

**Central Bank of Nigeria Communiqué No. 76 of the Monetary Policy Committee  
Meeting, May 23 - 24, 2011**

The Monetary Policy Committee (MPC) met on 23rd and 24th May, 2011 to assess current domestic and international economic and financial developments as well as the challenges facing the Nigerian economy in the short- to medium-term.

On the international scene, the Committee noted the recovery in some of the major developed economies along with improvements in stock market indices, although unemployment remained high. Inflationary threats, however, still persisted following sharp increases in international oil and commodity prices. In addition, there are serious concerns about debt sustainability in many developed countries, particularly the Euro-zone, requiring strong fiscal adjustment with attendant risk of economic slowdown in the medium-term.

Emerging market economies have become the engine of the global economic recovery, with their output levels above those recorded during the crisis years. It is expected that growth in Asia's exports in 2011, though below the very high rates of 2009 and 2010, will be supported by the slow but gradual recovery in the industrial countries. Sub-Saharan African countries are projected to record moderate growth and to face inflation threats. Weak economic recovery in industrialized countries may also affect exports from the region.

With regard to the domestic economy, the Committee noted the estimated high output growth in Q1 2011, improvement in stock market indicators, modest accretion to external reserves since the beginning of 2011 reflecting in part the high crude oil prices, stable naira exchange rate and rise in interbank rates in response to the tightening of monetary policy stance. Notwithstanding the

recent monetary policy tightening measures implemented since January 2011, the Committee observed that inflation rate remained at the double digit level, indicating the apparent role of structural factors and supply bottlenecks in the elevated inflationary pressures in Nigeria. The Committee, therefore, urged that economic reforms be fast-tracked to ensure that the downside risk of inflation to growth is minimized.

## **Key Domestic Macroeconomic and Financial Developments**

### **Domestic Output**

The Committee noted that the impressive output growth in 2010 was sustained in Q1 2011. Provisional data from the National Bureau of Statistics (NBS) indicated that real gross domestic product (GDP) was projected to grow by 7.43 per cent in the first quarter of 2011, compared with the 7.36 per cent recorded in the corresponding period of 2010. The non-oil sector grew by 8.46 per cent while the oil sector output growth was estimated at 2.90 per cent. Thus, the overall output growth was driven mainly by the non-oil sector with significant contributions from services, wholesale and retail trade, and agriculture. The Committee considers the outlook for 2011 to be generally good, underpinned by the favourable conditions for increased agricultural production, encouraging outcomes of the banking sector reforms and measures to channel credit to the real economy, as well as other initiatives by governments to stimulate the economy.

### **Domestic Prices**

The year-on-year headline inflation rate declined to 11.3 per cent in April 2011 from 12.8 per cent in March 2011. Food inflation also declined to 10.7 per cent in April from 12.2 per cent in March and February 2011. However, core inflation at 12.9 per cent in April was slightly higher than the 12.8 per cent in March 2011. The decline in headline inflation rate was primarily due to the decline in the

prices of some food items and non-alcoholic beverages, imported food items, transportation, and clothing and footwear. Notwithstanding the decline in the inflation rate in April, inflation expectations remain high owing to the subsisting high fiscal spending, the recent increases in public sector wages, the possible removal of subsidy on petroleum products in the near-term, and further liquidity injection due to AMCON activity.

### **Monetary, Credit and Financial Market Developments**

Provisional data showed that the growth in broad money (M2) during the first four months of 2011 was 3.24 per cent, or 9.72 per cent when annualized. Aggregate credit continued to decline largely as a result of reduction in credit to the core private sector, and to state and local governments. Net foreign assets, which posted positive growth in February and March, declined in April 2011. The huge growth in credit to government against the backdrop of continuing decline in private sector credit clearly indicates that government borrowing is crowding-out private sector credit. Besides, in the post-crisis period banks in their bid to rebuild their balance sheets have become increasingly risk-averse, and have preferred to channel their funds into the relatively risk-free government sector. The Committee, therefore, urged that efforts be sustained to de-risk the real economy through appropriate reform measures.

