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

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

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

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

On the domestic scene, the Committee noted that inflationary pressures which were traceable to the high expenditure levels associated with the April 2011 general elections as well as the effects of rising international energy, commodity and food prices had moderated by June 2011. This development was due in part to the tight monetary policy stance of the Bank since September of 2010. However, the Committee observed that the inflation outlook appears uncertain owing to the expected implementation of the new national minimum wage policy and the imminent deregulation of petroleum prices. Significant injection of liquidity from FAAC in the third quarter coupled with the impact of AMCON recapitalizing intervened banks to the tune of N1.6 trillion will both add to inflationary pressures. The Committee welcomed the favorable growth projections but cautioned that the current security challenges, infrastructural bottlenecks and the uncertainty in the international economy as well as fiscal developments could undermine investors' confidence and output growth in the near term.

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

Key Domestic Macroeconomic and Financial Developments

Domestic Output:

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

Domestic Prices:

Inflationary pressures remained elevated during the first quarter of 2011 but moderated towards the end of the second quarter. The year-on-year headline inflation rate, declined from 12.8 per cent in March and 12.4 per cent in May 2011 to 10.2 per cent in June 2011. The downward movement in inflation in June 2011 was due to the moderation in both food and core inflation. Food inflation fell for the first time since February 2008 to below 10 per cent. It declined from 13.6 per cent in March and 12.2 per cent in May to 9.2 per cent in June 2011. Core inflation decreased from 12.8 per cent in March and 13.0 per cent in May to 11.5 per cent in June 2011. Staff projections indicate that both headline and food inflation would continue to moderate in the second half of the year. However, core inflation is projected to increase during the same period driven mainly by cost of energy, power and imports.

Monetary, Credit and Financial Market Developments:

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

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

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

External Sector Developments

At the wDAS, the exchange rate closed at N151.61 (including the 1% commission) on 22nd July, 2011, representing an appreciation of 2.14 per cent over the N154.91/US$ on 23rd May, 2011. The Inter-bank selling rate opened at N156.67/US$ on 23rd May, 2011 and closed at N152.33 on 22nd July, 2011, representing an appreciation of 2.77 per cent. At the BDC segment of the market, the exchange rate closed at N166.00/US$ on 22nd July, 2011, representing a depreciation of 4.40 per cent over the opening rate of N159.00/US$ on 23rd May, 2011. In the light of this, the Committee noted that the premium between the rates at the wDAS and the interbank rate narrowed towards the end of the review period, while that between the wDAS and the BDCs widened which is not unconnected with the measures taken to limit sales to BDCs. However, while strengthening of currency is an important factor in mitigating inflationary pressures, the spread may lead to arbitrage by players and fuel unhealthy speculation.

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

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

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

Committee's Considerations

The Committee recognized the decline in inflation rate and the slow down in GDP growth rate as well as credit to private sector which would ordinarily advice maintaining rates at current levels. However, the consensus of the Committee is that the outlook is uncertain due to dark clouds on the International horizon and the rising spectra of a structural fiscal deficit. In view of the need to proactively address the impact of huge injections of liquidity in the third quarter to correct the negative real interest rate situation in the market and attract foreign capital inflows to build up reserves to protect the economy against possible external shocks, the Committee decided as follows:

Decisions:

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

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Governor

Central Bank of Nigeria

July 26, 2011