

**Central Bank of Nigeria Communiqué No. 68 of the 213th Monetary
Policy Committee Meeting, March 1-2, 2010**

The Monetary Policy Committee (MPC) met on 1st and 2nd March, 2010 to review domestic economic conditions for the first two months of 2010 and the challenges faced by the Nigerian economy against the backdrop of developments in the international economic and financial environments in order to chart the course for monetary and financial sector policies for the remainder of the year.

On the international economic scene, the Committee noted that the rebound in global economic activity which started in the second half of 2009 has continued. The rebound was driven largely by the unprecedented amount of fiscal stimuli undertaken in both the developed and emerging market economies in the wake of the global financial crises. As a consequence, monetary policy had been largely accommodative with interest rates down to record lows in most advanced and emerging markets, coupled with the considerable expansion of central bank balance sheets. The key concerns, however, remain the strength and sustainability of the recovery process which is proceeding at varying speeds across the different regions.

In the advanced economies, the recovery is still expected to be weak by historical standards, with real output projected to remain below its pre-crisis level until late 2011. Given their stronger initial economic conditions and swift policy responses, growth in the emerging and developing economies is expected to recover faster.

The Committee also noted the continuing rebound in commodity prices, particularly crude oil prices, which is helping to support growth in commodity producing regions. However, the inflation risk of the rebound in energy prices appears to be mitigated by the subsisting low levels of capacity utilization, weak private demand and well-anchored inflation expectations.

The MPC also observed that although financial markets have recovered remarkably faster than expected, financing conditions, especially for businesses and firms, are likely to remain difficult in the near-term as financial institutions continue to maintain a cautious approach to credit extension. Bank lending is likely to remain sluggish given the need to rebuild capital, maintain liquidity and the possibility of further credit write-downs, mostly related to non-performing exposures to commercial real estates and stock markets. The Committee further noted that although the bond markets have rebounded, the households, small and medium-size enterprises that have only limited access to capital markets, are likely worldwide to continue to face credit constraints, except where public lending programmes and government guarantees are in place. As investors increasingly differentiate across countries with the resumption in capital flows, the risk of sovereign debt default has been heightened in some countries with large government deficits and debts.

On the domestic scene, the MPC underscored the need for co-operation in fast-tracking on-going reform efforts in the banking sector to ensure the flow of credit to the real sector of the economy, aimed at supporting growth in the medium term. It also underlined the need for energizing reforms in critical

sectors of the economy such as power and other economic infrastructure, to attract the much-needed private sector/foreign investment and, thereby promote employment-generating growth.

Key Domestic Macroeconomic and Financial Developments

Output and Prices: Provisional data from the National Bureau of Statistics (NBS) indicates that real Gross Domestic Product (GDP) will grow by 6.68 percent in the first quarter of 2010, down from 8.23 per cent in the fourth quarter of 2009, but up from the 4.50 per cent recorded in the first quarter of 2009. Overall GDP growth for 2010 was projected at 7.53 per cent which is higher than the 6.90 per cent recorded in 2009. The non-oil sector, especially, agriculture, wholesale and retail trade, and services would remain the major driver of growth although this is likely to be complemented by a modest increase in the growth of the oil sector GDP following the sustained peace in the Niger Delta region. While noting the optimistic growth projections for the year, the Committee observed that the robust growth projections was predicated on the assumption that the reforms that have been initiated in certain key sectors of the economy would be carried through. It, therefore, urged strong commitment and political will on the part of the authorities to see these reforms through.

The headline inflation rate, as measured by the year-on-year increase in the all item consumer price index, was 12.3 per cent in January 2010, up from 12.0 per cent in December 2009, but lower than the 12.4 per cent recorded in November 2009 and the 14.0 per cent recorded in January 2009. Food inflation, which hovered between 13.5 and 13.6 per cent in the fourth quarter of 2009, rose to 14.0 per cent in the January 2010. Inflation outlook for

2010 remains uncertain, due to a combination of both domestic and international economic developments, namely, the planned full deregulation of petroleum product prices, the expansionary fiscal outlay for 2010, and the rising international commodity prices. The Committee, however, noted that against the backdrop of weak aggregate demand as mirrored in the contraction in monetary aggregates since the beginning of 2009, the inflation risk to growth appears mitigated. The Committee will continue to monitor price developments in the months ahead with a view to creating an enabling environment for sustainable growth and employment.

