CENTRAL BANK OF NIGERIA

MONETARY POLICY REVIEW

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Central Bank of Nigeria

Mandate

- Ensure monetary and price stability
- Issue legal tender currency in Nigeria
- Promote a sound financial system in Nigeria
- Maintain external reserves to safeguard the international value of the legal tender currency
- Act as banker and provide economic and financial advice to the Federal Government

Vision

To be one of the most efficient and effective of the world's central banks in promoting and sustaining economic development.

Mission Statement

To be proactive in providing a stable framework for the economic development of Nigeria through the effective, efficient and transparent implementation of monetary and exchange rate policy and management of the financial system.

Core Values

- Meritocracy
- Leadership
- Learning
- Customer - Focus

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CHAPTER 1
OVERVIEW

The primary focus of monetary policy in the first half of 2011 was to ensure price stability.........

During the first half of 2011, monetary policy continued to focus on maintaining price stability while sustaining the efforts to bring about stability and soundness of the banking system on a permanent basis. As a direct consequence of lax fiscal policy and monetary easing in the preceding year, inflationary pressures were high by the turn of 2010. The inflationary overhang was exasperated by increased public and private spending related to the April general elections, increased liquidity owing to purchases of troubled assets of DMBs by the Asset Management Corporation of Nigeria (AMCON), and growing concerns about the international economic and financial environment together with the rising global food and energy prices. Monetary policy in the period under review aimed at providing a balanced response to the varied challenges. Liquidity management operations were, accordingly carefully structured to meet the growing financial needs without losing sight of the need to sustain price stability and financial stability.

Finding and managing an appropriate mix of instruments to ensure price and financial system and growth was a key challenge.

The overall environment of monetary policy in the first half of 2011 was characterized by high inflationary pressures. Monetary policy responded to a number of other equally significant challenges. Finding and managing an appropriate mix of instruments to ensure price stability, banking and financial market stability and growth was a key challenge. Despite the enormous liquidity injection in the preceding half, monetary aggregates grew moderately but the flow of credit to the real sector of the economy continued to be low. As the deadline for withdrawing the Bank's guarantee on inter-bank placements drew close, the money market began showing signs of stress, evidenced by rising interest rates. The year-on-year headline inflation, which was 11.80 per cent in December 2010, rose to 12.80 per cent in March but eased to 10.20 per cent in June 2011. These challenges, combined with the relatively uncertain global outlook, defined the monetary policy landscape in the first half of 2011.

....effective communication and regular dialogues with market players helped significantly to shape market sentiments.....

The CBN used the Monetary Policy Rate (MPR) to anchor short-term interest rates, and rein-in inflation expectations in the first half of 2011. Reserve averaging was introduced to improve efficiency in the use of funds and the liquidity management by the DMBs. Reserve requirements and open market operations (OMO) supported by discount window operations (including the Standing Facilities, repos and reverse repos), remained the main instruments of monetary policy during the period. The Bank engaged complementary actions including primary market transactions in government securities, sale/purchases of CBN bills and foreign exchange in the management of system's liquidity. Efforts were made to bring about effective communication and more regular dialogues with market players, to shape-up market sentiments and ensure traction for monetary policy during the review period.

The Monetary Policy Committee (MPC) met thrice in the review period - January, March and May - to review domestic economic conditions and the attendant challenges against the backdrop of international economic developments. The MPR was adjusted upwards in all by 150 basis points, from 6.25 per cent to 6.50 per cent in January, 7.50 per cent in March and 7.75 per cent in May. Besides, the committee retained the symmetric interest rate corridor of +/-200 basis points. In addition, upward adjustments were effected in liquidity ratio in January by 500 basis points to 30.0 per cent from 25.0 per cent and cash reserve requirement by 100 basis points in January and again in May by 200 basis points. As at end -June 2011, CRR stood at 4.00 per cent as against 1.00 per cent at the end of 2010.

....decline in inflation rate ....was mainly the result traced to tight monetary policy.

The headline inflation fell from 12.80 per cent at the end of the first quarter to 11.3 per cent in April, and thereafter, rose to 12.4 per cent in May before dropping to 10.20 per cent at end-June 2011. The level of inflation declined by 3.90 percentage points in the first half of 2011 compared with the level in the corresponding period of 2010, reflecting in part the effectiveness of pursuing tight monetary policy.

Activities in the financial markets in the first half of 2011 were influenced, largely, actions to further calm the markets and to improve their resilience in meeting with the external and domestic pressures arising mainly from developments in the global economy). On the external front, sovereign debts had emerged to become an important source of concern as fiscal sustainability and solvency indicators deteriorated in some advanced economies, in particular in some euro area countries, prompting speculations about the possibility of defaults.

....credit to the private sector remained lower than envisaged and the demand for forex rose putting pressure on the exchange rate.

On the domestic front, market concerns about the condition of some intervened deposit money banks fuelled unease among participants while anxiety about the outcome of the April 2011 general elections led to bearish trends in stock prices. Credit to the private sector remained lower than envisaged while demand for foreign exchange rose, putting pressure on the exchange rate. As part of the measures to dampen the pressure, the Central Bank of Nigeria (CBN) extended the interbank guarantee from May 2010 to end-June 2011, and further to December, 2011. (This measure, combined with the continued actions of AMCON and other regulatory actions helped to calm the financial markets)

...liquidity management would remain challenging in view of the likely increases in government spending on infrastructures.....

The overall outlook for the second half of the year is somewhat mixed. While growth impulses appear to be robust, there are far too many uncertainties, partly emanating from the developments in the rest of the world. Current forecasts suggest that headline inflation could moderate with continued tightness in the stance of monetary policy. However, the year-on-year inflation rate may still remain at around the border of double digits. Liquidity management would continue to be challenging in view of the likely increase in government spending on infrastructure, salaries and wages, and further mop-up of troubled assets of the DMBs by AMCON, and the uncertain market behaviour of major participants. The good news is that the second half of the year would see the conclusion of bank consolidation.

CHAPTER 2
INTERNATIONAL ECONOMIC DEVELOPMENTS

2.1 The Global Economy

...global economy grew at an annualized rate of 4.3 per cent compared with 5.9 per cent in the corresponding period of 2010....

Provisional data indicate that the global economy grew at an annualized rate of 4.3 per cent in the first quarter of 2011, compared with 5.9 per cent recorded in the corresponding period of 2010 and the overall growth of 5.1 per cent for that year. Projections suggested a further drop in global output growth in the second half of 2011. The decline in global growth in the first half was largely attributed to the devastating effect of the Japanese earthquake and tsunami and the attendant supply disruptions which weighed heavily on global industrial production, the political crisis in the Middle East and North Africa (MENA) region and the sovereign debt crisis in the Euro Area.

Growth is expected to be weaker than previously projected in 2011, especially for the United States and Japan...

Growth in the advanced economies is projected to average 2.4 per cent during 2011–12, representing a modest decline from an average of about 3.0 per cent recorded in 2010. Growth is expected to be weaker than previously projected in 2011, especially for the United States and Japan, but could be partly offset by strong economic activities in core Euro area economies. The Japanese economy is forecast to rebound from the earthquake/tsunami in 2012 to offset the weaker growth in the United States.

Growth weakened in the United States due to transitory factors including higher commodity prices, adverse weather conditions,,,

At 2.5 per cent, annualized, growth weakened in the United States partly due to transitory factors including higher commodity prices, adverse weather conditions and supply chain disruptions from the Japanese earthquake on U.S. manufacturing. Preliminary estimates for the UK in the first quarter of 2011 indicate a growth rate of 0.5 per cent, while in Japan; it was estimated to have declined by 0.9 per cent over the last quarter[1]. In contrast, growth in the Euro Area was strengthened by robust investment in Germany and France. In the emerging and developing economies, growth

[1] US Bureau of Economic Activity

accelerated as projected, but with considerable variation across regions.

Output growth in emerging and developing economies is expected to average 6.5 per cent during 2011-12, compared with 7.5 per cent in 2010.

Output growth in emerging and developing economies is expected to average 6.5 per cent during 2011–12, compared with 7.5 per cent in 2010[2]. Generally, growth prospects vary across regions. For instance, growth in emerging Asia will decelerate only slightly from the very high levels of last year. Disruptions to regional production networks due to supply constraints from Japan appear contained, although some sectors, especially automobiles and electronics, could experience strains through the summer.

The Latin American economies would be bolstered by commodity exports and domestic demand but the pace will ease in some economies where policies have been tightening more aggressively. Growth in emerging Europe is now projected to be higher than previously expected in 2011, followed by a softening in 2012, driven in part by a sharp domestic demand cycle in Turkey. Activity is projected to continue strengthening in Sub-Saharan Africa, with domestic demand remaining robust and commodity exporters benefiting from elevated prices. Economic prospects in the MENA remain clouded by political and social unrest, although the outlook has improved for some oil and mineral exporters.

In the emerging and developing economies, inflation pressures were increasingly broad- based...

Global inflation picked from the 3.5 per cent in the last quarter of 2010 to 4.0 per cent in the first quarter of 2011, and was projected to rise further in the second quarter. Inflation accelerated mainly due to sharp increases in international commodity and oil prices occasioned in part by the negative impact of the political crises in the oil-producing MENA region. In the emerging and developing economies, inflation pressures were increasingly broad-based, reflecting higher share of expenditure on food and energy as well as rising aggregate demand pressure. Core inflation emerged as a major problem across a number of economies, especially in Latin America. However, among the advanced economies, core inflation

[2] IMF World Economic Outlook (WEO), April 2011 and June 2011 Update

remained subdued in the United States and Japan but rose moderately in the Euro area.

The global financial markets remained volatile during the first half of 2011, reflecting market concerns about sovereign debt risks in the Euro area, the recent softening in economic activity and persistent housing market weakness in the United States. The signals were mainly from rising sovereign credit default swap spreads in certain euro area economies, bearish global stock prices, and falling long-term bond yields in the major advanced economies. In addition, there were indications of insufficient pace of progress on banking system reform, notably in Europe, as well as risks related to re-leveraging in various market segments[3].

In the emerging and developing economies, the financial environment remained largely accommodative...

