

## **Central Bank of Nigeria Communiqué No. 75 of the Monetary Policy Committee Meeting, March 21-22, 2011**

The Monetary Policy Committee (MPC) met on the 21st and 22<sup>nd</sup> March, 2011 to assess the current domestic and international economic and financial developments as well as the challenges that lie ahead of the Nigerian economy in the short to medium term.

On the international scene, the Committee noted the continuing recovery in a number of developed economies but observed that unemployment rates continue to be high and threats of inflation strong in the light of the rising global commodity and energy prices. In emerging market economies, growth has been robust but inflationary pressures are strong and on the rise. The negative impact of the political crises in the oil-producing Middle East and North Africa (MENA) region on oil prices and the disruptions and destructions associated with the earthquake and tsunami in Japan have added to uncertainty about the sustainability of global economic recovery and growth. There are also concerns in the European periphery of increasing interest rates. The implications of these developments together with the likelihood of sharp increases in international interest rates for the Nigerian economy need to be kept under continuous watch.

With regard to the domestic economy, the Committee noted the continuing good output performance, the rising external reserves, the moderation in the inflation rate and the steady movement towards realization of banking sector stability. Monetary indicators have not picked up sufficiently while money market rates were generally high. The fiscal stance continues to be unduly expansionary. The Committee therefore emphasized the need to pursue sound policies, including exchange rate stability in order to ensure price stability

without losing sight of the imperative of maintaining the current growth momentum.

## **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 overall GDP growth for 2010 was estimated to be 7.85 per cent, higher than the growth rate of 6.96 per cent recorded in 2009. The non-oil sector remained the major driver of overall growth, with agriculture, wholesale and retail trade, and services contributing 2.39, 2.04 and 2.08 per cent, respectively. The Committee considers the outlook for 2011 to be generally good, given the expected improvement in the oil economy and the growing emphasis on the development of non-oil sector and key infrastructure.

### **Domestic Prices**

The year-on-year headline inflation in February was 11.1 per cent compared to 12.1 per cent recorded in January 2011 and 12.8 per cent in December 2010. Core inflation was 10.6 per cent in February 2011, down from 12.1 per cent in January and 10.9 per cent in December 2010. Food inflation however, rose to 12.2 per cent in February from 10.3 per cent in January but was lower than the 12.7 per cent in December 2010. The rise in food inflation was consistent with the

seasonal pattern. In addition, the increase in the costs of imported food items, transportation and energy prices contributed to food inflation. With the output performance being good, the challenge to inflation control lies, therefore, in containing aggregate expenditure and moderating the impact of imported inflation via exchange rate channel. This is where the role of fiscal prudence becomes very critical.

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

Provisional data showed that the growth in broad money (M2) in the first two months of 2011 relative to December was moderate. Credit to private sector continued to be sluggish partly because of the delay in the passage of the 2011 Federal budget and ongoing banking sector reforms. Net foreign assets in the first two months have posted positive growth, the first time since January 2009. Pick up in credit to private sector should be possible given the high potential for accelerated growth, the fact that the banking sector stability is largely restored and the intensification of the operations of the Asset Management Corporation of Nigeria (AMCON).

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 6.5 per cent from 25th January, 2011. Between January 25 and March 17, 2011, the inter-bank call and open buy-back (OBB) rates showed increases mainly in response to the MPC's increase of the MPR and a more effective implementation of monetary policy decisions. Consequently, inter-bank call and OBB rates rose from 4.93 and 4.75 per cent on 26<sup>th</sup> January, 2011 to 8.44 and 8.04 per cent, respectively, on March 17, 2011.

The Committee noted that the Central Bank of Nigeria (CBN) has recently fine-tuned its monetary policy implementation framework using reserve averaging over a reserve maintenance period extended to 4 weeks. The Committee urged continuous monitoring of the developments and taking appropriate measures necessary for improving the implementation framework in the months to come. Retail lending rates remained relatively high in the first two months of 2011 while the spread between the average lending rate and the consolidated deposit rate widened to 19.83 percentage points in February 2011 from 19.52 percentage points in January. The Committee noted that a policy challenge is to ensure that the interest rate spread is significantly moderated.

In 2011 thus far, share prices and market capitalization recorded significant decline due to both domestic and international developments. However, with the ongoing reforms by the regulatory authorities and robust growth prospects, the outlook in the medium term appears generally good.