Monetary, Credit and Financial Market Developments: Over the preceding December level, broad money (M2) declined by 3.11 per cent in January 2010, which was significantly below the indicative benchmark of 29.26 per cent growth for 2010. Similarly, the annualized decline in aggregate domestic credit (net) as at January 2010 was 22.44 per cent, compared with the provisional benchmark growth rate of 82.8 per cent for 2010. As in most periods of 2009, reserve money continued to be below the indicative benchmark for the first quarter of 2010 in the first two months of 2010. The annualized growth rate of private sector credit was -16.20 per cent, significantly below the provisional benchmark of 31.54 per cent, indicating that the private sector particularly, small and medium enterprises, were being starved of the much-needed credit. Banks lost about 66 per cent of their capital between December 2008 and December 2009 which has constrained the ability of the banks to grow credit. This underscores the need for Asset Management Corporation (AMC) to deal with non-performing loans and fast-track recapitalization of the institutions to enable them continue to grow their loan books. The trends in money supply

reflected a fall in all its components, including net foreign assets, credit to the private sector and credit to government. This development is a reflection of the slack in aggregate demand, underlining the need for the sustenance of the easing of monetary policy.

Notwithstanding the sub-optimal performance of monetary aggregates thus far, confidence in the money market has continued to improve following the inter-bank money market guarantee and other measures to strengthen the banking sector. This is reflected in the downward movement of the daily interbank call rates. Specifically, the average call rate for January 2010 was 2.31 per cent, down from 2.89 per cent at end-December 2009 and 5.25 per cent in November. The secured open buy-back (OBB) rate for January 2010 was 2.30 per cent down from 2.64 per cent at end-December 2009 and 4.53 per cent in November. As at February 25, 2010, the interbank call and OBB rates were 2.21 and 2.07 per cent, respectively. Thus, the rates appear to be converging, reflecting a restoration of confidence in the money market and favorable liquidity position in the banking system. However, this liquidity position of banks against the backdrop of declining private sector credit implies that the banks are reluctant to lend to the real economy. Thus, the focus of policy measures would be to ensure the flow of credit to the real economy by supporting targeted lending programmes.

In this regard, the Committee maintained its earlier position that despite falling interbank rates and growing banking system liquidity, the retail lending rates of deposit money banks (DMBs) were still very high. This is despite the marginal decline in the average maximum lending rate to 23.18 per cent in January 2010 from 23.45 and 23.1 per cent in December and

November, 2009, respectively. The average prime lending rate also fell to 18.38 per cent in January 2010 from 19.03 and 18.93 per cent in December and November 2009, respectively. The Committee reaffirmed that the reduction of structural and institutional impediments, DMBs risk perception of borrowers, as well as use of shared infrastructure by banks and the development of alternative funding sources for firms, could moderate the high lending rates. The Committee welcomed the efforts made thus far, on these issues, particularly the request to accord liquidity status to State Government bonds, the proposal for tax waivers on fixed income securities, the proposed national credit guarantee scheme for small and medium-scale enterprises, and on-lending programmes through the Development Finance Institutions (DFIs), such as the Bank of Industry. It urged their intensification for eventual actualization.

The Nigerian capital market is showing some signs of recovery compared to the last quarter of 2009. The All-Share Index (ASI), which was 20,827.17 at end-December 2009, rose by 10.36 per cent to 22,985.00 on 25th February, 2010. Market Capitalization (MC) also rose by 11.4 per cent, from N4.98 trillion at end-December 2009 to N5.54 trillion on 25th February, 2010. The NSE has attributed the improved performance of the stock market to share price increases in the Banking, Food and Beverages, and Oil and Gas sectors. However, the major stock markets around the world showed deteriorating performance over the period, following calls for increased regulation in the US and Europe, deteriorating government finances in Europe and poor unemployment reports in some advanced economies.

External Sector Developments: The foreign exchange market remained relatively stable in the first two months of 2010. In January 2010, the WDAS average exchange rate stood at ₦149.78 per US dollar, the same rate recorded in December 2009. As at 24th February 2010, the WDAS exchange rate had depreciated to N150.10. The inter-bank market rate averaged ₦150.33/US\$ in January, 2010. Thus, the spread between the WDAS and inter-bank market rates remains insignificant. The convergence reflected the continued confidence and clarity in expectation, engendered by the exchange rate stability. Policy will continue to focus on avoiding volatility in exchange rates and strengthening confidence in the market.