In the emerging and developing economies, the financial environment remained largely accommodative, although with greater variation across countries. In these countries, capital inflows were erratic probably reflecting the increased downside risks to the global economy and domestic policy concerns such as inflation. Some of the larger economies appeared to be witnessing rapid credit expansion, propelled by accommodative macroeconomic conditions and buoyant capital flows.

2.2 Regional/ Country Specific Developments

2.2.1 Economic Community of West African States (ECOWAS)

2.2.1.1 Output

ECOWAS countries recovered fast from the global financial crisis............ Gaps between actual production and potential output began to close in almost all Member States.

ECOWAS countries recovered fast from the global financial crisis. At 6.5 per cent, output expanded above the African average growth rate of 4.5 per cent in 2010 (Table 2.1). Gaps between actual production and potential output began to close in almost all Member States. With the exception of Cote d'Ivoire which recorded less than 3.0 per cent against 3.8 per cent recorded in 2009, all other countries in the region recorded higher growth rates in 2010. Niger and Guinea which had obtained negative growth rates of 0.9 and 0.3 per cent, respectively, returned to the path of economic growth with 7.5 and 1.9 per cent respectively in 2010. Nigeria and Ghana

[3] IMF June 2011 *Global Financial Stability Report (GFSR)*

recorded the highest growth rates of 7.9 and 6.6 per cent, respectively.

..economic growth would remain strong in many ECOWAS countries in 2011,

Estimates suggest that economic growth would remain strong in many ECOWAS countries in 2011, thus offsetting the declining growth in a few others on the overall output growth in the sub-region. The anticipated improvement in growth performance is largely attributed to rising commodity prices. The region, however, continues to be plagued by deficits in infrastructure and weak institutions.

Table 2.1
ECOWAS: Real GDP Growth (%)

	2007	2008	2009	2010	2011
AFRICA	**6.40**	**5.60**	**2.50**	**4.50**	**5.20**
ECOWAS	**5.70**	**5.60**	**5.60**	**6.80**	**6.50**
UEMOA	**3.20**	**3.90**	**3.10**	**3.90**	**4.40**
• Benin	4.60	5.00	2.70	2.80	3.50
• Burkina Faso	3.60	5.20	3.20	5.20	5.50
• Côte d'Ivoire	1.60	2.30	3.80	3.00	4.00
• Guinea Bissau	3.20	3.20	3.00	3.50	4.30
• Mali	4.30	5.00	4.50	4.50	6.00
• Niger	3.40	9.60	-0.90	7.50	3.20
• Senegal	4.90	3.20	2.20	4.00	4.40
• Togo	2.10	2.40	3.20	3.40	3.90
WAMZ	**6.40**	**6.10**	**6.40**	**7.60**	**7.10**
• Gambia	6.00	6.10	4.60	5.50	5.10
• Ghana	6.50	8.40	4.70	6.60	6.50
• Guinea	1.80	4.90	-0.30	1.90	4.00
• Liberia*	3.20	3.50	3.60	3.70	3.90
• Nigeria	6.50	6.00	6.70	7.90	7.30
• Sierra Leone	6.00	4.00	3.20	5.00	4.90
Other (Cape Verde)	8.60	6.10	4.00	5.60	4.50

Sources: WAMA, June 2011

Annual average inflation in ECOWAS stood at 9.9 per cent in 2010.

2.2.1.2 Inflation

Economic activity in ECOWAS during the period was within an environment of downward trending inflation occasioned by rising food and energy prices. Annual average inflation in ECOWAS stood at 9.9 per cent in 2010. In the first half of 2011, inflation trended downwards in some of the countries including Nigeria. Rates were generally lower among the UEMOA (Table 2.2).

Table 2.2
ECOWAS: Inflation Rate

	2007	2008	2009	2010	2011*
Africa	**6.30**	**7.50**	**7.70**	**7.50**	**7.80**
ECOWAS	**6.20**	**13.40**	**9.30**	**9.90**	**10.30**
UEMOA	**2.90**	**7.60**	**1.10**	**1.30**	**3.30**
Benin	1.30	7.90	2.20	2.10	2.10
Burkina Faso	2.00	10.70	0.90	-0.60	2.90
Côte D'Ivoire	2.50	6.30	0.50	1.70	3.70
Guinea Bissau	3.00	7.90	-2.80	2.20	4.00
Mali	0.00	9.20	2.40	1.20	3.20
Niger	4.70	13.60	7.10	0.90	3.30
Senegal	6.10	4.30	-1.20	1.20	3.40
Togo	3.40	10.20	2.40	1.40	3.60
WAMZ	**7.30**	**15.20**	**11.80**	**12.60**	**12.40**
Gambia	6.00	6.80	4.60	5.00	5.00
Ghana	12.80	18.10	20.70	14.70	16.00
Guinea	12.80	13.50	4.70	15.50	18.70
Liberia	11.70	9.40	7.40	7.30	7.30
Nigeria	6.60	15.10	11.20	12.40	12.00
Sierra Leone	13.80	13.20	12.50	9.90	17.10
Other (Cape Verde)	**4.40**	**6.80**	**5.80**	**3.10**	**1.00**

- *Estimates*

Source: WAMA, June 2011

Overall ECOWAS deficit was estimated in 2011 at 3.6 per cent of GDP compared with 3.9 per cent in 2010.

2.2.1.3. Public Finance and Debt

The ECOWAS budget deficit (including grants) widened from 3.2 per cent of GDP in 2009 to 3.9 per cent in 2010. Expenditure and net lending accounted for 23.9 per cent in 2010. The expansion in expenditure stemmed mainly from capital outlays which increased in most of the countries as a result of infrastructure development and implementation of poverty reduction strategies. The upward trend in recurrent expenditure was largely linked to rising wage bills. Revenues and grants accounted for 20 per cent of GDP in 2010. Provisional data point to some fiscal consolidation in 2011. Overall ECOWAS deficit was estimated in 2011 at 3.6 per cent of GDP compared with 3.9 per cent in 2010. UEMOA countries were expected to return a lower deficit-to-GDP ratio in the current year (Table 2.3).

Table 2.3
ECOWAS: Budget Deficit (including grants)
(% of GDP)

	2007	2008	2009	2010	2011
Africa	**-**	**2.20**	**4.40**	**3.30**	**1.90**
ECOWAS	**2.90**	**2.40**	**3.20**	**3.90**	**3.60**
UEMOA	**5.00**	**4.50**	**2.50**	**3.20**	**3.20**
Benin	1.80	3.50	4.90	2.50	2.60
Burkina Faso	12.10	8.30	6.20	7.50	3.50
Côte D'Ivoire	1.40	2.20	-0.90	1.60	2.20
Guinea Bissau	13.70	12.20	-1.80	1.10	1.10
Mali	7.90	5.60	2.80	4.40	3.80
Niger	6.70	4.20	5.70	2.80	0.70
Senegal	7.10	7.20	4.90	4.60	5.80
Togo	2.30	2.30	0.60	-0.60	2.70
WAMZ	**2.30**	**1.80**	**3.50**	**4.00**	**3.70**
Gambia	1.00	2.70	4.00	2.90	8.60
Ghana	14.50	19.50	4.30	4.10	3.90
Guinea	0.90	1.70	7.50	14.00	6.60
Liberia	3.40	2.00	-1.10	-6.60	2.00
Nigeria	1.20	0.20	3.30	3.80	3.50
Sierra Leone	5.00	7.10	2.70	6.10	8.40
Cape-Verde	**3.60**	**6.50**	**6.80**	**12.00**	**13.60**

Sources: WAMA, June 2011

The public debt position of ECOWAS countries improved due mainly to debt relief extended to some countries under the HIPC initiative. Thus, the overall level of outstanding debt declined from 19.3 per cent in 2009 to 17.4 per cent in 2010, *The public debt position of ECOWAS countries improved due mainly to debt relief extended to some countries under the HIPC initiative*

and was expected to improve further in 2011. Current estimates suggest that the debt ratio could crash in the WAMZ from 17.5 per cent in 2010 to 7.6 per cent in 2011. The prospects were not too bright for the UEMOA countries.

Given the rising cost of external debt, domestic debt has become an alternative source of financing the budget deficit. Consequently, the domestic debt of most ECOWAS countries as a percentage of GDP is upward trending.

2.2.1.4 Monetary Policy Measures

....a number of central banks in the sub- region adjusted their monetary policy stance to reflect changes in economic and liquidity conditions...

The slowdown in credit in the ECOWAS economies in 2010 informed most central banks in the sub-region to relax monetary policy. In the first half of 2011, however, a number of central banks in the sub-region adjusted their monetary policy stance to reflect changes in economic and liquidity conditions once the risks of the second-round effects of the global financial meltdown had crystallized. During the crises, most central banks lowered their refinancing rate and injected liquidity into their economies in addition to official guarantees on money market transactions.

Table 2.4
ECOWAS: Trend in Interest Rates (%)

Zones	Interest Rate	2006	2007	2008	2009	2010*
CFA	Savings	3.50	3.50	3.50	3.50	3.50
	Lending	Free	Free	Free	Free	Free
	Treasury bills	4.50	4.50	4.50	4.50	4.50
	Policy rate	4.60	4.80	5.50	6.75	4.25
Escudo	Savings	3.05	3.05	3.05	3.05	3.05
	Lending	13.50	13.50	13.50	13.50	13.50
	Treasury bills	6.30	6.30	6.30	6.30	6.30
	Policy rate	5.45	5.45	5.45	5.45	4.25
Dalasi	Savings	5.00	5.00	5.00	4.00	4.00
	Lending	14.00	13.30	13.30	18.00	18.00
	Treasury bills	12.80	12.80	12.80	12.40	12.40
	Policy rate	14.00	14.80	15.30	15.50	14.50
Cedi	Savings	1.50	1.00	2.20	2.00	2.00
	Lending	24.00	23.80	27.30	32.90	30.50
	Treasury bills	9.90	10.60	24.70	23.70	12.90
	Policy rate	12.50	13.50	17.00	18.00	14.70
GNF	Savings	14.70	14.70	14.00	16.00	16.00
	Lending	Free	Free	Free	Free	Free
	Treasury bills	22.30	21.40	20.81	19.03	4.82
	Policy rate	22.25	22.25	20.62	10.17	13.43
Dollars Lib	Savings	2.70	2.60	2.25	2.10	2.72
	Lending	15.92	15.25	14.88	14.20	15.50
	Treasury bills	9.80	6.80	9.80	9.80	9.80
	Key rate	3.00	3.00	3.00	3.00	3.00
Naira	Savings	2.00	2.00	2.00	2.00	0.50
	Lending	17.30	17.30	19.35	23.06	22.96
	Treasury bills	7.50	7.80	7.94	4.51	2.04
	Policy rate	9.10	9.10	9.90	7.50	6.10
Leone	Savings	5.50	5.50	4.00	3.50	3.50
	Lending	27.00	28.00	27.00	25.50	25.00
	Treasury bills	14.20	21.20	9.10	14.00	15.01
	Policy rate			20.01	21	23

- *Estimates*

Source: WAMA, June 2011

2.2.1.5 External Sector

....in ECOWAS, the current account position of member countries deteriorated as it dropped from 7.0 per cent of GDP in 2009 to 0.1 per cent of GDP in 2010.