### **External Sector Developments**

The Committee noted the re-emergence of demand pressures in the foreign exchange markets during the review period. The total supply to the wDAS segment by the CBN amounted to US\$5.145 billion from January through March 16, 2011, while demand stood at US\$6.815 billion during the same period. The Committee expressed concern that, of the amount supplied, US\$1.34 billion was spent on importing refined petroleum products alone, which has adverse implications both for the reserves position and government finances as a result of the huge subsidy implications.

The wDAS segment of the foreign exchange market, however, remained relatively stable. The Naira/Dollar exchange rate opened on February 1, 2011 at N151.85/US\$ and closed at N152.52/US\$ on March 17, 2011, representing a slight depreciation of 0.44 per cent (or 67 kobo). However, the premium between the rates at the WDAS and other segments of the market widened towards the end of the review period, reflecting a sharper depreciation in non-wDAS segments of the foreign exchange market. The Committee, however, observed that given strong oil sector fundamentals, this trend is likely to be temporary. The Committee urged the CBN to continue to pursue the strategy of maintaining exchange rate stability to contain inflation.

The Committee welcomed the recent build-up of foreign exchange reserves owing to increase in output and rising crude oil receipts. Foreign exchange reserves increased by US \$2.82 billion to US\$35.16 billion on March 16, 2011 from US \$32.34 billion recorded at the end of December 2010. However, the Committee welcomed the reserve build up and reiterated that the solution to reserve depletion lies in the implementation of appropriate reforms with regard to industrial and trade policies aimed at reducing import-dependency.

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

The MPC noted the positive growth outlook in the near to medium term but expressed serious concern over the heightened risk of inflation following from the proposed high expenditure outlay of the Federal Government as contained in the 2011 Appropriation Bill recently passed by the National Assembly, especially in the wake of rising global food and energy prices. In this regard, the Committee recalled that in the past few MPC meetings, it had stressed the need for fiscal retrenchment and drawn attention to the unsustainability of the rising

trend of domestic debt. However, the proposed expenditure outlay negates the initial sentiment for fiscal retrenchment which would have supported monetary policy effectiveness. The current fiscal stance is inconsistent with the objective of maintaining stability in exchange rates, prices and interest rates. The Committee, therefore, believes that unless the fiscal stance is reversed, the economy would have to bear a high cost in terms of pressure on foreign reserves, high interest rates and/or higher level of inflation.

Against the foregoing, the MPC is of the view that a further tightening of monetary policy is imperative. This stance needs to be appreciated in the context of the fact that resolution of the problems in the banking sector has not yet been completed. However, a number of banks have signed a memorandum of understanding with core investors and public announcement will be made this week. In the light of this, the inter-bank guarantees and guarantees of foreign credit lines will need to be extended beyond the deadline of June 30, 2011. The MPC, however, recognizes that any action that is taken at this point in time should not serve as a disincentive to the current high growth impulses. It, however, recognizes that the principal problem is access to finance in critical sectors like agriculture and manufacturing. This should remain the focus of CBN in the short to medium term.

## **Decisions**

In the light of the foregoing analysis, Members of the Committee voted unanimously for further tightening of monetary policy because of heightened risk of inflation. The Members specifically pointed out the rising international food and energy prices, the impact of import costs on domestic prices, the challenges that fiscal stance posed to the external value of the Naira and the

likely front-loading of public expenditure in the election period. Against this background, the following decisions were taken:

1. A majority of 9 to 3 Members voted for an increase in MPR by 100 basis points from 6.50 per cent to 7.50 per cent. The 3 Members voted for a 50 basis points increase;
2. A unanimous decision to,
  - a. Retain the symmetric corridor of +/- 200 basis points;
  - b. Retain the current CRR of 2.0 per cent and the liquidity ratio of 30.0 per cent; and
  - c. Extend the CBN guarantee on interbank transactions and guarantee of foreign credit lines by three months from June 30, 2011 to September 30, 2011.

**Sanusi Lamido Sanusi, CON**

Governor  
Central Bank of Nigeria

**March 22, 2011**

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

### **1.0 ALADE, SARAH**

Although headline inflation declined from 12.1 in January 2011 to 11.1 in February 2011, which could suggest monetary policy easing, however, the sharp rise in global commodity and fuel prices have heightened upside risks to domestic inflation. This would suggest that the balance of risk would be tilted towards intensification of inflation, thus continued monetary tightening is necessary.