The interbank market rates fluctuated at the various segments since the beginning of the year. Key interbank rates moved in tandem with the upward revision of the monetary policy rate (MPR) to 7.5 per cent from 22<sup>nd</sup> March, 2011. Between March 22 and May 13, 2011, the inter-bank call and open buy-back (OBB) rates fluctuated, increasing to a high interbank call rate of 11.95 per cent on April 12, 2011. A significant decline in both rates was recorded thereafter,

following the enhanced liquidity in the banking system occasioned by the use of AMCON bonds to secure funds and the impact of the new reserve averaging policy. Consequently, interbank and OBB rates softened, with the OBB recording a low of 6.90 per cent on 9th May, 2011.

Retail lending rates, however, remained relatively high with the spread between the maximum lending rate and the consolidated deposit rate widening slightly to 19.64 percentage points in April 2011, from 19.57 percentage points in March.

The All-Share Index and market capitalization recorded increases as the capital market began a gradual recovery since the last MPC meeting. This was due largely to share price increases in the Banking, Food/Beverages and Insurance sectors. With the ongoing reforms by the regulatory authorities and robust growth prospects, the outlook in the medium-term remains generally good.

### **External Sector Developments**

The Committee noted the persisting demand pressure in the foreign exchange market between March 23 and May 18, 2011. The total supply to the wDAS segment by the CBN (including US\$160.00 million worth of maturities at the wDAS Forwards) amounted to US\$4.32 billion.

The foreign exchange market remained relatively stable owing to a deliberate policy on the part of the CBN to increase supply to the market to maintain the exchange rate within a band of  $\pm 3$  percentage points, complemented by funding from autonomous sources. At the wDAS segment, the Naira/Dollar exchange rate opened at N152.63/US\$ (including 1% commission) on March 23, 2011 and closed at N154.74/US\$ on May 18, 2011, representing a slight depreciation of 1.38 per cent (or N2.11k). The interbank rates opened at

N155.97/US\$ and closed at N156.70/US\$, a depreciation of 0.47 per cent. The premium between the rates at the WDAS and other segments of the market narrowed towards the end of the review period.

The Committee noted the modest accretion to the external reserves in recent months. It, however, noted that inflow into the CBN is not consistent with the high oil prices and, this underscores the need for tighter fiscal controls around oil revenues as well as first line charges including JVC deductions and subsidies. A higher rate of retention of oil revenues should facilitate the efforts at maintaining exchange rate stability as an antidote to imported inflation without excessive reliance on monetary tightening measures.

### **The Committee's Considerations**

The Committee urged that in a highly import-dependent economy with large pass-through effects of import prices on domestic prices, it is necessary to create a climate conducive to larger foreign capital inflows through appropriate fiscal measures, particularly in the light of the gains that could be made in the current context of high crude oil prices. The MPC, therefore, stressed the importance of continuing structural reforms and infrastructural development to enhance domestic production to reduce the import bill and its pass-through effects on inflation. It also noted the inflationary impact of the likely deregulation of petroleum product prices.

The Committee held that it would be prudent to adopt a monetary policy stance that is consistent with the need to address inflationary expectations associated with excessive liquidity and pressure on foreign exchange market. Although the fiscal authorities have declared their intention to fiscal

consolidation, the MPC recognizes that time will be required for fiscal adjustment to take place. In the interim, monetary policy will have to bear the burden of adjustment through further tightening in order to rein in inflation to maintain price stability, as well as continuing with the progress toward positive real interest rates.

## **Decisions**

In the light of the above, Members of the Committee voted as follows:

1. 9:1 in favour of further tightening of monetary policy. All nine in favour of tightening voted for an increase in CRR from 2 per cent to 4 per cent with effect from June 8, 2011 to align with the next reserve averaging maintenance period; Six (6) members voted for 50 basis points increase in MPR from 7.5 per cent to 8.0 per cent, three (3) voted for 25 basis points increase while one (1) voted for no change; and
2. Maintain the symmetric corridor of +/- 200 basis points around the MPR.