The global economy commenced the path to recovery in 2010 following the devastating financial and economic crises, with sub-Sahara African countries performing particularly well. Consequently, the current account balance of most countries was expected to improve steadily. However, in ECOWAS, the current account position of member countries deteriorated as it dropped from 7.0 per cent of GDP in 2009 to 0.1 per cent of GDP in 2010. The decline was traceable to deterioration in balance of trade, income and current transfers which diminished as a result of declining budget support and migrant-worker remittances. The UEMOA countries were particularly hit in 2010 (Table 2.5).

Projections as indicated by WAMA showed that the current account position of most ECOWAS countries could improve in 2011 following improved commodity prices and exports.

Table 2.5
ECOWAS: Current Account and Balance of Payments Position (% of GDP)

	2007	2008	2009	2010	2011**	2007	2008	2009	2010	2011**
Africa	--	3.80	-2.90	0.04	--	--	--	--	--	--
ECOWAS	*8.80*	*11.70*	*7.00*	*0.10*	-	10.90	-0.20	-8.20	-2.80	--
UEMOA	*-6.40*	*-7.10*	*-3.50*	*-5.50*	*-5.90*	2.80	0.30	1.70	0.50	0.50
Benin	-9.00	-8.10	-7.80	-9.40	-9.60	-9.00	-8.10	-1.50	0.50	0.10
Burkina Faso	-8.30	-11.70	-4.60	-7.50	-6.90	-8.30	-1.10	7.40	0.60	0.60
Côte D'Ivoire	-0.70	1.90	7.40	4.60	3.00	2.30	-0.10	1.20	0.40	0.70
Guinea Bissau	-4.40	-3.40	-4.50	-7.80	-4.60	3.70	3.90	3.60	1.20	2.80
Mali	-8.10	-12.20	-7.30	-10.10	-8.70	-0.30	-0.90	5.80	0.60	0.30
Niger	-8.20	-13.00	-23.50	-24.40	-22.70	3.30	3.00	-3.70	1.10	0.20
Senegal	-11.60	-14.20	-8.40	-8.20	-9.20	1.30	-1.50	1.60	0.20	0.50
Togo	-8.50	-7.00	-7.00	-8.40	-8.20	0.00	2.60	0.30	0.20	0.70
WAMZ	13.60	17.70	10.50	2.10	--	13.60	-0.30	-11.30	-4.00	--
Gambia	-7.00	1.20	6.70	4.40	n.a	-9.90	-10.10	-0.70	8.00	n.a
Ghana	-12.90	-21.80	-10.40	-14.20	n.a	-12.90	-11.90	7.50	11.30	n.a
Guinea	-10.10	-6.10	-8.80	-7.30	n.a	-10.10	-0.60	1.30	-1.60	0.30
Liberia	-22.50	-18.40	-33.30	-38.80	-54.70	-22.50	-9.90	9.80	68.20	1.20
Nigeria	16.70	22.00	13.10	3.80	n.a	16.70	0.80	-13.40	-5.40	n.a
Sierra Leone	-9.30	-12.60	-20.20	-12.30	n.a	-9.80	-8.70	6.60	-5.40	n.a
Cape Verde	-14.60	-16.00	-16.70	-13.10	n.a	-14.60	1.70	-1.10	-1.30	n.a

*** Projections*
Sources: WAMA, June 2011

...Sub-Saharan Africa was projected to grow by 5.5 per cent in 2011. However, this forecast is laden with considerable uncertainty and risks related to the global economy,

Nominal exchange rates depreciated in all ECOWAS countries except the CFA and the escudo. At the sub-regional level, foreign reserves were below the end- 2009 level in 2010. The WAMZ countries, in particular, on the aggregate, witnessed a significant decline in reserves, linked to the depletion in Nigeria's external reserves.

2.2.2 Sub-Saharan Africa

The Sub-Sahara African region continued to show resilience in the face of sluggish global recovery from the economic and financial crisis. The region has maintained an impressive growth path overall. From 2.8 per cent in 2009, the region grew by 5.4 per cent in 2010 and currently projected to grow at 5.2 per cent in 2011. However, this forecast is laden with considerable uncertainty and risks related to the global economy, notably the impact of the earthquake and nuclear crisis in Japan, the political and social crises in the MENA region, Côte d´Ivoire and other flash spots in the sub-region, and their effects on neighboring countries.

Growth in the region continues to be accompanied by increased inflationary pressures. From 7.5 per cent average inflation rate in 2010, the region is forecast to witness an even higher inflation at 8.4 per cent in 2011; the main drivers being food and fuel prices. The oil producing SSA countries, especially Nigeria, Angola and equatorial Guinea have continued to experience higher inflationary pressures owing partly to rapid monetization of oil revenues. On the other hand, the non-oil SSA countries have had much lower inflationary pressures, thus moderating the region's average.

2.2.3 Middle East and North Africa (MENA)

Given the region's rapidly growing population, the demographic pressure on labor markets would continue in many countries.

Political and social instability continues to threaten growth in the MENA region, leaving a highly uncertain overall economic picture. The resulting paralysis of economic and social life has further dampened prospects of the region's recovery from the global economic crisis. Youth unemployment has remained a major problem in the region, contributing to the current wave of political unrests leading to the overthrow of governments in Tunisia and Egypt. Labour markets have not been flexible enough to absorb the growing supply of young workers. Given the region's rapidly growing population, the demographic pressure on labour markets could continue for some time.

However, high commodity prices and increased external demand are expected to boost production and exports in some of the countries. Increased government spending programmes could play a key role in fostering the recovery.

With regard to financial sector policy, assistance to financial systems helped in containing vulnerabilities and spillovers, especially from the Gulf Cooperation Council. In spite of such support, banks in the region have become more cautious, following recent episodes of financial sector distress that occurred amid sharp corrections in property markets.

2.2.4 Asia

Growth in Asia continued to out-pace other regions as broad-based recovery in most countries was supported by strong export performance, buoyant private domestic demand.....

Growth in Asia continued to out-pace other regions as broad-based recovery in most countries was supported by strong export performance, buoyant private domestic demand, and in some cases, rapid credit growth. During the first half of 2011, growth moderated from cyclically high levels to more sustainable rates. With the notable exception of Japan, output gaps in much of the region closed rapidly, creating concerns about inflation and overheating. Credit growth was accelerating in some economies, and remained especially high in China. Most of the increase in headline inflation in recent months had been due to hikes in food prices, and core inflation was on the increase, most notably India. Real estate prices were on a double-digit rise in a number of countries.

Capital flows to Asia are likely to continue, motivated by both cyclical and structural factors.

Asia is projected to expand rapidly in 2011 driven by robust export gains in market share with increased intra-regional trade partially offsetting the weakness in final domestic aggregate demand from the advanced economies. Capital flows to Asia are likely to continue, motivated by both cyclical and structural factors. Autonomous private consumption growth would remain strong, supported by robust asset valuations and improved labour market conditions. After growing by 10.25 per cent in 2010, China's growth was estimated to remain robust at 9.5 per cent in 2011 with the growth drivers shifting increasingly from public to private demand. Consumption was expected to be supported by rapid credit growth, improved market conditions, and continuing policy efforts to raise household disposable income.

2.2.5 The Euro Area

The recovery in Euro area has continued to be gradual and uneven following renewed financial turbulence in the peripheral economies during the last quarter of 2010. The region is projected to grow at 1.60 per cent in 2011 down from 1.80 per cent recorded in 2010. Growth in emerging Euro area is expected to slow to 4.30 per cent in 2011 from 4.50 per cent

The recovery in Euro area has continued to be gradual and uneven following renewed financial turbulence in the peripheral economies during the last quarter of 2011

in 2010, mainly as a result of declining consumption arising from the retrenchment of fiscal stimulus and weakening export growth occasioned by slowing external demand. There have been considerable variations in economic prospects across the region largely due to differences in the state of public and private sector balance sheets. In Germany, growth is expected to moderate from 3.60 per cent in 2010 to 2.70 per cent in 2011. On the other hand, growth in France is projected to scale up to 1.70 per cent in 2011 from 1.40 per cent in 2010. Amongst the advance euro zone economies, Italy and Spain appear to be showing the weakest recovery prospects with growth forecast for 2011 currently at 0.60 and 0.80 per cent, respectively. Weak growth performance in both economies may be partly a consequence of constrained export growth and the expected fiscal consolidation, as they struggle with protracted fiscal imbalances and severe structural unemployment.

...public debt sustainability remained a priority for most euro area economies.

Banking sector losses and the fiscal problems have combined to widen sovereign spreads in some of the euro zone economies in the first half of 2011, in some cases reaching levels not experienced since the commencement of the Economic and Monetary Union. Consequently, public debt sustainability remained a priority for most euro area economies. Sovereigns notably; Greece, Ireland, and Portugal which have been under severe market pressure are expected to continue with sizable front-loaded consolidation, and perhaps austerity measures to reduce fiscal deficits and reassure the markets. In addition to the financial strains from the sovereign debt crisis in the area, inflationary pressures appear to be gaining momentum. From 1.60 per cent in 2010, consumer prices are currently projected to rise by 2.50 per cent. The area's current account appears to be gaining a boost from Germany and Netherlands especially. Both countries are projected to close in year 2011 with a positive current account in excess of 4.0 per cent of GDP. This is expected to move the current account balance of the euro area from the deficit recorded in 2010 to the positive region in 2011.