External reserves stood at US\$41.54 billion on 24th February 2010, down by US\$0.51 billion or 1.21 per cent from the level of US\$42.05 billion recorded in the preceding month. Overall, the net outflow of foreign exchange which moderated significantly from US\$931.93 million to US\$138.37 million in the third and fourth quarters of 2009 turned to a net inflow of US\$0.10 billion in January 2010. The Committee was satisfied with this development, noting that the level of reserves remained robust and buoyant enough to support the country's external transactions in the near-term. It, however, believed that if the rising price of crude oil in the international market in recent months is sustained, coupled with improvement in output with peace in the Niger Delta, there is likely to be an improvement in the level of foreign exchange reserves.

The Committee's Considerations

The Committee noted the potential for inflationary pressure in the near-to-medium term, but observed that recent experience shows that inflation has

been driven largely by structural factors particularly the bottleneck experienced in the supply of petroleum products in the wake of the announcement of the full deregulation of the downstream petroleum industry. It noted that growth in both monetary and credit aggregates has remained weak since the beginning of 2009, and therefore any attempt at this time to tighten monetary policy will exacerbate the problem and further constrain credit availability to the real economy.

The MPC further stressed the need to unlock the credit market. Members also observed that there is sufficient liquidity in the money market as suggested by the low interbank interest rates, but that the perception of credit risk on the part of the DMBs remained a major constraint to their ability to lend to the real sector of the economy. In this regard, the Committee felt that a broader macroeconomic policy framework will be needed to unlock the credit market.

In this context, the MPC recognised the need to encourage the DMBs to channel the excess funds deposited with the CBN under the standing deposit facility to the real sector. It therefore considered the review of the setting of the standing facility corridor as imperative, to encourage banks to lend to the productive sectors of the economy.

As part of the efforts to bring lending rates down, provide alternative sources of long-term funds to finance development projects and deepen the capital market in line with the CBN's developmental mandate, the MPC, deliberated on the possibility of granting liquidity status to bonds issued by

state governments that meet certain eligibility criteria, including the Investment and Securities Act 2007 (ISA) and DMO requirements.

Decisions

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

1. MPR remains unchanged at 6.0 per cent;
2. Standing Lending Facility interest rate remains unchanged at 8.00 per cent, while the Standing Deposit Facility rate is lowered from 2.0 per cent to 1.0 per cent;
3. Granted liquidity status to bonds issued by state governments, subject to their meeting the specified eligibility criteria. Detailed guidelines will be issued in due course, principally related to meeting strict standards of fiscal responsibility; and
4. To continue with the quantitative easing policy by providing N500 billion facility for investment in debentures issued by the Bank of Industry (BOI) in accordance with Section 31 of the CBN Act 2007, for investment in emergency power projects dedicated to industrial clusters. The funds are to be channeled through the Bank of Industry for on-lending to the DMBs at a maximum interest rate of 1.0 per cent for disbursement of loans with a tenor of 10 – 15 years at concessionary interest rate of not more than 7.0 per cent. The Committee also approved in principle the extension of this facility to DMBs for the purpose of refinancing/ restructuring existing portfolios to manufacturers. However, the final approval for this will come after the consideration of the report of a technical committee to be set up to work out the modalities, for implementation within one month.

Membership of the committee comprises the CBN, the Bankers' Committee Sub-committee on Economic Development, Bank of Industry, Manufacturers Association of Nigeria (MAN), and National Association of Small and Medium Enterprises (NASME). The African Finance Corporation (AFC) will serve as technical adviser on the power project. In the case of the power projects, the following projects of the Federal Government will be covered under this facility subject to their being restructured into commercially viable projects on which banks are willing to take credit risks: Lagos (500 MW); Kano (250 MW); Onitsha/Nnewi (200 MW); Port Harcourt/Aba (200MW); Kaduna (225 MW); Funtua/Gusua/MFashi/Zaria (200 MW); Lokoja (200MW); and Maiduguri/Gombe/Bauchi (200 MW).

Other power projects currently being financed by banks may also be refinanced from the fund. However, banks will be required to secure the funds drawn with eligible securities. In addition, real sector projects certified bankable that emanate from the State Governors' engagement with the Bankers' Committee in line with the outcome of the Enugu Retreat will be accommodated under the facility.

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March 2, 2010