**Sanusi Lamido Sanusi, CON**

Governor

Central Bank of Nigeria

**May 24, 2011**

## **PERSONAL STATEMENTS BY MPC MEMBERS:**

### **1.0 ALADE, SARAH**

*Although headline inflation moderated to 11.3 in April from 12.8 in the previous month, a combination of intense pressure on the exchange rate as a result of pass through effect of imported prices, and the anticipation of frontloading of government expenditure in the second quarter calls for a modest tightening of monetary policy rate. In addition, policy tightening is needed to address the negative real interest rate in the economy.*

**While headline inflation has started to trend down, domestic inflation outlook going forward, will be impacted on what happens to global food prices.** Global food and energy prices are expected to harden in the coming months, driven by a combination of supply constraints and rising global demand as the advanced economies consolidate their recovery. This suggests that the current downward trend in headline inflation in Nigeria could be short-lived. Although food inflation moderated to 11.6 percent in April from 12.2 percent in March, the high international commodity prices could spill over to domestic prices.

**Core inflation is also increasing.** Core inflation which edged up to 12.9 percent in April was driven mainly by housing and electricity /gas prices. The prices of building materials like cement increased by more than 40 percent from its price in the last quarter of 2010 and all these prices are determined by global prices. These poses risk to the inflation outlook going forward.

**The risk of expansionary spending in the second quarter is anticipated.** Although negotiations are on-going to reduce the exact amount of the 2011 Federal Government budget, the possibility of frontloading expenditure in the second quarter is real. Given that the 2011 budget are yet to be passed, there is

a good chance that frontloading of expenditure could occur in the second quarter of 2011 for a number of reasons: First to accelerate already budgeted expenditures on critical government projects and, secondly, the implementation of the new minimum wage. These spendings are bound to have some inflationary impact, therefore monetary tightening is needed to mitigate the inflationary impact of such expansionary fiscal injection to the economy.

**The equity market is benefiting from the return of confidence in the economy after the successful general election.** The declining trend that was observed in the equity markets in March and February seems to have stabilized during the month of April. The Nigerian Stock Exchange All-Shares Index (ASI) increased marginally by 1.7% in April. Foreign investment inflow into the country increased marginally to US\$ 1.8 billion in first quarter as against the US\$1.5 billion in fourth quarter of 2010. Share equity and loans accounted for the bulk of the first quarter inflows. I believe containing inflationary pressure and reviewing interest rate will help increase confidence and participation in the market.

**AMCON bond issue will further inject liquidity in the system.** As AMCON tries to conclude the resolution of the troubled banks by bond issues, more liquidity will be injected into the system, putting additional pressure on the inflation dynamics.

**Monetary tightening is needed to preserve the value of the domestic currency.** Despite strong fundamentals (high oil prices, increased oil output, high GDP growth rate), the naira continues to depreciate against the US dollar. Although a number of factors could be responsible, one of such factor is the supply side effects of money supply. Tightening monetary policy will ease the pressure on the foreign exchange market.

**Based on the above**, monetary policy should focus on managing inflation expectation for price stability. Therefore, I will recommend a modest tightening of the monetary policy rate to 50 basis points and 2 percent increase in Cash Reserve Requirement (CRR).

## **2.0 BARAU, SULEIMAN**

The modest decline in the year-on-year Headline Inflation from 12.8 percent in March to 11.3% in April should ordinarily give MPC the comfort that the inflationary pressure is moderating and this trend may be sustained. The key question for me therefore is that, is this trend sustainable?

In order to take a position, one must look for the factors responsible for this decline, determine their outlook and those of the other key components of the inflation basket. The decline in year-on-year Headline is largely due to the food component of the inflation index. Accordingly, Food Inflation over the corresponding period declined sharply from 12.2% to 10.7% on account of the fall in farm produce and relative decline in the contribution of the imported food component during the same period.

Indeed the outlook for the farm produce looks positive with the harvest season in sight. This is also consistent with Staff Projections. However, I do not want to lose sight of the huge demand side issues of the inflation equation which may tilt the balance of risk in favour of an increased inflation rather than a decline, at least on a sustained basis. These factors include:

- The deficit nature of the Federal budget.
- Activity of AMCON and its impact on systemic liquidity
- The threat of imported inflation as energy and food prices remained high.
- Upward review in minimum wage particularly for State employees.
- Possible withdrawal of petroleum subsidy.