..burst of growth in the U.S economy in late 2009 which slowed in early 2010, picked again in the second half of that year, ...

2.2.6 United States of America (USA)

The recovery of the U.S. economy slowed in the first half of 2011, prompting downward revisions in growth forecasts. Currently, the economy's real GDP is forecast to grow at 1.50 per cent in 2011 down from 3.0 per cent recorded in 2010. During the first half 2011, output growth in the United States was slower than expected due to weak consumer demand which declined from 2.1 per cent in the first quarter to 0.1 per cent in June 2011. Other factors at play included higher commodity prices, bad weather, and the effects on manufacturing of supply chain disruptions due to the Japanese earthquake. The deterioration in global financial conditions derived mainly from increased market concerns and apprehensions over sovereign risks in the euro area and persistent housing market weakness led to a prolonged softening in economic activity in the U.S.

Consumer prices in the U.S have, in general, trended upward despite the slowdown in economic activity. This is in part traceable to the prolonged fiscal and monetary expansion following the housing and financial crisis. Currently, year-end headline inflation is forecast to rise in 2011 to 3.0 per cent from 1.6 per cent in 2010.

The trade position of the country continues to be a major source of weakness. The overall current account position remained negative during the period under review, and has been projected at -3.1 per cent for 2011. This weakness could persist unless there is significant improvement in the country's major trading partners especially the euro area.

CHAPTER 3
MONETARY POLICY

3.1 Introduction

In the first half of 2011, the thrust of monetary policy was the promotion of price stability, in contrast to the liquidity enhancing measures up to the third quarter of 2010

The Central Bank of Nigeria (CBN) achieved significant progress in the restoration of stability in the financial sector by end-December 2010. In the first half of 2011, the thrust of monetary policy was the promotion of price stability, in contrast to the liquidity- enhancing measures up to the third quarter of 2010 aimed at achieving financial stability. Domestic inflation remained high in the first half of 2011; partially on account of the rise in international oil and other commodity prices, and partly on account of the high spending prompted largely by the compulsions of the general elections and to an extent the lagged effect of the measures taken to increase the liquidity of the financial system, during the crisis period of 2009 and also the AMCON operations related to banking system stability.

3.2 Monetary Policy Measures

...persistent inflationary pressures in the first half of 2011 led to the continuation of the tight monetary policy stance

To address the persistent inflationary pressures, the monetary policy stance has been tightened since September 2010. The stance was reflected in the rise of the policy rate, the MPR, from 6.25 per cent at the end of 2010 to 7.50 per cent by June 2011, and rise in the liquidity ratios (LR and CRR).

3.3 Activities of the Monetary Policy Committee (MPC)

The MPC held 3 regular meetings during the period under review. The Committee reviewed trends in domestic and global economic conditions and the challenges facing monetary policy in an ever-changing financial environment.

3.3.1 Decisions of the MPC

The MPC observed that economic growth was fundamentally constrained by structural deficiencies....

At its first meeting in 2011 held January 24 - 25, the MPC noted significant downside risks to inflation arising mainly from prospects of increased liquidity injections from high government spending in the run up to the April 2011 general elections. In addition, purchases by AMCON as well as rising global energy and food prices (and the expected pass-through to the domestic economy) constituted other sources of downside risks to inflation. The Committee also expressed serious concerns about the low savings deposit rates (of about 1.0 per cent) and its implications for financial intermediation and the mobilization of critical long-term funds for real sector investment. The MPC observed that economic growth was fundamentally constrained by structural deficiencies as the economy was largely import-dependent, leading to a continued depletion in external reserves (Table 3.1). To meet these challenges, the MPC decided to tighten the monetary policy with emphasis predominantly on quantitative measure.

Table 3.1
Decisions of the Monetary Policy Committee (July to December 2010)

	Decision	MPR Adjustment	Standing Facility Adjustment
January 24-25, 2011 (Communiqué No. 74)	- Raised the MPR by 25 basis points from 6.25 per cent to 6.50 per cent - Maintained the symmetric corridor of +/- 200 basis points - Raised the Cash Reserve Requirement (CRR) Ratio by 100 basis points from 1.00 per cent to 2.00 per cent. - Raised the Liquidity Ratio (LR) by 500 basis points from 25.00 per cent to 30.00 per cent.	Raised MPR to 6.50 per cent	Corridor +/- 200 basis points
March 21-22, 2011 (Communiqué No. 75)	- Increased in MPR from 6.50 per cent to 7.50 per cent - Retained the Symmetric Corridor at +/- 200 basis points - Retained CRR at 2.0 per cent - Retained the Minimum Liquidity Ratio at 30.0 per cent - Extended CBN guarantee of the Interbank Market and foreign creditors to September 30, 2011.	Raised MPR to 7.50 per cent.	Corridor +/-200 basis points.
May 23-24, 2011 (Communiqué No. 76)	- An increase in the MPR from 7.50 per cent to 8.00 per cent - An increase in the CRR from 2.0 per cent to 4.0 per cent - Retained the symmetric corridor around the MPR	Raised MPR to 7.75 per cent	Corridor +/- 200 basis points

Source: Central Bank of Nigeria

The MPC observed the negative impact of the political crises in the oil – producing Middle East and North Africa (MENA) region on oil prices...

The MPC raised the MPR by 25 basis points from 6.25 per cent to 6.50 per cent and raised the Cash Reserve Requirement (CRR) by 100 basis points from 1.00 per cent to 2.00 per cent with effect from February 2011 and raised the Liquidity Ratio (LR) by 500 basis points from 25.00 per cent to 30.00 per cent with effect from 1st March 2011. The interest rate corridor was left unchanged at +/- 200 basis points in relation to the MPR.

At the March 21st and 22nd 2011 meeting, the MPC observed that 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 destruction associated with the earthquake and tsunami in Japan had added to the uncertainty about the sustainability of the global economic recovery and growth. The Committee, however, noted the positive growth outlook in the domestic economy in the near-to-medium term but expressed serious concern over the heightened risk of inflation arising from the high expenditure outlay of the Federal Government as contained in the 2011 Appropriation Act. The Committee observed that money market rates were generally high and that credit to the private sector continued to be sluggish attributable partly to the delayed passage of the 2011 federal budget and, partly, to the ongoing banking sector reforms. To address the concerns identified, the MPC extended the CBN guarantee on interbank transactions and foreign credit lines by three months from June 30, 2011 to September 30. The MPR was increased by 100 basis points from 6.50 per cent to 7.50 per cent.

..there were serious concerns about debt sustainability in many developed countries, particularly in the euro zone,

At the May 23rd – 24th 2011 meeting, the MPC noted the pace of economic recovery in some major developed economies along with some improvements in stock market indices. Inflationary threats persisted following sharp increases in international oil and commodity prices. In addition, there were serious concerns about debt sustainability in many developed countries, particularly in the euro zone, requiring strong fiscal adjustment with attendant risk of economic slowdown in the medium-term. On the domestic scene there were concerns about the high liquidity engendered by the high spending in the run up to the April elections and by the AMCON operations. In addition, the release of intervention funds would have significant impact in the short run. The MPC, therefore, stressed the importance of continuing structural reforms and infrastructure 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 also reaffirmed its commitment to exchange rate stability ..

The MPC increased the MPR by 50 basis points from 7.50 per cent to 8.00 per cent, maintained the symmetric corridor of +/- 200 basis points as well as Liquidity Ratio 30.0 per cent. The CRR, however, was increased by 200 basis points from 2.00 per cent to 4.00 per cent to reduce the liquidity impact of the excessive spending. The Committee reaffirmed its commitment to exchange rate stability and support for the existing fiscal mechanisms to bolster domestic output growth and extended the CBN guarantee on interbank transactions and guarantee of foreign credit lines by three months from June 30, 2011 to September 30, 2011 (Table 3.2).

Table 3.2
Changes in CBN Key Interest Rates
(%)

	MPR	Standing Facility		CRR	Liquidity Ratio
		SDF	SLF		
MPC Communiqué No.74	6.25	**4.25**	**8.25**	2.00	25.00
MPC Communiqué No.74	6.50	4.25	8.25	2.00	30.00
MPC Communiqué No.75	7.50	5.25	9.25	2.00	30.00
MPC Communiqué No.76	8.00	6.00	10.00	4.00	30.00

Source: Central Bank of Nigeria

..banking system liquidity had been sufficiently restored and inflationary pressures, ...pre-occupied the attention of monetary management.

3.4 Liquidity Conditions and Management

The CBN took simultaneously, measures that will help improve growth impulses in the non-oil sector. The measures are given in Table 3.3. They are also designed that they help deliver financial services at affordable prices and terms to a larger proportion of the population and to connect the unbanked with mainstream financial services. A total disbursement of ₦538.07 billion was made during the first half of 2011. With this, the banking system liquidity was restored and presented challenges for managing liquidity.

Table 3.3
CBN Intervention for Agriculture, SME and Infrastructure Initiatives

Name of Scheme	Size of Intervention	Disbursement (as at June 2011)
Agricultural Credit Guarantee Scheme Fund (ACGSF)	75.0 per cent guarantee in respect of DMBs loans granted for agricultural purposes	N44.34 billion
Agricultural Credit Support Scheme (ACSS)	N50.0 billion	N19.43 billion
Commercial Agricultural Credit Scheme (CACS)	N200.0 billion	N131.49 billion
Refinancing/Restructuring Small and Medium Enterprises (SME) Manufacturing Fund	N200.0 billion	N199.67 billion
Small and Medium Enterprises (SME) Credit Guarantee Scheme (SMECGS)	N200.0 billion	N22.75 billion
Power and Aviation Infrastructure Fund (PAIF)	N300.0 billion	N120.39 billion
The Nigerian Incentive-Based Risk Sharing System for Agricultural Lending (NIRSAL)	US$500.0 million	(CBN Management approved the establishment and implementation of NIRSAL on June 14, 2011)
Total	**N1,450.00 billion**	**N538.07 billion**

Source: Central Bank of Nigeria

The major tool of liquidity management in the first half of 2011 remained Treasury Bills auction through Open Market

The major tool of liquidity management in the second half of 2010 remained Open Market Operations...

