MINUTES OF THE 216TH MEETING OF THE MONETARY POLICY COMMITTEE (MPC) HELD ON TUESDAY 21ST SEPTEMBER, 2010 IN THE MPC MEETING ROOM, 11TH FLOOR, CBN, ABUJA

ATTENDANCE

1. Sanusi L. Sanusi - Governor, (Chairman)
2. Sarah O. Alade - Deputy Governor, (Econ. Policy)
3. Kingsley Moghalu - Deputy Governor, (Financial System Stability)
4. Sam O. Olofin - Board Director
5. Danladi Kifasi - Board Member, Perm. Sect, Fed. Min. Fin.
6. Adedoyin R. Salami - Member, MPC
7. Abdul-Ganiyu Garba - Member, MPC
8. John Oshilaja - Member, MPC
9. Okorie A. Uchendu - Director, MPD, Secretary
10. Uwatt B. Uwatt - Dep. Director, Deputy Secretary

OBSERVERS

11. Vincent Akinyosoye - Statistician Gen., Nat. B. of Statistics
12. Joe Alegeiuno - Director, Development Finance
13. Charles N. O. Mordi - Director, Research
14. O. F. Owolabi - Ag. Director, Financial Markets
15. Chris Chukwu - Ag. Director, Fin. Policy & Regulation
16. Lamido A. Yuguda - Ag. Director, Reserve Management
17. Folakemi Fatogbe - Ag. Director, Risk Management
18. Nathaniel T. Igba - Dep. Director, Trade & Exchange
19. Ahmad Abubakar - Dep. Director, Banking Supervision
20. Ibrahim Adamu - Dep. Director, Statistics

ABSENT WITH APOLOGIES

1. Tunde Lemo - Deputy Governor, (Operations)
2. Suleiman Barau - Deputy Governor, (Corporate Services)
3. Shehu Yahaya - Member, MPC
4. Chibuike U. Uche - Member, MPC

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<u>Opening</u>

1.) The meeting commenced at 10.07 a. m. with a general prayer at the instance of the Chairman.

<u>Minutes of the Previous Meeting</u>

2.) With no observations for corrections, the minutes of the 215th meeting, held on Monday 5th July, 2010, were adopted with motions by Sam O. Olofin and Adedoyin Salami. The Committee, therefore, commended the Secretariat for the error-free Minutes.

<u>Matters Arising from the Minutes of the Last Meeting</u>

3. None was raised.

4.) Presentations by the Departments:

<u>Real Sector, Monetary Developments, Financial Markets, Global Developments and Outlook</u>

The highlights of the Economic Report were:

i) Projections by the National Bureau of Statistics indicated that real Gross Domestic Product (GDP) would grow by 7.72 per cent in the third quarter of 2010 compared with 7.69 per cent and 7.23 per cent in the second and first quarters of 2010, respectively. GDP was projected to grow by 8.19 per cent in the fourth quarter of the year which would be driven by the agriculture, wholesale/retail trade and services sectors with relative contributions of 3.09, 2.38 and 2.38 per cent, respectively. The oil sector was projected to positively contribute 0.62 percentage point in the third quarter and 0.63 percentage point in the fourth quarter of 2010 as against the contributions of 0.12 and 0.14 per cent in the third and fourth quarters of 2009.

ii) The year-on-year headline inflation increased marginally to 13.7 per cent in August 2010 from 13.0 per cent in July 2010, compared with 14.1 per cent in June and 12.9 per cent in May 2010. The higher inflation rate was attributed to the enlarged and rebased index of consumer prices.

According to the National Bureau of Statistics (NBS), the change in base year, from May 2003 = 100 to November 2009 = 100, arose from the need to adjust the composite weights of the major commodity groups. The new basket contained new products which reflected the growing importance of expenditure on non-food items such as clothing and footwear, furnishings, household equipment and household maintenance, health, transport, communications, and education, while a few obsolete items in the basket were removed.