I have therefore come to the conclusion after the above review that inflation threat is still real and the arguments for tightening are compelling.

However in making my recommendation, I'm very conscious of the fact that radical measures to tighten could hurt growth and financial stability. Growth; since any upward adjustment of the MPR would translate into higher lending rates particularly lending to the private sector. Financial Stability; since any upward review of MPR would impact yields on Bonds, lead to huge market to market losses and ultimately the profitability of Banks given their current huge holdings of these Bonds.

However, inflation remains our enemy number one as it impacts on Nigerians across social groups.

On the basis of the above and other factors, I'm compelled to argue for sustained tightening and to make the following specific recommendations;

- Upward review of MPR by 0.5% to 8%.
- Increase in Cash Reserve Ratio (CRR) from 2% - 4% to directly impact liquidity in the banking system. This would also impact directly on liquidity, inflationary pressure and reduce speculative pressure on the Naira exchange rate.

### **3.0 GARBA, ABDUL GANIYU**

#### **Justification**

1. The data on Consolidated Balance Sheet of the Banking System (December, 2010 to April, 2011) indicates that liabilities (M2) significantly overshoots assets (NFA and Net Domestic Credit). Further, whereas M2 rose at an annualized rate of 9.27%, NFA and Net Domestic Credit declined by 10.71% and 1.8% respectively. The policy implications of the

data are (a) reduce liabilities; grow assets or both until equilibrium is restored. If not, excess liabilities will hurt both exchange rate stability, growth and trigger rapid inflation. The MPC has stated clearly, its commitment to price and exchange stability which reduce risks (inflation and foreign exchange) and promote investment, job creation and growth. Growing assets (NFA) will require both policy and institutional changes that are outside the control of the MPC. Private credit has not responded to the regime of quantitative easing and growing the public debt has both short and long term consequences. This leaves quantitative tightening as the only viable option.

2. A close analysis of the Forex market data reveals patterns of demand consistent with speculative behavior. Tightening can reduce speculative demand and ease pressure on the Naira.
3. The policies of the last MPC (March 2011) and the implementation are producing expected impacts. The 100 basis point increase in MPR raised the short term rates around target levels. However, FAAC releases (FAAC Effect) and opportunities to repo AMCON bonds (AMCON Effects) moderated the effects. FAAC Effects increased volatility while AMCON Effect moderated the rates downwards from May 6. Inflation the key policy objective appears to be moderating. However, the moderation may not be sustainable given the upward movements in key categories of food inflation and core inflation as well as the rise in global prices.
4. Before I decided, I asked three questions: (a) should we tighten further? (b) what instruments are most effective? (c) what are the cost-benefit of each option. The analysis convinces me that further tightening is necessary especially given expected injections by AMCON, existing dis-

equilibrium, inflation concerns and commitment to price and exchange rate stability.

5. The CRR is the most effective tool for tightening of liquidity. Its pass through effects on speculative demand for forex are revealed by data on demand for forex which show significant decline after the CRR was raised by 100 basis point at the January MPC. A 200 basis point increase in CRR is expected to impact significantly on liquidity and speculative forex activities.
6. The increase in MPR by 25 basis point signals commitment to tightening. It also takes notes that MPR effects on short term interest rates are expected to be moderated by FAAC and AMCON Effects.

## **Decision**

I vote for:

1. quantitative tightening
2. 200 basis point increase in CRR from 2% to 4%.
3. Increase in MPR by 25 basis point.

## **4.0 KIFASI, DANLADI**

The current Federal Government budget under review is expected to be expansionary due to Government's desire to invest massively in infrastructure as well as create employment opportunities through investment in public works and other job-creating schemes. Moreover, various Governments' interventions in Agriculture, SMEs and Manufacturing have their liquidity implications.

Specifically, these have the tendency to create excess liquidity in the system and exert pressure on foreign exchange demand.

2. Furthermore, inflationary threats could arise from the high energy price in the developed economies coupled with the implementation of the new minimum wage policy.

3 In order to achieve the single-digit inflation objective of the Government; ensure exchange rate stability; as well as sustain the gradual build up in the external reserves, there is need to further tighten monetary policy.

