected in the data on monetary and credit aggregates and abundant liquidity with some banks as evidenced from the data on standing facilities. The CBN, in the light of these considerations, has to take a balanced view of the measures required for fostering growth prospects and containing inflationary pressures on a sustained basis and also to further strengthen the liquidity management.

Decisions

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

1. The Monetary Policy Rate (MPR) will remain unchanged at 6 per cent, but an asymmetric corridor of interest rates around the MPR is introduced. The rate on the standing lending facility will remain at 200 basis points above the MPR, while the rate on the standing deposit facility will be 400 basis points below the MPR.
2. There will be quantitative easing to bridge the gap currently estimated at about N500 billion between the levels of the current monetary aggregates and the benchmark levels for 2009. The modalities for quantitative easing include investments in bonds to be issued by Asset Management Company (AMC). The setting up of AMC, however, is subject to the approval of the National Assembly. Other modalities include the redemption of promissory notes issued by the Federal Ministry of Finance as well as by the CBN in connection with the retirement of debt and liabilities arising from purchase and assumption of failed banks.
3. Purchase of loans by banks under the AMC will be based on terms aimed at strengthening the balance sheets with a focus on asset quality, improving liquidity and capital adequacy as well as on reducing debt overhang relating to the stock market in order to stimulate activity in the capital market.

4. With effect from November 16, 2009, the temporary ban placed by the CBN on the use of Bankers' Acceptances (BAs) and Commercial Papers (CPs) will be lifted. Guidelines will be issued by the CBN prior to that date.
5. In view of the fact that the audit of banks have been concluded and adequate provisions have been made for non-performing loans and to stimulate credit growth and strengthen banks' balance sheets, the 1 per cent general provision on performing loans contained in the existing prudential guidelines is hereby waived for the year 2009 as a countercyclical measure. New prudential guidelines will be issued before the end of Q1 2010.

The totality of these measures is aimed at improving system liquidity and financial stability to regenerate confidence in the Nigerian markets and to further stimulate growth. The MPC is conscious of the upside risks as a result of quantitative easing but holds the view that progress in the execution of capital projects and favourable outlook on agricultural output growth will moderate the upside risks. The priority, therefore, is to stimulate growth in output and to ensure financial stability with a view to improving the effectiveness of monetary policy.

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