Operations, complemented by Discount Window Operations and Statutory Reserve Requirements. Total subscription to Nigerian Treasury Bills (NTBs) in the primary market during the first half of 2011 was higher at ₦1,466.47 billion than the subscription of ₦1,269.95 billion recorded in the second half of 2010 and ₦734.46 billion in the first half of 2010.(Table 3.4).

Table 3.4
Nigerian Treasury Bills Auction (N'million)
(January 2009-June 2011)

Date	2009	2010	2011	% Change over the Previous Year
Jan	115,466.62	149,834.17	205,585.55	
Feb	80,106.56	100,217.01	216,924.18	
Mar	80,000.00	65,000.00	284,056.99	
Apr	101,356.24	160,494.88	215,067.41	
May	120,217.01	100,217.01	204,607.78	
Jun	120,000.00	158,700.00	340,233.10	
1st Half	**617,146.43**	**734,463.07**	**1,466,475.01**	**99.60**
Jul	125,356.17	250,912.17		
Aug	105,217.01	141,157.45		
Sep	91,648.64	206,567.24		
Oct	170,260.38	167,012.31		
Nov	120,217.01	205,930.87		
Dec	162,557.83	297,909.82		
2nd Half	775,257.04	1,269,489.86		**15.52**
Cumulative Figure	**1,392,403.47**	**2,003,952.93**		**43.92**

Source: Central Bank of Nigeria

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3.5 Standing Lending/Deposit Facilities

The volume of transactions at the CBN Standing Lending Facility (SLF) in the first half of 2011 stood at ₦17,628.46 billion compared with ₦3,340.46 billion recorded in the second half of

..CRR was reviewed in January from 1.0 to 2.0 per cent and in May 2011 to 4.0 per cent,...

2010 and ₦428.7 billion in the corresponding period of 2010. The level of SLFs at end-June 2011 represents an increase of 427.7 and 4,012.1 per cent over the level in the second half and the corresponding period of 2010, respectively. This reflects the increased pressure on the funding requirement in the light of the constraints imposed by the increase in the CRR from 1.00 per cent to 2.00 per cent in January and from 2.00 per cent to 4.00 per cent in May 2011 (Table 3.5).

Table 3.5
CBN Standing Lending Facility (₦'billion)
(January 2009-December 2010)

Date	2009	2010	2011	Percentage change over the preceding year
Jan	846.18	135.50	565.51	
Feb	3,457.57	-	1,369.60	
Mar	4,592.69	-	3,425.47	
Apr	3,875.48	-	3,328.35	
May	2,581.43	270.97	3,722.41	
Jun	3,691.75	21.70	5,217.30	
1st Half	**19,045.11**	**428.17**	**17,628.64**	**4017.21**
Jul	4,675.02	55.76		
Aug	3,733.78	0.00		
Sep	2,287.90	73.10		
Oct	1,231.61	983.44		
Nov	537.58	1,374.80		
Dec	1,022.60	853.50		
2nd Half	**13,488.49**	**3,340.60**		**680.20**
Total	**32,533.60**	**3,768.77**		**(88.42)**

Source: Central Bank of Nigeria

..decrease in the standing deposit facility was as a result of its discontinuation following the introduction of the reserve averaging mechanism....

The Standing Deposit Facility (SDF) in the first two months of 2011 was lower than the amount recorded in the corresponding months of 2010. Following the introduction of the reserve averaging mechanism and the introduction of remuneration of the reserve balances in excess of the required

..decrease in the standing deposit facility was as a result of its discontinuation following the introduction of the reserve averaging mechanism....

reserve from March 09, 2011, the Standing Deposit Facility ceased to be relevant. However, all excess reserve could be interpreted to be equivalent of balances held in the SDF since they are remunerated at the rate that would have been applied on balances held in SDF. From this standpoint, SDF during the period under review amounted to N2,932.88 billion (Table 3.6), which was lower than the amount held in the first half of 2010 as well as the second half of 2010.

Table 3.6
Standing Deposit Facility (N'billion)
(January 2009-June 2011)

Date	2009	2010	2011*	% Change over the preceding year
Jan	-	5,622.63	1,864.94	
Feb	-	6,101.90	666.25	
Mar	-	9,413.45	180.65	
Apr	-	6,853.06	49.65	
May	-	1,735.45	74.21	
Jun	-	5,563.64	97.18	
1st Half	-	**35,290.13**	**2,932.88**	(91.69)
Jul	162.00	4,055.52		
Aug	1,453.38	6,849.71		
Sep	1,058.75	4,224.80		
Oct	3,106.30	1,117.30		
Nov	1,050.59	443.78		
Dec	1,797.92	1,191.78		
2nd Half	8,628.94	17,882.89		83.6)
Cumulative Figure	8,628.94	53,173.02		516.22

Source: Central Bank of Nigeria

- **The figures reported for the months of April, May and June are in actual fact the excess reserves of DMBs remunerated at the SDF rate.**

..standing facilities were supported by the reserve averaging framework...

The Reserve Averaging and Interbank Market Activity

During the review period, reserve averaging helped to facilitate improvement in the day-to-day liquidity management. However, with the increase in cash requirements the DMBs incurred additional costs by resorting to the Standing Lending Facility frequently, especially so in the periods when the structural liquidity was under pressure. The DMBs therefore maintained a daily average of ₦81.0 billion to meet the cash reserve requirements. The resultant cost to the CBN arising from the remuneration of the surplus reserves of DMBs also rose (Table 3.7)

Table 3.7
Reserve Averaging Framework
(First to Fourth Maintenance Period)

Maintenance	Total CRR	Total Reserve	Surplus Reserves	Interest Paid	Interest Rate
Period	(N)	(N)	(N)	(N)	(%)
09/03-05/04	190,462,851,803.00	278,127,368,198.42	87,664,516,395.42	333,318,533.46	4.50-5.50
06/04-10/05	191,355,931,279.00	241,010,729,510.54	49,654,798,231.54	261,878,045.47	5.50-5.50
11/05-07/06	189,434,914,876.00	263,640,030,498.71	74,205,115,622.71	329,515,587.97	5.50-6.00
08/06-05/07	376,957,073,367.00	474,133,289,743.90	97,176,216,376.90	447,276,831.54	6.00-6.00

Source: Central Bank of Nigeria

.shortfall in the supply of structural liquidity ...., increased pressure on short-term interest rates in the interbank market...

Following the decision of the Monetary Policy Committee at its meeting of May 23-24, to raise the CRR from 2.0 to 4.0 per cent, the DMBs had to closely manage their portfolios to ensure that they met the adjusted required reserves level. The increase in the CRR had a particularly adverse impact on the intervened banks as it further increased their reliance on overnight funding to meet the higher cash reserve requirement. At the same time, the non-intervened banks reduced their exposure to the intervened banks because they also needed to meet the higher cash reserve requirements.

Besides, uncertainty about the prospects of the recapitalization of the intervened banks led to some liquid banks to reduce their exposures to them in anticipation of the removal of CBN guarantee on interbank placements. The reduction in this line of credit was particularly detrimental to the stability of the interbank market. This situation called for further policy fine-tuning.

Box 3.1
Reserve Averaging Framework

In February 2011, the Bank announced a reserve averaging framework in a bid to refocus its monetary policy framework to complement the use of the monetary policy rate (MPR) introduced in December, 2006 to anchor short-term money market rates and other interest rates. The new reserve averaging method which commenced effectively on March 9, 2011 had a maintenance period of 28 days unlike the hitherto CRR maintenance period of 14 days. The extended maintenance period provided DMBs with the leverage to have more flexibility in keeping their reserves. The policy also impacted positively on money market liquidity as it freed more reserves into the market.

Thus, the bank's standing facilities for lending and deposit were supported by reserve averaging to ensure optimal day-to-day liquidity management. Generally, short-term operations were conducted by banks through the Standing Lending Facility (SLF). The supply of structural liquidity relative to demand, determined the interbank interest rate over a medium term. In contrast, the effectiveness of fine-tuning operations had an impact on the degree of short-term volatility around the medium-term interest rate.

The operation of the reserve averaging framework impacted profoundly on the liquidity of the intervened banks which had relied heavily on overnight funding to meet their funding gap, as they required more cash balances to meet their CRR requirements. This phenomenon was more evident given the oligopolistic structure of the banking system when the few big banks provided leadership in cautiously extending interbank temporary accommodation to the intervened banks because of their high risk perceptions. The policy, however, came with additional costs to the DMBs as structural liquidity fell significantly forcing the market to borrow daily substantial funds from the SLF to meet their cash reserve requirements and other operational needs.

The cost of liquidity was further exacerbated by liquidity drain through CBN sales of foreign exchange. Moreover, the increase in the CRR (from 2.0 to 4.0 per cent) in June 2011 had a significantly adverse effect on the DMBs, thus increasing the uncertainty about the prospects of bank recapitalization as some highly liquid banks tightened their hold on available liquidity lines in the interbank market in anticipation of the removal of the CBN guarantee by end-September 2011.

Monetary Policy and the Interbank Money Market

Interbank Market Guarantee

need to sustain confidence in the interbank market necessitated the CBN to extend , ...the guarantee on transactions in the interbank money market,...

The need to sustain confidence in the interbank market necessitated the CBN to extend, during the review period, the guarantee on transactions in the interbank money market, introduced in July 2009. The guarantee was initially introduced to restore the integrity of the money market and to mitigate counter-party risks. Following the tight monetary policy regime since September 2010, activities in the money market slowed. While the CBN guarantee encouraged trading amongst the DMBs, and helped reduce the pressure on the CBN standing lending window, active monetary operations using OMO and foreign exchange interventions, were used to stabilize short-term interbank interest rates (Table 3.8). Although the interbank guarantee was initially designed to last till 31st December 2009, it was extended to 30th June 2011 and further to 30th September 2011 (and 31st December 2011 for the intervened banks that had signed Transaction Implementation Agreement (TIA) with prospective core investors), as signal of the central bank's commitment to the liquidity and stability of the financial system. The CBN's guarantee of July 2009 also covered deposit money bank's exposures to foreign banks.