Similarly, the core measure of inflation rose to 12.4 per cent in August 2010 from 11.3 per cent in July 2010, compared with

12.7 per cent in June 2010. Food inflation also increased to 15.1 per cent in August 2010 from 14.0 per cent in July 2010.

The implications of the rebasing of the CPI for monetary policy were that the inflation rate based on the old index might have been under-estimated, while the declining weight of food in favour of non-food items indicated changes in the structure of prices in the economy in favour of non-food necessities for modern living, thus reducing the influence of volatile components in the CPI.

According to the report, while inflation trended upward during the review month, anticipated injection by the AMCON, expected fiscal injection from 2011 election expenses, payment of salary arrears to Federal civil servants, increased expenditure during the end of year festivities and the implementation of the CBN quantitative easing policy measures could constitute sources of further inflationary pressures.

iii) As at September 17, 2010, the inter-bank call and OBB rates rose to averages of 3.56 and 2.91 per cent, respectively, above their levels of 1.26 and 1.25 per cent in August 2010. The average maximum lending rate rose to 22.31 per cent in August 2010 from 22.27 per cent in July 2010. However, the average prime lending rate consistently fell to 16.89 per cent in August 2010, from 17.40 and 17.65 per cent in July and June, 2010, respectively.

The weighted average savings rate declined consistently to 1.41 per cent in August 2010 from 1.62 and 1.95 per cent in July and June 2010, respectively. The consolidated deposit rate also declined to 2.27 per cent from 2.40 per cent in July 2010.

Thus, the spread between the average maximum lending rate and the consolidated deposit rate widened marginally to 20.04 per cent in August 2010 from 19.87 per cent in July 2010.

iv) The average foreign exchange demand and sales per auction in August 2010 stood at $309.90 million and $216.50 million, representing a sales-demand ratio of 69.86 per cent as against the average demand and sales of $224.58 million and $201.56 million in July 2010, or sales-demand ratio of 89.79 per cent.

On September 17, 2010, the wDAS exchange rate closed at an average of N150.96/US$1 as against an average of N150.78/US$ in August 2010, indicating a depreciation of N0.18 or 0.11 per cent. In the BDC segment of the foreign exchange market, the average selling rates of N153.50/US$ and N152.23/US$ were recorded on September 17, 2010 and

August 2010, respectively, representing a depreciation of 0.83 per cent. Similarly, in the inter-bank market, the average selling rates on September 17, 2010 and August 2010 were N152.05/US$ and N151.55/US$, respectively, indicating a depreciation of 0.33 per cent.

The country's gross external reserves stood at US$36.93 billion on 16th September, 2010, indicating a decline of US$0.21 billion or 0.61 per cent when compared with US$37.16 billion at the end of July 2010. The reserve level fell by US$6.41 billion or 14.97 per cent when compared with US$43.34 billion as at end-September 2009. The available reserves level as at end-September could cover 18 months of import at the current level of utilisation.

Total foreign exchange inflows in July 2010 was US$2.25 billion, representing an increase of US$0.19 billion or 9.22 per cent over the US$2.06 billion recorded in June 2010. Of this inflow, crude oil/gas revenue was US$2.16 billion or 93.97 per cent while the other sources of inflow contributed US$0.09 billion or 6.03 per cent. Total outflows for the same period amounted to US$4.03 billion, indicating an increase of US$0.15 billion or 3.78 per cent over the US$3.88 billion recorded in the preceding month. Thus, there was a net outflow of US$1.78 billion during the review period. Inflows from autonomous sources like oil companies, international institutions and home remittances in July and August 2010 amounted to US$5.3 billion and US$4.7 billion, respectively. Autonomous inflows from January to August 2010 totalled US$37.8 billion. These inflows helped to augment foreign exchange inflows from official sources and stabilized the exchange rate.

v) The retained revenue of the Federal Government in August 2010 was N175.00 billion compared with an expenditure of N390.79 billion during the month under review, resulting in a deficit of N215.79 billion as against the proportionate budget deficit of N222.15 billion for the month. The cumulative retained revenue of the Federal Government from January to August 2010 stood at N1,574.54 billion, which was lower than the proportionate budget revenue of N1,662.55 billion for the period by N88.01 billion or 5.29 per cent. The cumulative expenditure of the Federal Government for the same period was estimated at N2,411.97 billion and was lower than the proportionate budget expenditure of N3,439.76 billion by N1,027.79 billion or 29.88 per cent. The estimated deficit resulting from the projected expenditure for the period was

N837.43 billion.