**The surge in global food and fuel prices posses a heightened inflationary risk to the Nigerian economy.** As an import dependent economy, the likelihood of the country being affected by the global food and fuel crisis is very high and if action is not taken to mitigate the effect, the inflationary impact could be serious. Food inflation has remained at an elevated level as our major food items such as rice are imported and year-on-year imported food inflation surged to 20.2 percent in February from -5 percent in the previous month. Many countries are already experiencing high consumer price inflation due to the high global food prices. In Nigeria, Composite Food Index increased by 12.2 percent year-on-year and by 2.9 percent between January and February of 2011. The forecast for the current food and fuel price increase is that it will stay for awhile as a result of many factors, the event in the Middle East and North Africa (MENA), and the rising global trend in general food prices. As high food prices persists, the prospect of it spilling over to the general inflation process is rapidly becoming a reality. All these will put upward pressure on domestic inflation, thus justifying the tightening of monetary policy to mitigate these risks.

**The 2011 Federal Government budget of N4.9 trillion is expansionary and in an election year, the amount could further increase through supplementary budgetary allocation.** The Federal Government submitted a budget of N4.9 trillion which is higher than the N4.6 trillion for 2010 and 20 percent higher than the initial budget proposed in December of 2010. This expansionary budget poses risk to inflation. In addition, to pre-election expenditure, there is high likelihood of a supplementary budget in the near future. Therefore to mitigate the impact of such expansionary fiscal injection in the economy and to maintain the objective of single digit inflation, continued monetary tightening is necessary.

**The effect of AMCON BOND Purchase and foreign investment in intervened banks.** The liquidity injection to the banks from the transaction will increase money supply and put additional pressure on the inflation dynamics.

**Reserve money has remained close to target in recent times, but the forecast is that it could rise.** In the past two (2) months reserve money has been very close to the target benchmark of N1775.15 billion, but projection is that it could rise above the benchmark in the short term. Staff estimates suggest an increase compared to indicative benchmark in the short to medium term. Depending in money multiplier, this can result in rapid increase in money supply.

**Monetary tightening is needed to contain the recent pressure on exchange rate.** While the fundamentals do not support depreciation of the naira (high oil prices, increased oil output, high GDP growth rate), the naira has depreciated by 3.3 percent y-o-y against the dollar. Although a number of factors could be responsible, one of such factor is the supply side effects of fiscal injection. Tightening monetary policy will ease the pressure on the foreign exchange market.

**Based on the above**, monetary policy should tilt towards containing the spill-over of high food and fuel prices into general inflation and anchor inflation expectation, while standing ready to respond to any further build-up of inflationary pressure. Therefore to balance the goal of economic growth and price stability, I will recommend a moderate tightening not more than 100 basis point based on the following:

- a) The full impact of the 2011 fiscal expansion will not be immediate; therefore, 100 basis point is adequate.
- b) Although growth in private sector credit is picking up, policy should be geared at nurturing this trend and full tightening could crowd-out private sector growth.

**Extension of the guarantee is necessary for continued financial stability.** I also agree with the extension of guarantee till September 30, 2011 to allow for the full and complete resolution of the intervened banks as Mergers and Acquisition (M&A) are still at critical stages.

## 2.0 BARAU, SULEIMAN

The challenge of monetary policy formulation and implementation in the recent past and indeed since the last MPC has been the continued fiscal dominance. This and a few other factors duly recognized during the last Monetary Policy Committee (MPC) have heightened my perception of sustained inflation risk.

The measures taken at the last Monetary Policy Committee have had some salutary effect on this threat as demonstrated by the largely downward trend of some inflation numbers. The Headline Inflation Rate for example trended from

11.8% in December, 2010 to 11.1% in February 2011. Core Inflation also trended downward from 12.1% in January 2011 to 10.6% in February 2011.

In spite of this modest success, I'm convinced that sustained inflation remains a threat for the following reasons:

- We have not witnessed the complete mop up of liquidity injected into the economy from the year end festive activities of 2010.
- This is an election year and the sustained spending associated with political activities have complicated the liquidity surfeit.
- The biggest threat has emerged from the Harmonized Budget passed by the National Assembly. In the first instance, the budget itself is a deficit one and therefore is expansionary. Secondly and more significantly, the recurrent component of N2.467 trillion is about 50% of the total budget of N4.970 trillion. These factors would aggressively exacerbate the inflationary pressures.
- Continued threat of imported inflation from increases in food and energy prices in the international market. Being an import dependent economy, this factor has had significant effect on the build-up of inflation numbers in the recent past.

Liquidity is manifested by the substantial liquidity position of Deposit Money Banks, the recent increased demand for foreign exchange and the huge spending by the Government.

