CHAPTER 1

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...during the second half of 2010, the threat of inflation shifted the stance of policy…

The primary focus of monetary policy in the second half of 2010 was to maintain price stability and provide adequate liquidity in the banking system. Thus, while the stability of the banking system was paramount during the second half of 2009 and the first half of 2010, this emphasis was moderated when rising inflationary pressures threatened price stability in the second half of 2010. To complement the Federal Government's efforts at stimulating economic growth, the CBN provided support to agriculture, small scale industries, power, aviation and the development of other critical infrastructure.

The Bank continued to use the Monetary Policy Rate (MPR) to anchor short term interest rates. The major instrument of monetary policy was open market operations (OMO) in Treasury Bills complemented by discount window operations (including CBN standing facilities, repo and reverse repo transactions) and cash reserve requirement (CRR). Primary market transactions in government securities, sales/purchases of CBN bills, and foreign exchange were also used to manage liquidity in the system.

MPC held 3 regular statutory meetings in the second half of 2010

In the second half of 2010, the Monetary Policy Committee (MPC) held 3 regular meetings, an interactive retreat and a Monetary Policy Workshop. The MPR which was maintained at 6.00 per cent since the beginning of the year was adjusted to 6.25 per cent in September and remained at that level for the rest of the year. Also, the asymmetric interest rate corridor of standing facilities which was introduced in the first half of the year was maintained at 200 basis points above the MPR for the lending facility and 500 basis points below the MPR for the deposit facility, in July. The corridor was adjusted in September 2010 to 200 basis points above the MPR for lending and 300 basis points below the MPR for the deposit facility.

The major challenge of monetary policy was the persistently low growth of credit to the private sector in the face of rising credit to government. Sustained shortage of banking system liquidity from the first half of 2010 resulted to increase in short

..major challenge to monetary policy was the persistently low level of domestic banking sector credit...

term interest rates. This discouraged interbank placements by DMBs and lending/credit to private sector, prompting the monetary authorities to de-risk the market by guaranteeing placements in the interbank market. Consequently, short term interest rates fell remarkably to historically low levels in the second half of 2010. In response to anticipated inflationary pressures towards the end of the year, the regime of monetary easing was gradually reversed by the Bank in September. In the end, headline inflation fluctuated to 11.8 per cent at end-December 2010 from the 13.9 per cent recorded a year earlier. The combined effect of the monetary and fiscal stimulus packages, reform of the banking system and favourable weather conditions for agricultural output contributed to a robust real GDP growth of 7.85 per cent at the end of the second half of 2010, up from 7.69 per cent in the first half.

Short term interest rates fell continually as the credit crunch became sustained..

The economic environment in the second half of 2010 presented significant challenges to the attainment of domestic price stability objective and recovery of the banking system. The stance of fiscal policy during the period was largely expansionary. The continued divestment of portfolio investment by foreign investors in the first half negatively impacted on the capital market. Although the global economy showed signs of recovery, the demand pressure in the foreign exchange market which was building up in the first half intensified in the review period leading to substantial drawdown of the stock of external reserves. While the exchange rate depreciated early in the year, it stabilized at around ₦150.56/US$ at the end of the year. The stock of external reserves fell from US$37.40 billion at end-June 2010 to US$32.34 billion at end-December, 2010.

..stance of fiscal policy was largely supportive of monetary expansion.

The task of addressing the problem of illiquidity in some DMBs, which continued throughout the first half of 2010, was sustained in the second half. To clean up the DMBs balance sheets, AMCON which was established in the third quarter of 2010, acquired non-performing loans from 21 DMBs valued at ₦2.165 trillion in the last quarter of the year. In exchange, it issued 3-year zero coupon bonds valued at ₦1.036 trillion. In addition, a ₦500 billion infrastructure development fund (manufacturing, power and aviation), introduced by the CBN

AMCON was created to buy up the bad debts and non-performing loans of the DMBs in the first half of 2010, also commenced operations in the second half of the year.

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The overall economic outlook suggested that the current global recovery from the abating financial and economic crises would stimulate aggregate demand in the domestic economy and sustain output growth in 2011. While domestic economic activity is expected to be bolstered by global recovery, the debt crisis in the Euro Area poses serious challenges to economic growth with the possibility of austerity measures in the affected Euro Area countries, including: Greece, Spain, Italy and Portugal. The outlook suggests that the stance of monetary policy in 2011 would largely be non-accommodating, to forestall the risk of inflation.