The report also showed that the total borrowing requirements of the Federal Government was N600 billion and that the Debt Management Office (DMO) would raise the sum of N150 billion every month beginning from September 2010 to the end of the year.

The Committee was informed that three State Governments had accessed the capital market to raise funds through the issuance of bonds. These were Lagos State (N57.50 billion), Bayelsa State (N50.0 billion), and Kaduna State (N8.50 billion). Ebonyi State was processing its application to raise N16.50 billion before the end of the year.

vi) The broad measure of money supply (M2) increased by 7.0 per cent in August 2010, which when annualised, represented a rise of 10.50 per cent compared with the indicative benchmark of 29.26 per cent for 2010. The increase in the growth of M2 mainly reflected the substantial growth in credit to the Government. Aggregate credit to the economy grew by 18.0 per cent, which annualised to 27.0 per cent compared with the target credit growth of 55.54 per cent for 2010. Credit to the private sector fell by 0.91 per cent in August 2010 or 1.37 per cent on annualised basis as against the benchmark of

31.54 per cent for 2010. Credit to the core private sector declined by 0.78 per cent in August 2010 which annualized to 1.17 per cent. Credit to the government grew substantially by 65.81 per cent in August 2010 or 98.72 per cent on annualised basis compared with 51.36 per cent indicative target for 2010. The decline in reserve money (RM) observed since 2009 continued into the third quarter of 2010 and remained below the indicative benchmark. Reserve money, which stood at N1,691.29 billion as at end-August 2010, fell by 16.78 per cent to N1,407.51 billion on September 13, 2010 and was below the indicative benchmark of N2,006.02 billion for the third quarter of 2010 by N598.51 billion or 29.83 per cent. The decline in RM was attributed to the sharp drop in DMB's deposits with the CBN which fell to N257.70 billion on September 13, 2010 from N596.79 billion as at end-August 2010, while currency in circulation increased to N1,149.81 billion on September 13, 2010 from N1,094.5 billion as at end-August 2010.

There was no request for the Standing Lending Facility (SLF) in August and up to September 17, 2010. The Standing Deposit Facility (SDF) fell to N131.40 billion on September 17, 2010 from a monthly average of N294.57 billion in August 2010.

vii) The decline in key Nigerian capital market indicators continued. The All Share Index (ASI) fell by 9.4 per cent to 22,993.77 on 17th September 2010 from 25,384.14 at end-June 2010. Similarly, market capitalisation decreased by 8.7 per cent to N5.63 trillion on 17th September, 2010 from N6.17 trillion at end-June 2010. The number of deals, volume and value of shares traded fell by 4.6, 14.8 and 6.1 per cent, respectively. The decrease in ASI and MC was partly attributed to share price decreases in the banking, food/beverage, insurance and oil and gas sectors.

viii) **Developments in the Global Economy**:

The performance of the global economy was mixed:

- There was a mild threat of inflation observed in most of the countries surveyed;
- Stock prices fell in most countries;
- Exchange rate developments were mixed across countries.
- All the countries surveyed maintained their policy rates except Chile and South Africa which increased their policy rates.
- Selected indicators for the US economy suggested a slow down in economic activities.