### **Recommendation**

In the light of the foregoing, I recommend;

- The continuation of tight monetary stance;
- The increase in the Monetary Policy Rate (MPR) by 100 bps to 7.50% for the following reasons:
  - Movement in Policy Rates are usually gradual and should be so. But the more radical increase is the right response to the renewed inflation risk.
  - Impact on banking sector reforms and financial stability is responsible for the moderate increase being recommended. We have to be careful not to shock the money markets, yields, the fortunes of banks and ultimately the stability of the financial system.
  - The complementary and perhaps more effective measures already in place which should be continued. These include the increase in CRR to (2%), MPR to (30%) and the corridor of +2% around the MPR which should be maintained.
  - Frequency of MPC meeting provides window for further review (even if through an emergency MPC) for further tightening if current measures are not effective.
- The CBN Guarantee for interbank lending should be extended to September 30<sup>th</sup> to cushion the possible effect of the above policy measures on the banking system.

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

#### **FOUNDATION**

1. Review of the MPD's Economic Report and the BSD/FPR Banking System Stability Review and the discussions that followed.
2. Analysis of the impacts of the decisions of the 218<sup>th</sup> MPC on (a) discount rates (OBB and Call Rate); (b) Interest Rates; (c) Asset Prices; (d) Inflation Rates and (e) Exchange Rates using available data and, the framework for Monetary Policy in Nigeria.
3. Commitment to (a) reducing inflation rates; (b) a stability in the foreign exchange market in 2011 and (3) a gradual return to normalcy in the financial system as AMCON completes the cleaning up of the Balance Sheets of DMBs.
4. My concerns:
  - a. Inflationary pressured driven by mainly by fiscal operations and rising import prices of food and petroleum product: government remains committed in 2011 to an expansionary fiscal policy that will raise deficits, the public debt and crowd-out private sector investments, employment and growth [for example, the January figured for government spending overshoots budget by 0.2% and is 97% recurrent. The outlook for prices of imported food and petroleum products point to import price inflation.
  - b. Major trade-offs either imposed or strengthened by expansionary fiscal policy: credit to government and credit to the private sector; growth and inflation; current expenditure and capital expenditure;

exchange rate stability and reserves; assets prices (bonds/stocks and money).

C. Financial System stability effects of movements in bond prices.

## **DECISION**

I vote to:

1. extend the CBN Guarantee on interbank transaction to September 30, 2011; and
2. an increase in MPR by 50 Basis Point: from 6.5% to 7%.

## **JUSTIFICATIONS**

5. I vote to extend the guarantee on interbank transactions (a) to sustain confidence in the financial market and (b) to promote stability of the banking system as AMCON completes its assignment of cleaning up the balance sheets of DMBs.
6. I vote for a 50 basis point rise in interest rate for the following reasons:
  - a. Preference for a gradual path to normalization in the banking system to minimize the risks of volatilities.
  - b. Analysis of the impacts of the decisions of the 218<sup>th</sup> MPC on targets (operating, intermediate and goals) indicates that targets were being realized also, in recognition of policy lags and that a 50 basis point can achieve the right amplitude.
  - c. The need to strike the right balance between key tradeoffs: growth-inflation; exchange rate stability and reserves and assets prices (bonds/stocks and money).

- d. To moderate growth in disproportionate impacts on interest rates and to moderate the positive effects of an MPR increase in interest rate spreads.

#### **4.0 YAHAYA, SHEHU**

I vote for a tightening of monetary policy. My position is predicated on the evidence of increases in price levels in January and particularly food inflation in February, which, in addition to the continuing increase in election spending, expansionary budget and rising international food and energy prices, threaten to stoke inflationary pressures in the coming months.

Furthermore, and notwithstanding the high crude oil prices in the international market, there is already significant pressure on the value of the naira in February-March , which can add to the inflationary pressures. The combination of these factors, particularly the risk of significant naira depreciation and its inflationary effects on an import dependent Nigerian economy necessitate a sharper response than envisaged in the last MPC meeting but balanced to avoid an excessive break on lending to the productive sector of the economy. I therefore vote for an increase in the MPR of 100 basis points.

#### **5.0 KIFASI, DANLADI**

The 2011 Federal Government Budget, which has now been passed, reflects Government's desire to create more jobs, maintain existing infrastructures and finance other capital projects. This would result in increased fiscal deficit, which

in turn will lead to excess liquidity in the system. This poses a great challenge to the achievement of low inflation and exchange rate stability.

2. In order to mitigate the attendant inflationary pressure and achieve the objective of exchange rate stability, I support that there is need for a tight monetary policy.

3. The appropriate instrument to use is the Monetary Policy Rate (MPR) which should be adjusted upward. I therefore support that the MPR be increased by 100 basis points from 6.5% to 7.5%.