Table 3.8
Cumulative Interbank Market Guarantee*
(N'billion)

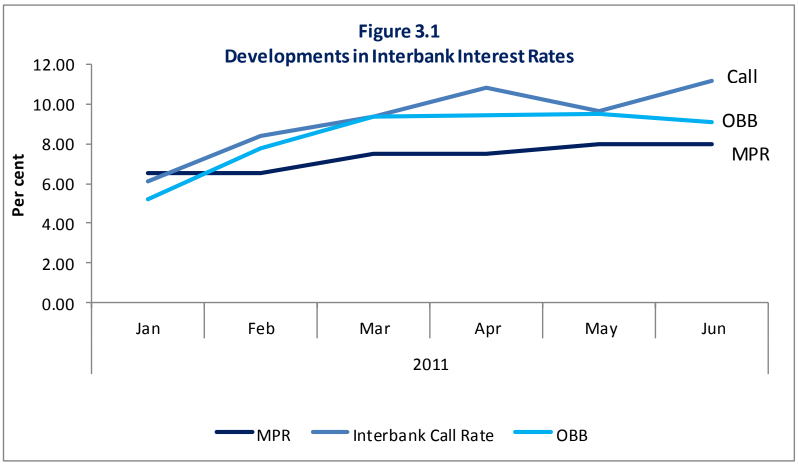
S/No.	Bank	Jan-11	Feb-11	Mar-11	Apr-11	May-11	Jun-11
	Total	610.46	645.60	454.90	246.10	472.40	589.44

Source: Central Bank of Nigeria

..gap between the unsecured call rate and the secured OBB rate narrowed significantly ....

Interbank Placements

The interbank money market in the first half of 2011 was very active. Interest rates in the interbank money market were relatively moderate during much of 2010. Short-term–interest rates started to rise with the CBN having reversed its monetary policy stance since September 2010.

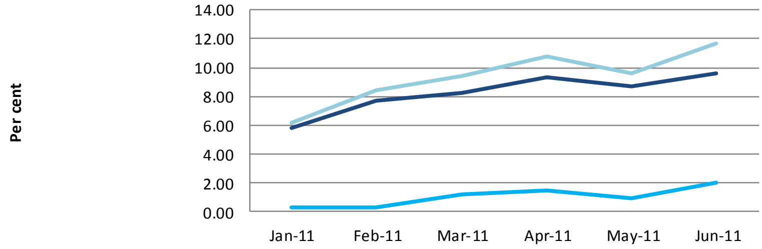


Source: Central Bank of Nigeria

Risk Premium at the Interbank Money Market

The risk premium, as measured by the spread between the unsecured interbank money market rate and the risk-free rate has generally remained low since the introduction of the placement guarantee by the CBN in July 2009. However, despite the guarantee, spread between the average interbank and the OBB rates rose gradually in the first half of 2011. Specifically, the gap between the two rates rose from 0.29 percentage points in January to about approximately 2 points in June, reflecting increased risk perception by market participants (Figures 3.2 and 3.3).

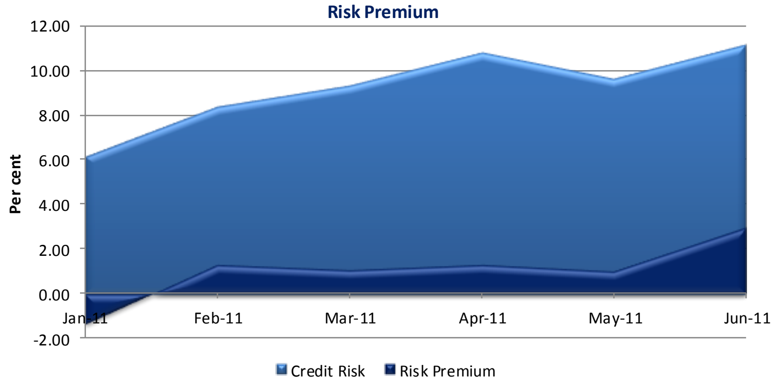
Figure 3.2
Relationship Between Call Rate and OBB Rate (Jan - Jun 2011)



	Jan-11	Feb-11	Mar-11	Apr-11	May-11	Jun-11
Average Call Rate %	6.13	8.38	9.45	10.79	9.61	11.66
Average OBB Rate %	5.84	7.66	8.22	9.35	8.65	9.61
Difference btw Call Rate and OBB rate (% pts)	0.29	0.27	1.23	1.44	0.96	2.05

Source: Central Bank of Nigeria

Figure 3.3
Risk Premium



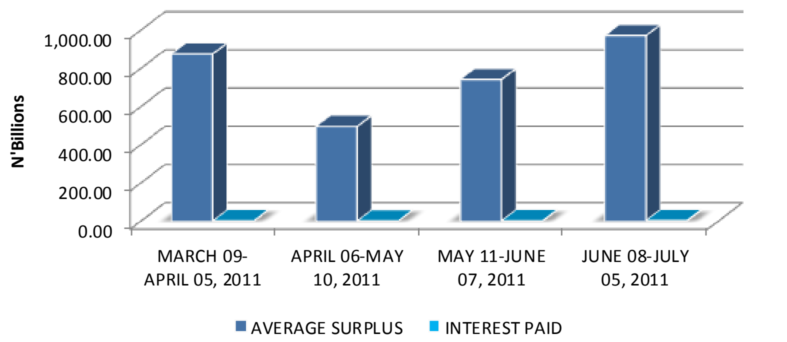
Source: Central Bank of Nigeria

.With .the consistent increase in the MPR and the CRR, the level of bank reserves declined......

Cost of Liquidity Management

Efficient liquidity management continued to be at the heart of the Bank's monetary management during the first half of 2011. Reserve averaging as a tool for liquidity management commenced in March 2011. With the consistent increase in the MPR and the CRR, the level of bank reserves declined in April before rising steadily during May and June, 2011. As bank reserves grew, the remuneration cost also increased during the period (Figure 3.4). The CBN incurred N1,370.0 billion on the remuneration of excess reserves of the DMBs in the first half of 2011.

Figure 3.4
Excess Reserve and Interest Paid in the First Half of 2011



Source: Central Bank of Nigeria

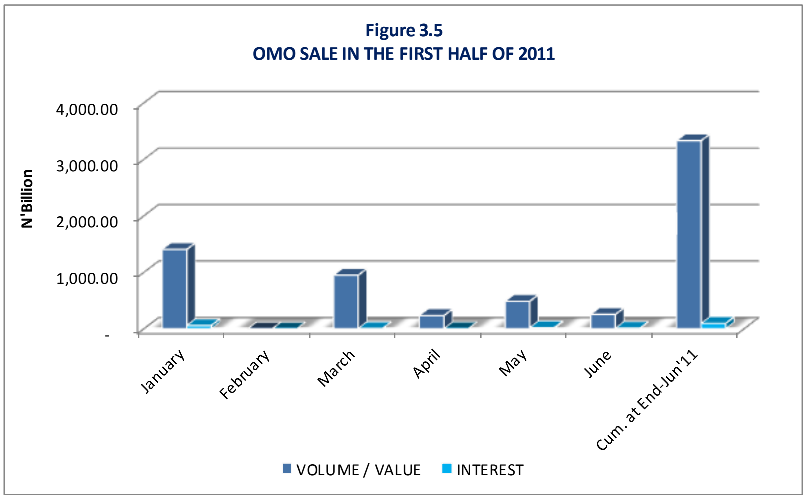
..DMBs frontloaded their reserve balances and traded in other markets, thus creating the impression of tight liquidity conditions in the market.

It is pertinent to note that the attraction for remuneration on reserves became strong incentive to invest excess reserves with the CBN. The attendant implications were twofold: notably, the growing cost of liquidity management and the shallow interbank market as a viable source of liquidity. An additional concern was the cost of OMO during the first half of 2011. Besides, the DMBs frontloaded their reserve balances and traded in other markets, thus creating the impression of tight temporary liquidity conditions in the market. Thus, at end-June, 2011, the Bank incurred N9.47 Billion as interest payments on treasury bills issued during the period (Table 3.9, Figure 3.5).

Table 3.9
OMO Sales in the First Half of 2011
(N'Million)

Date	Volume/Value	Interest Paid
January	140,539.22	5,856.76
February*	0	0
March	94,828.62	576.15
April	23,387.20	227.22
May	48,607.56	1,865.30
June	25,470.00	945.92
Total	**332,832.58**	**9,471.35**

Source: Central Bank of Nigeria
*OMO was suspended in February



Source: Central Bank of Nigeria

3.5.1 Banking Sector Reforms

Banking System Stability

The banking sector recorded improved performance in the first half of 2011. At end-June 2011, 17 banks were granted Approval-in-Principle (AIP) under the new banking model (9 International, 6 National and 2 Regional banks) of which 13 banks opted to hive-off their non-banking subsidiaries while 4 expressed interest to operate Holding Company structure in order to retain their investments in non-banking financial service subsidiaries. A total of 7 banks were not granted AIP until core investors had taken over and presented credible compliance plans. During the review period, one AIP each was issued for Non-interest bank and another for Non-interest banking window operations while 3 banks had completed the Transaction Implementation Agreements in their recapitalization plans.

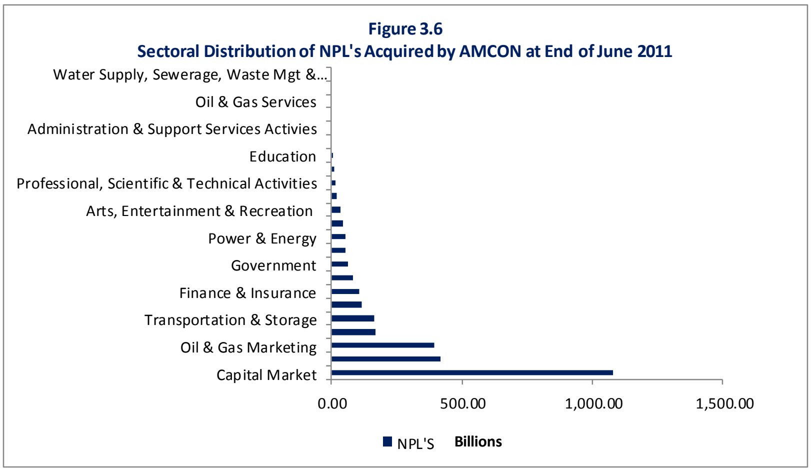
The banking industry gross credit facilities of N7,167.0 billion in December 2010 rose marginally to N7,321.85 billion in June 2011. The total deposits of N10,838.0 and N11,633 billion were reported for December 2010 and June 2011, respectively. The industry liquidity ratio increased from 47.46 per cent in December 2010 to 50.25 per cent in June 2011. Similarly, the capital adequacy ratio rose from 4.03 per cent in December 2010 to 4.24 per cent in June 2011.