4. In view of the above, I recommend that the Monetary Policy Rate (MPR) be further increased by 50 basis points from 7.5% to 8.0%. Furthermore, the Cash Reserve Ratio (CRR) should be increased by 200 basis points from 2% to 4%, while the open market operations should be actively pursued.

## **5.0 LEMO, TUNDE**

The economy continues to face inflationary pressures arising from expansionary fiscal stance as well as the impact of international prices of energy and food on domestic price levels. The inflation expectation remains elevated with possible implementation of new minimum wage and removal of petroleum subsidy.

The growth in broad money exceeded the benchmark in the period under review, with the possibility of further expansion through the proposed AMCON injection of about N600b in the next few weeks. Credit to the private sector declined by 4.62% in the first 4 months of the year while credit to the Federal Government grew substantially by 35.82%. The negative credit growth to the

private sector is as a result of structural factors as well as high government borrowings.

Unlike other major oil producing countries, gross external reserve has remained flat (USD33.37b as at May 18, 2011), in spite of very strong international price of crude oil and increase in average daily output of over 2m barrels.

The pressure on foreign exchange is as a result of importation of highly subsidized refined product as well as speculative demand due to expectation of future depreciation of the Naira. In addition to this pressure the reserve level may be adversely affected by the likely reduction in production as a result of the recent short-in of Shell Bonga Field.

Monetary Policy Rate remains negative in real terms. Thus, interest and deposit rates are unlikely to influence savings mobilization for the much needed growth. The negative yield has also had negative impact on the inflow of foreign capital and portfolio funds.

The most important challenge remains the reduction of demand pressure on the foreign exchange to maintain healthy foreign reserve and preserve the value of the Naira. This is a necessary condition for the maintenance of price stability in an import dependent economy. The current crowding out of the real sector through increase in government borrowing should also be reversed through the likely adjustment in interest rates to reduce inflation, and stimulate real sector growth and increase the inflow of much needed Foreign capital flows while not losing sight of the potential losses to banks due to correction in the bonds yields.

## **DECISION**

It is very clear that the pressure on the Naira, driven by excess liquidity as well as cheap Naira (as long as interest rates remain negative, in real terms) require a less accommodative monetary policy stance.

In view of the foregoing therefore, I vote for a further monetary tightening with increase in MPR by 50 basis point from 7.5% to 8.0%. This will return the policy rate to the pre-crisis level. In addition, the Cash Reserve Ratio should be increased from the present 2% to 4% being a blunt instrument should have a more immediate impact on the system's liquidity.

### **6.0 MOGHALU, KINGSLEY CHIEDU**

I vote for an increase in the monetary policy rate by 50 basis points as well as an increase in the cash reserve ratio from the present 2% to 4 % for the following reasons:

1. Despite the recent deceleration in consumer price inflation from 12.8% to 11.3%, the medium term outlook for inflation remains significant in light of increases to the minimum wage - the full effects of which are yet to register - and the potential impact of a possible removal of the petroleum subsidy. Such a policy change, in my view, remains necessary in order to address fundamental distortions in fiscal policy.
2. Real interest rates remain negative; it is necessary to bring inflation down into single digits or close the gap between interest rates and inflation.

3. The discountability of bonds issued by the Asset Management Corporation, and increases in money supply over the past two months imply that liquidity clearly remains a continuing concern for the economy.
4. While there still remains some distance to restoring full financial stability in the banking system, Nigerian banks have been stabilized enough to balance out the potential effects of further monetary tightening measures. Weighed against the imperatives of combating inflation, any concerns about the impact on credit growth must be secondary at this time.
5. From a strategic perspective, it is necessary to move, to the extent possible, to improving exchange rate stability by means additional to CBN intervention in the foreign exchange market. Higher interest rates will attract higher levels of foreign investment as a result of expectations of higher yields by foreign investors, and this will have a stabilizing effect on the naira.
6. Higher deposit rates, which in my view require further attention from the Central Bank of Nigeria, will also bring more savers into the banking system and discourage the disintermediation threat that has become a real danger as a result of low deposit rates. Considering that the exchange rate is the dominant channel of inflation in Nigeria, higher interest rates and reducing liquidity through the cash reserve ratio will help reduce speculative demand for the currency.