## **6.0 LEMO, TUNDE**

The fiscal activities in my view are expansionary and not in line with fiscal consolidation advocated by MPC in January 2011. The Federal Government budget of N4.9 trillion as well as the total budgets of the 36 states may result in significant growth in public debts with the resultant crowding out of the private sector. The benchmark price of USD75 per barrel adopted in the Federal Budget may be too ambitious as oil price is volatile and significant shock may result in increase in government's domestic borrowing. Already, staff reports revealed a decline in aggregate credit to the private sector in January 2011 whereas credits to Federal, States and Local Governments grew by almost 60%. The growth plan of 2011 may therefore be impaired.

Inflation remains a major threat as a result of the fiscal activities and the problem has been exacerbated by the rising food and energy prices globally. With the present administration having less than 10 weeks to go, money supply resulting from heightened expenditure in the run-up to May 29 is expected to be high.

It is also important to check excessive liquidity injection through monetary policy tightening if the objective of building foreign reserve will be realised, given the positive correlation between money supply and demand for foreign exchange. Growth in reserve level should be pursued, especially now that crude oil prices are high in the international market.

Furthermore, interest rate adjustment is important at this juncture to correct the negative real interest rate which has in the last few years heightened the risk of disintermediation. The sluggish growth of deposits and savings in the past few years is a pointer to the need for significant adjustments in savings/deposit rates. Long-term growth can only be guaranteed with efficient domestic savings mobilization and this can only be done through positive real interest regime.

In the light of the foregoing therefore, I am in support of an increase in MPR by 100 basis points from the present level of 6.5% to 7.5%. This will restore the MPR rate close to the pre Quantitative Easing period. I am also in support of the maintenance of the symmetric corridor as well as the extension of the CBN Guarantee on banks' interbank and foreign obligations to September 30, 2011.

## **7.0 MOGHALU, KINGSLEY CHIEDU**

The Monetary Policy Committee at its last meeting had identified a number of factors that were likely to lead to a rise in inflation in 2011 and voted to raise the Monetary Policy Rate by 25 basis points from 6.25 percent to 6.50.

Purchases of non-performing loans of CBN-intervened banks by the Asset Management Corporation of Nigeria (AMCON), election-related spending in 2010, and the possibility of a removal of subsidies on imported petroleum products were seen as potential inflationary factors.

All these factors remain true today. And a most important additional factor has emerged: the Harmonized 2011 Budget adopted by the National Assembly on March 16, 2011, by which total approved expenditure is 4.9 trillion naira, just over 50 per cent of it dedicated to recurrent expenditure.

The main implication of the 2011 budget is that, at a time when all the indicators call for a tight fiscal stance, the approved budget is bound to markedly increase liquidity and feed inflationary pressures.

A sharp increase in tightening monetary policy in response is called for, and I believe the Monetary Policy Committee should provide this response. I therefore vote for an increase in the Monetary Policy Rate by 100 basis points as opposed to the incremental approach to monetary tightening that the MPC commenced at its last meeting. The transmission corridor should remain symmetric at +/-200 basis points.

While a return to higher interest rates has certain potential downsides, mainly that of a negative impact on bank lending, (in particular the availability and management of credit) every economic choice has a consequence, and the consequence of not tightening money supply through monetary policy action would be a lot worse. The potential adverse impact on financial system stability, considering that the CBN-intervened Banks are still returning to stability, should be obviated by the CBN extending its guarantee of deposits and credit lines beyond the deadline of June 30, 2011.

A depreciation of the naira at this time in response to pressures on the currency – an alternative approach – would in fact increase inflation considering the structural deficiencies of Nigeria's import-dependent economy. Such an approach is not supported by the prevailing economic fundamentals; on the

contrary, tightening of monetary policy is essential to protect exchange rate stability by making it more expensive in naira terms to buy dollars and thus reduce speculative demand for dollars and encourage the current increase in foreign reserves.

The case for increasing the interest rate is supported not just by the potential inflationary pressures the recurrent expenditure-dominated 2011 budget will likely bring, but also by the results of the Quarter 1 2011 Consumer Expectations and Inflation Attitude Survey Report prepared for the Monetary Policy Committee.

Clearly, Nigerians do not want increased inflation. A majority of the individuals surveyed believed Nigeria's economy would be weakened by fast-rising prices. While they would prefer lower interest rates, confronted with a choice between higher interest rates and high inflation, they would opt for higher interest rates. Lowering expectations about inflation is critical to lowering inflation in fact. A marked increase in the MPR will help contain inflationary trends, among other reasons because it will send a strong anti-inflationary signal.