- There was risk of economic downturn in Sub-Saharan Africa due to the European fiscal retrenchment.
- The global commodities market was affected by several natural disasters such as flooding in China and Pakistan as well as wild firestorms in Russia. Consequently, commodity prices, especially food grains, trended upwards with the risk of inflation pass-through from major food exporters to consuming countries including Nigeria.

ix) <u>Outlook for the Future</u>

- Money market rates and other interest rates were expected to remain low in the light of the existing guarantee of inter-bank fund transactions and anticipated liquidity injection.
- There was heightened inflation risk thus making it difficult to realise the single digit inflation target for the year.
- The growth in M2 would likely improve in the fourth quarter following the implementation of the CBN quantitative easing measures such as utilisation of the N250 billion and N50 billion by the Power and Aviation sectors, respectively; refinancing/restructuring of DMB's exposures to manufacturers worth N200 billion, expected

huge electioneering expenses, payment of FGN workers' salary arrears; increased end of year festivities expenditures as well as the commencement of AMCON operations.

- Reserve money (RM) would continue to be below the indicative benchmark in the near term.
- With increased oil production following relative peace in the Niger Delta region and higher oil prices expected to rise up to $84 a barrel and efficient tax collection, Federally-collected revenue would improve.
- The naira exchange rate would remain stable in the near term following the 2009 liberalization of the market, while foreign exchange from autonomous sources would continue to increase.
- The capital market was expected to resume its upward trend in the near term following on-going reforms in the market.

<u>Pressure Points and Policy Challenges</u>

x) The pressure points identified in the report were:

  - The continued under-performance of monetary aggregates
  - Heightened inflation threat resulting from anticipated

liquidity injections

- High demand for FGN Bonds and possible market bubble.

The challenges for monetary and credit policy in the near term were identified as:

- provision of adequate incentives for banks to lend surplus funds to the real sector
- sustaining exchange rate stability
- avoiding the incidence of FGN Bond market bubble
- Moderating inflationary expectations; and
- Minimising the crowding out effect of increased issuance of bonds by both the Federal and States Governments.

xi.) **Update on the Implementation of Previous MPC Decisions before the September 21, 2010 Meeting**:

The updates were as follows:

a) Of the N500 billion approved for power and aviation sectors as well as for the refinancing/restructuring of manufacturer's portfolios with the DMBs, about N199 billion had been paid to the Bank of Industry (BOI) for disbursement towards the refinancing/restructuring of manufacturers' exposures to the DMBs.

b) The nominees for the Board of the AMCON were awaiting Senate confirmation.

c) Of the other liquidity injections approved by the CBN, N80.701 billion had already been disbursed under the Commercial Agricultural Credit Scheme (CACS), while N368.84 million had been paid by the Bank as its 6.0 per cent interest rebate obligation on 35 large scale agricultural projects under the Agricultural Credit Support Scheme.

Discussion of the Report

5.) A member observed that the gap between the deposit and lending rates were still wide and asked whether there was a model for determining interest rates in Nigeria. The Chairman noted that the banks had failed to submit their risk-based interest rate pricing model arising from the non-implementation of the decision taken at the April meeting of the MPC. The Deputy Governor, Financial System Stability, informed the meeting that the decision had been implemented but that more pressure needed to be exerted on the banks for full compliance with the directive. Currently, there appeared to be no link between the MPR and interest rates.

Another member requested to know what accounted for the slow pace in the disbursement of SME intervention funds. The Committee was informed that the disbursement had been done and that the Bank had been commended by Mr. President

	who noted that the intervention had saved jobs in the beneficiary companies. On the power intervention fund, members were informed that the fund was tied to having the right power policy and that the Bank would provide guarantees for PENCOM to release about N400 billion for the power sector. Funding the power sector from PENCOM funds would reduce the burden of high interest rates as well as remove the foreign exchange risks arising from funding such projects through foreign loans. Another member expressed concern about the increasing exposure of the CBN balance sheet to risk through the quantitative easing policy and noted that measures should be taken to mitigate such risks. According to him, there was pressure on interest rates. Increased Government funding of its expenditure through bonds had the potential for crowding out the private sector while there was the prospects of a bubble in FGN bonds. In view of all these, there was need for the Bank to express its concern in a way that would send out appropriate signals to the market. In response to a question that the time had come to de-emphasise financial system stability and focus on the inflation threat, the Chairman pointed out that there was no time at	

which the MPC neglected the control of inflation, but that the inflation risk had not been very high. On credit risk, he emphasised that the dimension of the risk was what mattered. On the concern about inflation, it was noted that interest rates might not rise with an increase in the MPR.