Combating inflation and maintaining price stability is an imperative for the CBN, but the actions of the fiscal authorities over the next several months will influence how easily or quickly this objective can be achieved.

## **7.0 OLOFIN, SAM**

There are sufficient indicators at this meeting to warrant a further strengthening of the tight monetary policy stance adopted by this committee over the last two meetings. Inflationary pressure has not abated significantly, and there is no strong evidence that pre-election deficit spending by fiscal authorities would in the short term be reversed, to embrace inflation curbing fiscal restraint in recurrent government expenditure, or to encourage growth enhancing emphasis on capital expenditure. The recently approved wage increases, and more than overdue removal of petroleum subsidies are likely to add to inflationary pressure. Similarly the prospects of good harvests and its likely ameliorating effects on domestic food prices notwithstanding, rising energy costs and imported food prices that currently account for the imported component of inflation are not likely to trend down-wards significantly over the short run.

As far as developments in the financial sector are concerned, there appears to be strong indications that the threat to financial system stability, which warranted extraordinary accommodating monetary easing measures that have been sustained since June 2009 is about being resolved. Among other things MPR witnessed a major reduction from an average of 10 percent to 6 percent, going negative in real terms and has remained so, while inflation rate has remained at a two digit level. As stability is restored to the banking sector of the economy, there is sufficient good reason for the Committee to return to its primary responsibility of focusing greater attention on price stability. However, if we must sustain our tight monetary policy stance there is the problem of determining what the most appropriate policy instrument(s) should be, and at what magnitudes.

Developments at the foreign exchange market have been worrisome. There appears to be a sustained attack on the Naira fuelled by a difficult to justify rise

in demand for foreign exchange that is most probably largely speculative. The resultant effect is to produce pressure on the exchange rate with potentials for further fuelling inflation if the excessive demand is not curbed, and supply of foreign exchange increased, to preserve a healthy level of reserves that would ensure a stable exchange rate and reduce the need for devaluation.

Given the foregoing, we need to focus on at least two critical elements in our choice of instruments to tackle inflationary expectation. First we need to work towards a real rate of interest that would encourage net inflow of FDI and portfolio funds that would enhance accretion to foreign reserves, without necessarily endangering credit flows to the real sector. Available data on post-crisis capital inflows by way of FDI and Portfolio investment, show that countries like Ghana, Mauritius, Kenya and Zambia are experiencing strong or moderate recovery in post –crisis net capital inflows, whereas Nigeria continues to experience decline in both net FDI and Portfolio investment inflows. The MPC's current monetary tightening policy stance therefore must be viewed against the backdrop of negative real MPR, and related yield rates, and the need for upward adjustment in rates to stem the speculative demand for foreign exchange, and encourage inflow of FDI and portfolio funds.

Secondly there is the need to reduce the speculative hedging against the Naira at the foreign exchange market by increasing the cost of borrowing to finance speculative demand for foreign exchange. As we have argued consistently in the past outright devaluation of the Naira is not a viable option in our present circumstances. This would only accentuate the current run on our reserves and exacerbate the inflationary pressure. The options we are left with therefore is a double pronged approach of raising the MPR, to signal a continuation of our tightening policy stance, and raising the CRR to curtail diversion of loanable funds into speculative demand for foreign exchange, thereby reducing the pressure on the Naira and its potential inflationary

consequences. One would therefore vote for a 200 basis point increase in the current level of CRR from 2 percent to 4 percent, and raising the MRR by 50 basis points from the current 7.5 percent to 8 percent. While the latter may not necessarily be high enough to bring about positive real interest rates, it would be supplemented by upward adjustment of market rates, once the current interbank credit guarantees are removed later in the year.

## **8.0 SALAMI, ADEDOYIN**

The moderation in Headline inflation from 12.8% in March to 11.3%, YoY, in April and -0.54% change in the monthly index in the same period is doubtless welcome. A sharp deceleration in food prices – including imported food – provided the impetus for lower pace of price rises recorded. It is however noteworthy that Core Inflation rose faster than that of food. Taken with figures since January, a clear trend is not discernible.