In the prevailing circumstances, given the Central Bank of Nigeria's mandate to maintain price stability, a marked increase in the MPR is unavoidable.

I conclude by noting the intrinsic link between monetary and fiscal policy and the impact of one on the other. It is essential that the formulation of fiscal and monetary policy be well coordinated, and to favour policy stances that stimulate diversified real-sector economic growth over the medium to long term. The MPC at its January 2011 meeting had advocated fiscal tightening and consolidation. It has become imperative that the Central Bank of Nigeria increase its ongoing efforts to advise the Federal Government on economic

policy in accordance with its mandate, and that the Government reflect that advice in its formulation of fiscal policy.

## **8.0 OLOFIN, SAM**

From the facts and figures that we have before us at this meeting there is every indication that if anything has changed since our last meeting, it is the fact that inflationary pressure has been further accentuated. This is due largely to rising energy prices and imported food that impact significantly on the CPI despite the prospects of improved harvests that may have ameliorating effects on domestic food prices. On the fiscal front with elections just around the corner, it is a difficult period to preach the virtues of fiscal discipline. It is equally unlikely that there would be any significant adjustment in government expenditure pattern that has been highly inflationary, given the preponderant emphasis on recurrent, rather capital expenditure. In the short to medium term therefore, there is the need to sustain the monetary tightening stance that has been in place since the last two MPC meetings.

The most obvious policy instrument available for this purpose would be the upward adjustment of the MPR. The destabilizing effects of alternative policy measures such as adjusting the exchange rate, may be highly destabilizing and counterproductive in a highly import dependent economy like ours; both demand for imports and supply of exports are inelastic. The signaling mechanism of adjusting the MPR and related ancillary measures however need not be such as to suggest panic for two reasons. First it is likely that after the elections in April, the fiscal authorities would be more open to the need for fiscal tightening if not voluntarily, possibly as the consequences of massive inflation inducing deficit spending begin to manifest. Secondly there is need for a gradual adjustment of rates to pre-crisis levels, as opposed to rattling jumps or

spikes that may be suggestive of destabilizing panicky measures. A slight upward adjustment in the MPR may be all that is needed for now, to signal our continued commitment to combating inflation, as stability gradually returns to the financial sector.

There is however an immediate policy challenge, which is that of combating speculative demand for foreign exchange as a way of hedging against the risks and uncertainties surrounding the elections. If this is not tackled immediately, it could accentuate the rate of decumulation of already dwindling foreign reserves. A spike in the MPR by 100 basis points from 6.5 to 7.5 percent may therefore be justifiable as a way of raising the cost of borrowing to finance the speculative demand for foreign exchange.

## **9.0 OSHILAJA, JOHN**

The origins of today's comparatively loose monetary and pro-cyclical, or complementary, fiscal policies lay in a series of extraordinary economic and financial events that threatened to cripple an already fragile Nigerian economy. Oil export production became increasingly vulnerable to disruptions occasioned by political agitation and outright militancy, in producing regions of the country. Resulting revenue shortfalls undermined the fiscal capacities of Federal and State governments to pursue their respective development imperatives. At about the same time, a global financial systems crisis (of confidence) precipitated stunning reversals, in strategically vital investment flows within and towards the country. This exposed significant regulatory, governance and structural weaknesses in host Nigeria's banking system. To such an extent, that official intervention was urgently needed, in several of the country's banks, to avert the potentially devastating and contagious effects of

a domestic financial meltdown. The policy remedies adopted were unavoidable, and came at no mean cost.

Frankly, in marshalling resources needed to cushion the impact of these extraordinary events on economic activity, and their knock-on effects on vulnerable actors and public service institutions – Nigeria once again borrowed from its future. And if this future is to be secured, i.e., anchored to the country's positive attributes and natural endowments, such loans and investments must be repaid. This is one context in which current Monetary Policy can be understood.

Export earnings have regained fundamentally favorable footings. Soundness and stability are being restored to our financial system. Policy-wise, we are engaged in "normalization" i.e. reasserting base, pre-crisis Monetary conditions and objectives.