Policy Proposals for Monetary Policy Actions

6.) On the basis of the reports and discussions, the following proposals for monetary policy actions were presented to the Committee:

Scenario 1:

Retention of the MPR at 6.0 per cent: The arguments in favour of this proposal were that maintaining the existing monetary policy stance would sustain market expectations with respect to inflation, interest and exchange rates. This would allow uninterrupted implementation of approved policies and the achievement of their objectives.

On the other hand, allowing the existing policy rate to remain would signal insensitivity to the inflation threat arising from the various liquidity injections anticipated towards the end of the year.

Scenario 2:

Raise the MPR by 50 basis points:

The policy decision based on this proposal would signal monetary policy tightening in response to the prospects of heightened inflationary pressures arising from anticipated liquidity injections in the near term. This proposal also took cognizance of the moderating impact of the Debt Management Office and State Governments sourcing of funds from the financial market. The argument against this policy action was its potential of raising MPR-tied lending interest rates.

Scenario 3:

Retain the MPR at 6.0 per cent but raise the cash reserve ratio and liquidity ratio by 100 and 500 basis points, respectively.

This policy decision would signal monetary policy tightening while interest rates that were linked to MPR might not rise. The argument against this proposal was that there would be an upward pressure on some components of cost of funds.

The Committee was invited to consider the proposals as presented.

7) <u>Discussion of the Proposals for Monetary Policy Actions</u>

In considering the proposals for monetary policy decisions, the Chairman invited comments from the members on the components of the Consumer Price Index (CPI) that the

Committee could reasonably focus attention on. This question arose as a result of the rebasing of the CPI by the National Bureau of Statistics which had effectively showed the declining proportion of food in the index. A member raised concerns about the proposal to increase the MPR. According to him, an increase in the MPR would cause interest rates to rise, and asked what the impact would be on the naira exchange rate. He enquired whether the Bank was ready to sacrifice the foreign exchange reserves in defending the exchange rate. Responding, the Chairman informed the members that with the liquidity injections expected towards the end of the year from the Federal Government's expenditure, the AMCON purchase of non-performing loans and election expenses, the Bank could mop up liquidity through the use of open market operations. This monetary policy action would reduce liquidity and reduce pressure on the exchange rate, he noted, adding that raising the MPR would also increase the cost of borrowing by the Government.

Voting and Decisions of the Meeting

8) After deliberations, the Committee unanimously voted to:

i) raise the Monetary Policy Rate (MPR) from 6 per cent to 6.25 per cent.

ii) adjust the asymmetric corridor of interest rates at MPR+200 basis points and MPR-300 basis points for the Standing Lending Facility and Standing Deposit Facility, respectively.

iii) resume the sale of Treasury Bills through the open market operations (OMO).

Any Other Business

9) The Deputy Governor (Economic Policy) sought the permission of the Chairman for the dates of the meetings to be shifted from the first to the third week of the month so that departments providing inputs for the report could have enough time to get reliable and up-to-date data. Responding, the Chairman directed that meetings should continue to hold in the first week of the month until the end of the year when the calendar for the 2011 meetings would be announced.

The Deputy Governor (Economic Policy) also requested the Chairman's approval to move the MPC meeting to the new meeting room in order to have enough space for participants.

Date of Next Meeting

10.) The next meeting was scheduled to hold in the third week of November 2010.

Closing

11.) The meeting ended at 1.12 p.m. with a general prayer directed by the Chairman.

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CHAIRMAN   SECRETARY

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DATE