With regard to the outlook for inflation, while some factors, for example approaching harvest season, gives a basis for a positive outlook, there are significant upside risks which cannot be ignored. Having noted the likely moderation of inflation by harvests, we must continue to keep an eye on global food prices. In addition to global food prices, the role of the exchange rate in influencing imported food prices cannot be understated.

Liquidity, especially resulting from fiscal operations remains a source of concern. Q1 2011 outcomes show Federal Government revenues, at NGN540.98bn, to be almost 24% below expectation. Notwithstanding lower than 'budgeted' spending – amounting to NGN874bn (63% of which was recurrent expenditure), the resulting deficit of NGN333.4bn in Q1 is only marginally lower than the NGN 347.44bn provided for in the 'budget'. It is thus not surprising that lending to the

government continues to surge – growing almost 36% since December 2010 – despite strong oil prices.

Notwithstanding encouraging noises from both the Executive and Legislative Arms of government about ‘reshaping’ the 2011 budget, it remains to be seen how quickly this can be done to reduce the pressure exerted by rising government borrowing. Whilst deregulation of Petroleum product prices will undoubtedly go a long way towards achieving a more sustainable fiscal environment, it is again not clear how quickly this will be achieved. Minimum wages are also anticipated to add to spending at the sub-national level. It is important that whilst awaiting action to reshape the budget, government must be made aware of the cost implications of its borrowing activities.

Unlike the public sector, private sector borrowing has continued to shrink – declining by a further 4.5% this year. Resolution of the banking sector issues however represents a risk to systemic liquidity. The impending injections into the banks by AMCON – estimated at approximately NGN600bn – represent a clear risk to liquidity. Added to the Central Bank’s guarantee on interbank market transactions, the AMCON-related liquidity is likely to reinforce the negative ‘real’ interest rates which characterize the deposit side of our financial system. Action to move ‘real’ rates into positive territory needs to continue.

Perhaps the biggest threat to the outlook for price stability is the exchange rate. Since the beginning of the year the Naira has depreciated by almost 3% - notwithstanding successful conclusion of the general elections. With strong oil prices and volumes continuing to rise, the depreciation of the Naira is counter intuitive. The thick opaqueness surrounding Nigeria’s oil industry – upstream and downstream - affords an explanation for the discrepancy between oil prices and receipts. A scenario which combines foreign currency inflows lagging both oil prices and production volumes and increasing outflows offers an incentive to

speculation against the Naira. A depreciating currency not only spells difficulty for the goal of attaining price stability but if allowed to continue for any length of time will itself fuel inflation. In this light, it becomes imperative to take measures which deter speculation against the Naira.

Bearing all of these in mind, I am clear that steps need to be taken to

- Mitigate the speculative attack on the exchange rate;
- Ensure that the government pays adequately for the resources it utilizes; and
- Encourage the emergence of positive 'real' interest rates.

I am thus comfortable to see a further tightening of the monetary conditions. An increase in both the Monetary Policy Rate (MPR) and the Cash Reserve Ratio (CRR) should stem the flow of liquidity for speculation against the Naira.

## **9.0 UCHE, CHIBUKE U.**

1. The attainment of price stability, which is the core mandate of monetary policy, depends on the ability of a central bank to contain inflation and maintain a stable exchange rate. Price stability should however not be seen as an end in itself. Its underlying essence is the promotion of economic growth. This is a very tall order in a rentier mono product economy where prudent fiscal management is not considered a priority by government. It is troubling that the current increase in government oil revenues is positively correlated with increased government borrowing. The recurrent expenditure dominance of the budget simply means that vital infrastructural development is not responsible for this trend. Growing concerns about oil income leakages further complicate monetary policy.