At issue is the pace of normalization, against the fundamentally fragile nature of the Nigerian economy, continuing structural deficiencies (which still need to be decisively tackled), and trade-offs to be made in achieving constructive balances between Consumption and Investment. In simpler terms, aggressive normalization expresses strong signals for investment, while less strident recalibrations signal calls for increased rates of Consumption. Increased rates of Consumption are not advisable at this time. At a minimum, inflationary pressures need to be checked in order to safeguard general price stability. Expended savings need to be rebuilt to strengthen financial buffers and incentives essential for promoting real growth. It is unfortunate that major forces in Nigeria's Public and Private Sectors do not always act in concert, pulling in the same, desired directions. Nonetheless, it remains important that the Monetary Authorities continue to promote appropriate financial conditions for those with a mind and

will to save and invest. This is the background against which I have cast my vote today.

## **10.0 SALAMI, ADEDOYIN**

Notwithstanding the slight easing of the inflation rate in February, the immediate prospect for continuing moderation of prices looks bleak. Dependence on import to meet supply of significant components of food and refined petroleum products continue to create challenges for management of price stability and exchange rates. The foregoing difficulty is compounded by the unwillingness of managers of the fiscal space to align expenditure, reflected in the budget to which the National Assembly has assented, with the objectives of moderating prices and maintaining a stable macro-economic environment.

Unlike January, when the CPI showed the cost of imported food declined, data for February indicates that rising global food prices are being transmitted to Nigeria. Notwithstanding the subsidy on the pump price of petrol, rising international energy prices are already manifested in the price for Diesel and Kero. Implications of the budget numbers offer the biggest source of concern for inflation management. The case for higher public spending could have hinged on the need to begin the recovery of private consumption spending which declined in 2010 by 26.66 percent and has declined almost 50percent relative to levels attained in 2007. Similarly, business investment - adjusted for inflation - shrank by 3.56 percent respectively in 2010. Consumption by the State, in contrast, rose by 17.8percent!!

Two components of the budget have been raised – Capital spending and Statutory Transfers. Raising Capital spending, which past evidence suggests

unlikely to be implemented with any regard to quality, creates doubt as to purpose. More worrying is the rise in Statutory Transfers which exceeds 100 percent. Rather than the budgetary consolidation and promotion of private sector participation required at this stage, the budget numbers, by monetising higher levels of oil revenue, will create liquidity thereby exacerbating the challenge of inflation and forex management.

Whilst the international prices for Crude Oil are currently attractive, it is foolhardy to ignore the downside risks as the amended budget does. It is also helpful to note the recent depreciation in the Naira's value in both the Interbank and parallel markets. In my view, the Naira's recent loss of external value is driven by uncertainty about post election outcomes. These cannot have been helped by the budget numbers. The spectre of speculation against the Naira, funded by 'cheap' loans looms large!

Beyond these immediate issues is the need to continue movement away from the disincentive of negative 'real' rates. Granted that the Central Bank's guarantee on inter-bank transactions - which, in light of the additional time required to complete of banking recapitalisation is being extended to Sept., 2011 - continues effectively to de-risk the market and dulls the competition for deposits which I expect to raise rates, the worsening outlook for inflation means that the depositors' loss intensifies with adverse consequences for savings mobilisation and long term economic growth.

It is in light of all these that I am convinced of the need to move beyond the strategy of a gradual exit from Quantitative Easing that previous MPC decisions had signified and followed. A sharp increase in interest rates and tightening of liquidity remain the only effective ways of ensuring that the goal of price stability remains in sight.

## **11.0 UCHE, CHIBUIKE**

From the evidence before the MPC, the environment for the formulation and implementation of monetary policy in Nigeria is being made increasingly difficult by activities within the government fiscal arena and to a lesser extent developments in the international economic environment. Government's inability or unwillingness to curtail its budget deficits coupled with rising global food and oil prices have continued to put pressure on inflation. The result is that all indicators show that inflation is on the rise and indeed is expected to rise even further with the recent passing of the 2011 budget of N4.97 trillion which represents a 17 percent increase over what President Jonathan proposed. I find it particularly troubling that the recurrent expenditure (N2.47 trillion) exceeds capital expenditure (N1.56 trillion) by N 0.91 trillion.

In order to curtail the above inflationary pressures, I believe there is need to raise MPR at this point. Unfortunately, this also has costs. Specifically, an increase in MPR will raise lending rates. This portends great danger not just to the real sector but also for the banking system which is still recuperating from a major crisis. Policies that distort the growth of the real sector will have long term negative consequences on the economy. It is in my view, difficult to achieve and sustain price stability, which is the core mandate of monetary policy, without growing the real sector of the economy. In light of the above, I am of the opinion that MPC should adopt a gradualist approach to increasing the MPR. Specifically, I recommend that MPR should be raised by 50 basis points to 7.0 percent at this stage. I also recommend that the Central Bank should adopt a more combative posture in its role as financial adviser to the government. This has become necessary because unless the fiscal management of the economy improves, we

will soon get to the point where monetary policy will become an ineffective tool for stemming inflation and ensuring stable exchange rates both of which are central to the attainment of price stability.