...NPLs ratio of the industry improved from 15.5 per cent in December 2010 to 10.3 per cent in June 2011,.

The NPLs ratio of the industry improved from 15.5 per cent in December 2010 to 10.3 per cent in June 2011, although still above the prescribed maximum of 5.0 per cent. The unaudited profit before tax of N162.3 billion in June 2010 inched up marginally to N165.3 billion in June 2011. Specifically, the financial soundness of the non-intervened banks measured in terms of capital adequacy, liquidity and earnings improved except the quality of the assets of 3 banks that had NPL ratio of more than 10.0 per cent as at June, 2011.

Issuance of AMCON Bonds

The Asset Management Corporation of Nigeria (AMCON) continued to play a critical role of distress resolution in the Nigerian banking sector during the first half of 2011. In December 2010, AMCON purchased a total of N1,230.0 billion non-performing loans (NPL) of the banking system. During the first half of 2011, AMCON issued two three-year zero coupon consideration bonds with face value of N534.48 billion to 22 DMBs in exchange for their eligible bank assets. This brought the total face value of bonds issued by AMCON to N1,764.48 billion in exchange for eligible bank assets valued at N2,827.0 billion at end-June 2011, representing 33.28 per cent of the total outstanding bonds issued in the market.



Source: Central Bank of Nigeria

Table 3.10
Eligible Bank Assets of the DMBs Purchased by AMCON (Jan - June 2011)
(N'million)

SECTOR	January	February	March	April	May	June	Total
Capital Market	7,244.86	926.21					**8,171.07**
Construction		913.48					**913.48**
General Commerce		3,426.96	30.00	4,127.84	264.26	1,566.46	**9,415.52**
ICT		70.00					**70**
Oil and Gas Marketing		1,486.51			577.64		**2,064.15**
Real Estate			1,500.00		450.00	874.85	**2824.85**
Education						686.05	**686.05**
Manufacturing						1,603.26	**1,603.26**
Total	**7,244.86**	**6,823.16**	**1,530.00**	**4,127.84**	**1,291.90**	**4,730.62**	**25,748.38**

Source: Central Bank of Nigeria

AMCON Bonds and the Money Market

The ₦1,700.0 billion zero-coupon bonds issued by AMCON since its inception to resolve the non-performing assets of the DMBs attracted yields significantly below the corresponding 3-year FGN bond yields. The current yield of the bond is 11.0 per cent compared to 15.0 per cent for similar FGN bonds.

AMCON bonds faced a number of challenges in the market bordering largely on their features, yield, tenor, redemption and availability

AMCON bonds faced a number of challenges in the market bordering largely on their features, yield, tenor, redemption and availability. The features of AMCON bonds were not compatible with the 2-way quote platform, thereby creating a stalemate in its trading in the secondary market. As such, holders of AMCON bonds were invariably compelled by the market to hold them to maturity. The bonds were issued at yields that were lower than their FGN equivalent, thus conferring on them a superior status than the FGN bonds which were trading at a higher premium in the market. The market was, therefore, uncertain about the tenor of the bonds and the capacity of AMCON to redeem them at maturity. Moreover, the bonds were only available to the banks that had non-performing loans in their portfolios. These challenges limited the tradability of the bonds and its impact on deepening the money market in the near to medium-term.

At the time of issue, the AMCON bonds were accorded liquidity status and were specified as one of the liquid assets for purposes of liquidity management. They are accordingly included in the liquidity ratio computation. However, the bonds could not be discounted, traded in the secondary market or used at the interbank market because the market was not fully aware of its key features. The bonds however, could be used for Repo transaction at the CBN Standing Lending Facility (SLF) window. This condition adversely affected banks profitability or earnings ability because of the high cost and collaterised nature of the SLF (above market rate) arising from increases in the MPR. Nevertheless, access to the CBN SLF with AMCON bonds, improved the liquidity of banks and enabled them to meet their contingent cash obligations.

3.6 Performance of Monetary Aggregates

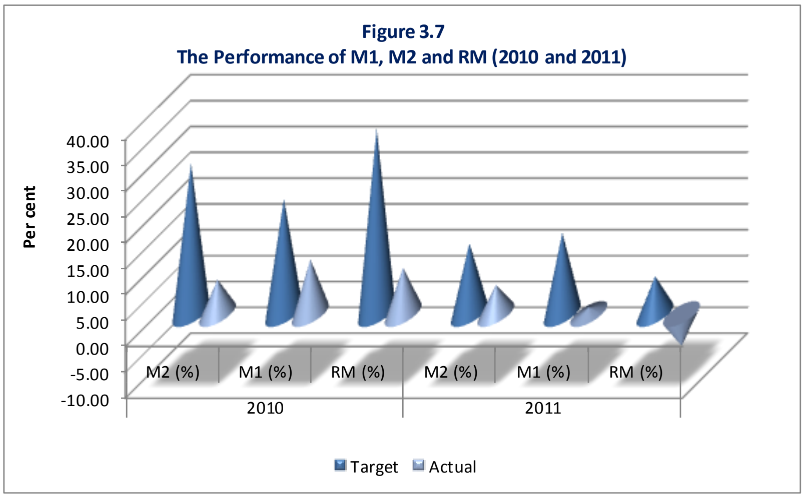
In the first half of 2011, monetary aggregates generally underperformed relative to their targets.

In the first half of 2011, monetary aggregates generally underperformed relative to their targets. The growth in broad money stock in the first half of 2011 recorded an improvement over the corresponding and the preceding periods of 2010, although, it was still below the target for the period. In absolute term, the broad money grew by ₦651.86 billion or 5.66 per cent in the first half of 2011 compared with ₦680.03 billion or 6.27 per cent in the second half of 2010. On annualized basis, the growth in broad money during the review period was 11.32 per cent compared with the annual target of 13.75 per cent (Table 3.11).

Table 3.11
Monetary Aggregates

	Actual June 2010	Target 2010	Actual Dec 2010	Deviation	Target 2011	Actual June 2011	Change in 2010:H2	Change in 2011: H1
M2	10,845.50	13,916.83	11,525.53	-2,391.30	13,067.98	12,177.39	680.03	651.86
M2 (%)	0.60	29.25	6.91	-22.98	13.75	5.66	6.27	5.66
M1	4,917.99	6,122.72	5,571.27	-551.45	6,406.17	5,642.56	653.28	71.29
M1(%)	-1.98	22.36	11.05	-9.08	15.75	1.28	13.28	1.28
RM	1,535.11	2,232.44	1,845.71	-386.73	1,936.00	2065.1	310.60	219.35
RM(%)	-7.18	35.98	20.23	-15.75	7.32	11.88	20.23	11.88
NDC	8,612.49	11,968.71	8,708.55	-3,260.16	11,444.78	8,908.46	96.06	199.91
NDC(%)	8.97	51.43	10.0	-50.31	27.69	2.30	1.12	2.30
CG	-1489.88	-1,710.60	-1,121.80	969.88	-23.76	-1,064.75	749.16	57.05
CG(%)	35.29	25.10	51.27	42.73	29.29	5.09	(50.28)	5.09
CP	10,102.82	13,425.08	9,830.34	-3,594.74	11,968.54	9,773.21	(272.48)	142.87
CP(%)	-1.14	31.54	-3.81	-34.24	23.34	1.45	(2.70)	1.45
NFA	6,484.76	8,132.44	6,506.62	-1,625.84	6,978.11	6,453.69	21.84	(52.91)
NFA(%)	-14.60	7.01	-14.31	6.67	10.70	-0.81	0.34	-0.81

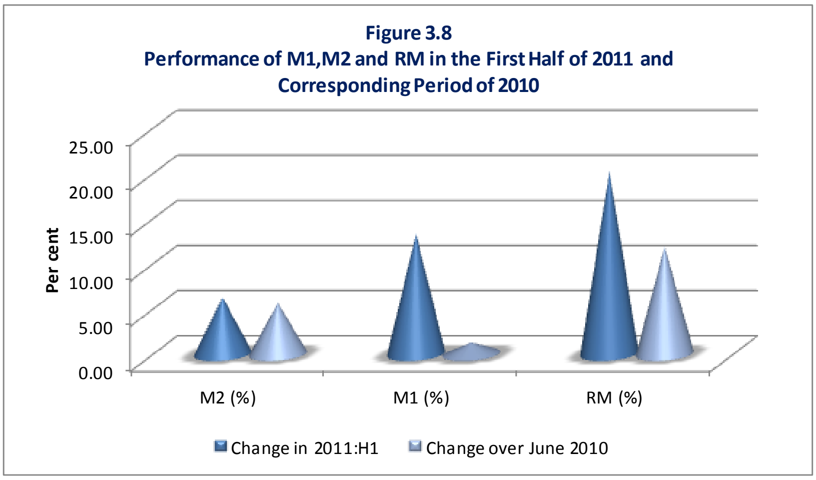
Source: Central Bank of Nigeria



Source: Central Bank of Nigeria

..growth in narrow money was sluggish during the review period.

The growth in narrow money was sluggish during the review period. In absolute terms, it grew by ₦71.29 billion compared with ₦653.28 billion in the second half of 2010, translating to an increase of mere 1.28 per cent. On annualized basis, the growth rate during the period was 2.56 per cent which was significantly below the target of 15.75 per cent. The performance of narrow money, although very low, represented a significant improvement over the decline of 1.98 per cent recorded during the corresponding period of 2010 (Figure 3.8).



