

CENTRAL BANK OF NIGERIA'S COMMUNIQUE NO. 57 OF THE MONETARY POLICY COMMITTEE, AUGUST 5, 2008

The Monetary Policy Committee (MPC) met today August 5, 2008 and reviewed extensively the major macroeconomic developments in the domestic and global economy during the first seven months of 2008. In addition, it assessed the outlook for the rest of the year. The MPC noted that key domestic macroeconomic outcomes were mixed. The international financial markets deteriorated further while there was a marked slowdown in global economic activities and acceleration in inflation. The US dollar continued to fall against major currencies while the international crude oil prices remained high in the first seven months of 2008. Specifically, on the domestic scene, inflation pressures have mounted and most key interest rates maintained an upward trend. The naira exchange rate, however, remained fairly stable. There has been strong liquidity upsurge mainly due to rise in fiscal expenditures. Overall, the outlook for the rest of the year remains uncertain. These concerns posed serious challenges to the Committee in its consideration of the appropriate monetary policy actions to be taken.

The Committee recognized that the current rate of inflation year-on-year requires urgent attention because of the adverse effects of inflation on the economic well being of the citizens. Aggregate demand has been at very high levels due to large public as well as private expenditures. Domestic liquidity management as a result has posed a major challenge. The MPC, therefore, restated its commitment to price stability through the pursuit of appropriate monetary policy to rein in the emerging inflationary pressures.

KEY MACROECONOMIC DEVELOPMENTS

Inflation

The Committee noted the sharp rise in the year-on-year inflation rate of 12.0 per cent compared with 7.8, 8.2 and 9.7 per cent recorded in March, April and May 2008, respectively. The increase in the inflation rate was traceable to the sharp rise in the prices of food and fuel, particularly diesel. Food inflation on a year-on-year basis was 18.1 per cent in June as against 14.7 per cent in May. Although, the outlook for inflation based on current trajectory raised serious policy concerns for the MPC, the Committee noted that moderation in inflation could be expected by the end of the year if the projected good agricultural performance and rice import intervention scheme are sustained, coupled with a credible slowdown of both public and private expenditures.

Output

Aggregate output measured by real gross domestic product (GDP) at 1990 constant basic prices, according to the National Bureau of Statistics (NBS) was estimated to have grown by 6.65 per cent in the second quarter of 2008, compared with the provisional growth rate of 5.54 per cent in the first quarter of 2008 and 5.43 per cent in the second quarter of 2007. The growth in the second quarter of 2008 was largely driven by the non-oil sector, which grew by 8.82 per cent. The NBS projects a favourable outlook for output in 2008 on the assumption of projected strong growth in the non-oil sectors, particularly agriculture and services.

Money and Credit

Provisional data show that broad money (M2) growth over the end-December 2007 level continued to be excessive at 37.7, 34.3, 29.9 and 37.4 per cent in March, April, May and June 2008, respectively. The growth in M2 was driven

largely by the growth in credit to the core private sector, complemented by growth in net foreign assets. The threat of sustained rapid growth in money and credit aggregates for the remainder of the year remains strong against the backdrop of the prospect of further liquidity injections during the third and fourth quarters as governments intensify efforts to fully implement their annual budgets by the end of the year and as preparations are made for the end of year festivities.

External Sector Developments

The MPC noted with satisfaction the continued increase in international reserves. The gross external reserves amounted to US\$60.31 billion as at July 31, 2008 representing an increase of US\$8.98 billion over the level in December 2007. The level of external reserves is likely to remain high in the remainder of the year partly owing to the expectations that oil prices would remain at elevated levels and partly to private capital inflows.

The MPC noted that the exchange rate of the naira has generally been stable. The staff assessment is that there would be continued orderliness in the foreign exchange market in the remaining months of the year.

Interest Rates

The MPC noted the upward movement of most key interest rates in response to the prevailing market conditions. The average inter-bank call rate edged up by about 0.2 percentage point to 10.40 per cent in June, 2008. It rose to 13.95 per cent at end July 2008. Rates on time deposits of various maturities as well as the maximum lending rate also rose.

Fiscal Operations

The Committee noted that the total federally-collected revenue for the first half of 2008 was about 21.71 per cent higher than the proportionate budget estimate for the period. The MPC noted with concern the huge liquidity injection from the fiscal arm which emanated from the sharing of part of the excess crude proceeds and the enhanced regular Federation account allocations. It noted the negative impact these have had on overall liquidity and the threat posed to macroeconomic stability from other disbursements scheduled for the remaining part of 2008. The MPC also noted that moderating the impact of fiscal operations on liquidity through innovative mechanisms involving monetization would be worthwhile for ensuring that macroeconomic stability is maintained.

The Outlook and Policy Considerations

The MPC noted that in the short term, the expected good harvest of agricultural products and the implementation of the rice import intervention scheme by the Federal Government are likely to exert a downward pressure on food prices and, hence, headline inflation. This notwithstanding, current projections indicate that inflation rate may remain in the double-digit zone, if the current trajectory is maintained till the end of the year. The Committee expects that, the sustenance of a restrictive monetary policy stance to counter balance the excessive expansionary fiscal stance, anchored on a more intense liquidity mop-up operations, could deliver a lower headline inflation outcome by the end of the year than current forecasts suggest.

Decisions

The Committee decided as follows:

1. The MPR will remain unchanged at 10.25 per cent since the core inflation is expected to remain at a relatively moderate level.

2. After reviewing developments in the financial market and the misplaced perceptions that the interest rate trends are linked to the requirement of a common year-end, the MPC decided that the common year-end for banks would no longer be a requirement and therefore left to the discretion of the banks to decide.
3. In order to ensure a transparent pricing regime in the money market and thereby foster healthier competition, banks are required to fully disclose to the public their deposit rates as well as their base lending rates and other charges for all the sectors of the economy. These should be published on their respective websites and updated daily. The banks are required to report these rates to the CBN to enable the Bank to publish a summary of the rates for each deposit money bank every month.

Professor Chukwuma C. Soludo, CFR

Governor,

Central Bank of Nigeria, Abuja

August 5, 2008