## **12.0 SANUSI LAMIDO SANUSI, CON**

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

### **The Issue**

The year on year (Y-O-Y) inflation rate dropped to 11.1% in February, compared to 11.8% in December, 2010 and 12.1% in January. However, staff reports note that food inflation increased from 10.3% in January to 12.2% in February. The Energy index also witnessed an upward movement. The last MPC had anticipated increased pressure in the Consumer Price Index (CPI) on the back of rising global oil and food prices. The imported food index rose by 29.2% between January and February. In the two months over \$1.3billion was purchased at WDAs for the importation of petroleum products alone. The increased subsidy burden implied by the huge outlay strengthens the likelihood of post election pricing reforms to reduce the burden on government finances and this pose a short-term risk to inflation.

In addition to the structural factors the 2011 budget that has just been passed by the National Assembly clearly indicates a lack of commitment to early fiscal retrenchment and consolidation. This committee has previously noted that the loose fiscal stance of government continues to pose a grave risk to price stability, exchange rate stability, foreign reserves position and domestic debt sustainability. The budget of N4.9 trillion which includes recurrent spending of

about N2.47trillion and almost N500billion of "statutory transfers" is a source of concern especially as we cannot at this point rule out the possibility of a supplementary budget during the year. The exuberance fuelled by recent oil price increase as a result of the crisis in North Africa seems to have produced a raised budget based on rather optimistic assumptions about oil price (\$75/barrel) and output (2.3mbpd) for the year. Raising the oil price benchmark upward by \$10/barrel facilitated a 20% increase in budget spending without recourse to any other revenue measures such as tax increases.

The budget or, rather, this fiscal stance in general, poses a grave threat to inflation in the medium to long term through the sustained expansion in money supply due to monetization of higher oil revenues. In the short-term, the risk is posed through increased demand for foreign exchange leading either to acceleration of inflation via the exchange rate channel or a depletion of reserves to maintain exchange rate stability and moderate inflation. However it is viewed, increased government spending creates difficulties for monetary policy. Staff reports have shown a historical pattern of correlation between FAAC releases and naira depreciation of WDAs, indicating tentatively that increased government spending does fuel demand for dollars. Pre-election disbursements and spending therefore add significant naira liquidity to the system and increase the pressure on the naira with attendant inflation and reserve management risks.

## **Decision**

It is clear that, in my view, there is a strong risk of rising inflation due to a combination of external and structural factors (food imports, fuel imports etc) on the one hand, and the significant increase in fiscal spending especially in the

election period, on the other. This committee had wanted a phased withdrawal from QE and a gradual normalization of policy complemented by a similar move on the part of the fiscal authorities.

The budget as proposed leaves us, in my view, with no option to the pursuit of a much more aggressive timetable for tightening in order to protect foreign reserves from erosion while maintaining a stable exchange rate and also mitigate the inflationary impact of spending increases that potentially compound the structural pressures in the CPI. It is also important for the credibility of Monetary Policy that we send a clear signal of our dissatisfaction with the fiscal stance. Fortunately, the significant progress on banking reforms gives us more flexibility on the interest rate side.

A sharp rise in rates carries the attendant risk of a sharp correction in the bond markets and possible losses on fixed income positions. It also may slow down the recovery of the equities market. However, in my view, the inflationary risk posed by fiscal expansion at a time of concern with exchange rate stability and rising global food and energy prices is more fundamental to our mandate.

Finally, the pressure on the naira is driven partly by excess liquidity and cheap funds. An overly accommodative monetary policy stance at this point heightens the risk of rising inflation through the import and exchange rate channel.

For all of the above reasons my vote is for an accelerated "normalization" of the MPR. Because most of the liquidity pressure is likely to come in the election period, we need in my view, to "front load" tightening measures rather than pursue a gradualist approach. I therefore vote for a 100 basis-point increase in

the MPR from 6.5% to 7.5%, and retention of CRR and liquidity ratio in line with the last MPC meeting for operational reasons as the CBN has just commenced reserve averaging.

**Vote:**

1. Increase in MPR from 6.5% to 7.5%
2. Retention of Symmetric Corridor at  $\pm$  2%
3. Retention of CRR at 2%
4. Retention of Minimum Liquidity Ratio at 30%
5. Extension of CBN guarantee of the Interbank Market and foreign creditors to September 30, 2011.