2. The above scenario has led to a situation where our currency is now under immense speculative attack. The consequence is that the demand for foreign exchange has increased at an alarming rate in recent times. A strict interpretation of the MPC price stability mandate means that the MPC will need to increase the MPR and possibly use other monetary tightening mechanisms in order to curtail money supply and stem the speculative attacks on the Naira. On the face of it, this option looks attractive. I am however not convinced that it can lead to economic development which is the underlying reason for the price stability objective of monetary policy. This is because given the structure of our credit system the real sector would be the first to be crowded out in a further tightened market. Furthermore, it would be overly optimistic to expect that a government that has resorted to increased borrowing even in periods of jumbo oil prices to fund predominantly recurrent items would curb borrowing just because MPR has been increased. Stemming the speculative attacks on the Naira through credit tightening only may therefore not be sustainable even in the near future. It is in the light of the above, that I am reluctant to recommend another increase in MPR.
3. At another level, I believe that we need to allow more time for the CBN banking sector intervention to resolve in order to be in a position to fully appreciate the interest rate lending mechanics of commercial banks. As argued by Dr. Doyin Salami, the current CBN interbank guarantee distorts the real dynamics of interest rates. In the light of the above, I am of the view that MPC should maintain the status quo at this time. Doing nothing, no doubt, has risks especially in the arena of hastening a possible devaluation of the Naira. While this is a legitimate concern, I am not convinced that the continued aggressive tightening of money supply will exterminate this threat. The March 2011 100 basis points increase in MPR has done little to stem the speculative attacks on the Naira. If the Central

Bank, which is also financial adviser to the Federal Government, is unable to convince it to adopt a more prudent fiscal stance, then I believe that tightening monetary policy which will further crowd out an already battered private sector and negatively impact on the current banking sector distress resolution, may not be enough to contain Naira speculators even in the near future. This is the painful reality of the entwinement of fiscal and monetary policy.

## **10.0 SANUSI LAMIDO SANUSI**

### **Governor of the Central Bank of Nigeria and Chairman of the Monetary Policy Committee**

The principal question facing us today is the appropriate stance to adopt in view of the decline in the year-on-year inflation rate to 11.3% in April from 12.8% in March.

On the one hand there is the argument that the significant tightening since the last MPC meeting is beginning to show an impact. Staff reports however indicate that the principal drivers of this deceleration were imported food and farm produce components of the Consumer Price Index. Considering the fact that we are approaching the harvest season, it is indeed plausible that in the short-term inflationary pressures may remain subdued.

On the other side of the argument are significant risk factors. First, although food inflation declined, there has been a continuation of inflation in other components, mainly diesel, kerosene, rent and household utilities. In addition there continues to be an increase in distribution costs. The sustained strong demand for foreign exchange has exerted pressure on the naira and this

heightens the risk of cost – push inflation through the import/exchange rate channel.

In addition, this strong demand for foreign currency is clearly an indication of significant systemic liquidity driven by fiscal spending and recent AMCON activity. Both of these sources of liquidity are expected to remain active in the short-term as AMCON recapitalizes distressed banks and Government grapples with the challenges of reducing the cost of governance and overheads.

The economy is not helped by the fact that actual foreign exchange inflows to the Central Bank from the oil sector fall short of expected levels given the significant increase in oil price and output, as well as in comparison to the inflows at comparative price levels pre-crisis. In addition to the oft-repeated concerns about NNPC deductions for JVC Cash Calls and Petroleum subsidies, it would seem that there is a need to look closely at the quality of fiscal controls around oil revenues in order to block apparent leakages.

The oil revenue shortfall restricts the ability of the Central Bank to significantly increase foreign exchange sales and use a strong currency as an antidote to imported inflationary pressure.

The sum total of the second argument would suggest that the outlook for inflationary expectations is such that the recent decline may be unsustainable without measures aimed at addressing excess liquidity and reducing the demand pressure at the foreign exchange window.

For these reasons I am inclined towards siding with the majority argument for tightening. I also agree with the majority that given the effectiveness of the Cash

Reserve Ratio as a blunt tool, an increase to 4% from the current 2% level should impact the liquidity of the main banks driving foreign exchange demand.

On the actual level of systemic liquidity tightening as reflected in the MPR, my view is that given the 100bp increase at the last MPC, and the CPI figure for April, a gradual tightening by raising MPR by 25bps should suffice for now. In July, based on a review of developments, we may consider further measures. I therefore do not agree with majority view of a 50bp hike in MPR.

My vote therefore is for:

1. An increase in the CRR from 2% to 4%
2. An increase in the MPR from 7.5% to 7.75%
3. Retention of the symmetric corridor around the MPR