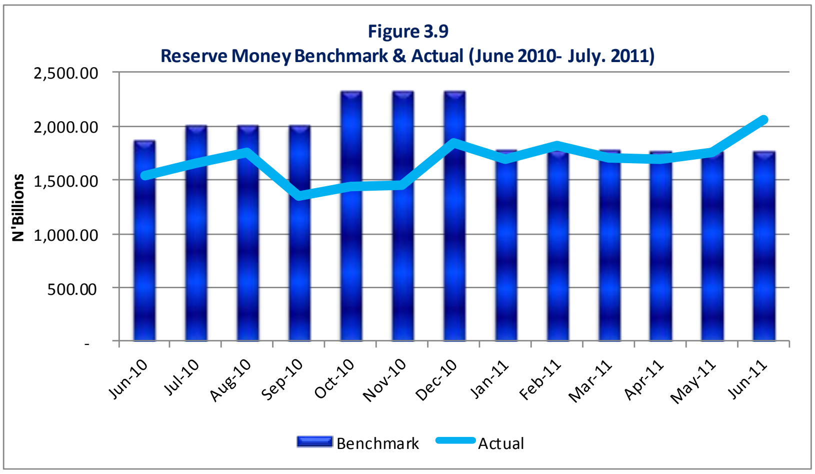
Source: Central Bank of Nigeria

Table 3.12
Reserve Money Actual and Benchmark

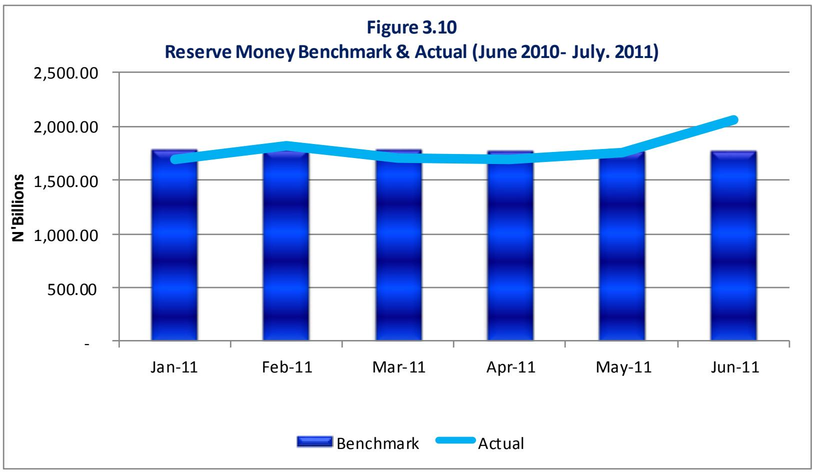
Date	Benchmark	Actual	Deviation
Jun-10	1,872.80	1,535.11	(337.69)
Jul-10	2,006.02	1,658.88	(347.14)
Aug-10	2,006.02	1,752.95	(253.07)
Sep-10	2,006.02	1,344.33	(661.69)
Oct-10	2,332.44	1,438.35	(894.09)
Nov-10	2,332.44	1,450.82	(881.62)
Dec-10	2,332.44	1,845.71	(486.74)
Jan-11	1,775.15	1,694.89	(80.26)
Feb-11	1,775.15	1,820.89	45.74
Mar-11	1,775.15	1,705.92	(69.23)
Apr-11	1,771.40	1,696.24	(75.16)
May-11	1,771.40	1,750.91	(20.49)
Jun-11	1,771.40	2,065.06	293.66

Source: Central Bank of Nigeria

Reserve money performed better during the review period. It stood at ₦2, 065.06 billion at the end of June 2011, compared with ₦1, 845.71 in December 2010 and ₦1, 535.11 in the corresponding period of 2010, representing an increase of 11.89 and 34.52 per cent, respectively. The performance of the reserve money during the review period was above the benchmark of ₦1,771.40 billion by N293.66 billion or 16.6 per cent (Figure 3.9). The improvement in reserve money during the period could largely be attributed to the revision in the CRR from 1.0 to 2.0 per cent in January and further to 4.0 per cent in May 2011.



Source: Central Bank of Nigeria



Source: Central Bank of Nigeria

In the first half of 2011, aggregate bank credit to the domestic economy increased to ₦8, 908.46 billion from N8, 708.55 billion at end-December 2010, representing an increase of ₦199.91 billion or 2.30 per cent. On annualized basis, the growth in bank credit represented 4.60 per cent compared with the prescribed annual target of 27.69 per cent. The moderation was attributable, largely to sluggish growth in credit to the private sector, as bank credit to Government remained dominant.

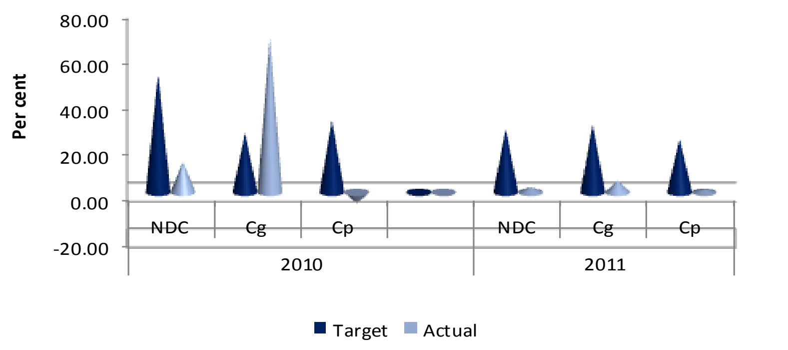
..the low growth in credit to private sector was influenced by the general cautious approach to lending by the DMBs

Credit to the private sector increased to ₦9, 973.21 billion in the first half of 2011 from N9 , 830.34 billion at end December 2010, representing an increase of N142.87billion or 1.45 per cent. Compared with the corresponding period of 2010, however, credit to the private sector declined by N129.61 billion or 1.28 per cent. On annualized basis, the performance represented 2.90 per cent as against programme target of 23.34 per cent for 2011. Overall, the low growth in credit to private sector was influenced by the general cautious approach to lending by the DMBs.

Although the fiscal deficit increased in the first half of 2011, the financing was more from the bonds market and drawings from the excess crude account

Bank credit to government, as in private sector credit, did not show appreciable growth during the review period. In absolute term, credit to government grew by N57.05 billion, representing an increase of 5.09 per cent in the review period compared with N35.29 billion in the corresponding period of 2010. On annualized basis, the growth in credit to the government was 10.18 per cent compared with the programme target of 29.29 per cent of 2011. Although, the fiscal deficit increased in the first half of 2011, the financing was more from the bonds market and drawings from the excess crude account than from the banking sector. This development created potential access to credit for the private sector as competition for available funds was low. The increased growth in bank credit to the public sector notwithstanding, government remained a net creditor to the system during the period. Indeed, the growth in credit reflected the draw-down of government deposits with the banking system (Figure 3.10 and 3.11).

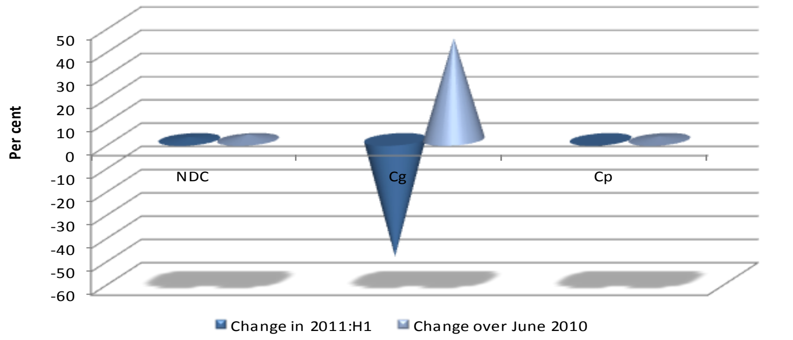
Figure 3.11
The performance of Credit (NDC, Cg,CP) 2010 and 2011



Source: Central Bank of Nigeria

The Net Foreign Assets (NFA) of the banking system decreased by ₦52.93 billion or 0.81 per cent over the level at end-December 2010 compared with the increase of N21.84 billion or 0.34 per cent in the corresponding period. The decline was partly due to the financing of the foreign exchange market to sustain the stability of the exchange rate.

Figure 3.12
Performance of Credit (NDC, Cg,Cp) in the First Half of 2011 and the Corresponding Period of 2010



Source: Central Bank of Nigeria

CHAPTER 4
DOMESTIC FINANCIAL MARKETS

4.1 Introduction

sovereign debts had become an important source of concern as solvency indicators deteriorated in some EU countries.

Activities of financial markets in the first half of 2011 were influenced largely, by the need for stability and to improve their resilience in the face of domestic developments. On the external front, the high sovereign debts had started to become an important source of concern in some EU countries and the limited fiscal stance in the U.S, prompted speculations of possible default. In the domestic markets, apprehension on the state of health of some financial institutions fuelled anxiety about the stability of the system. Combined with uncertainty about the outcome of the April general elections, stock market and other financial indicators soon started to reflect the sentiments. At the money market, lending to the real sector remained lower than envisaged and the demand for foreign exchange rose putting pressure on the exchange rate.

As part of the measures to calm the markets, the Central of Nigeria (CBN) extended the interbank guarantee from May 2010 to end-June 2011 (and to December, 2011 for the category of intervened banks). This measure, combined with other initiatives (like the extension of reserve maintenance period to 28 days) and the successful conduct of the general elections in April/May, had some calming effects on both the markets toward the end of June, 2011.

... upward adjustments to the MPR in response to the upward trending inflation rate, prompting a rise in key interbank interest rates.

Key interbank interest rates responded positively to the upward adjustments to the MPR during the first half of 2011. Deposit rates however, remained largely subdued while the lending rates rose. Consequently, the spread between the average lending and the consolidated deposit rate widened considerably during the period.

.... ensuring a narrower interest rate spread became very challenging in the first half of 2011.

In view of these developments, ensuring a narrower interest rate spread became very challenging in the first half of 2011. To this end, and in focus, the overall price and financial stability objective, the Bank continued to promote good corporate governance across the system and improvement in liquidity conditions during the period. Related key areas of attention included coordinated regulation of the financial system, capacity building; and fast-tracking the implementation of risk-based, consolidated and cross-border supervision.

4.2 The Money Market

Sustained reform pressure created relative stability in money market interest rates,

The money market continued to lead other segments of the financial markets in terms of activity in the first half of 2011. The Nigerian Treasury Bills (NTBs) continued to serve as the key instrument of transaction in the market. Modes of transaction included the usual OMO, Discount Window (DW) operations, Repurchase (repo) transactions, Reverse repo transactions, Pledges and Open Buy Back. Sustained reform pressure created relative stability in money market interest rates, although concerns about the longer term overall stability of the market still persisted.

4.2.1 Developments in Short-Term Interest Rates

A key challenge to monetary management during the period was to contain and stabilize the volatile and the upward trending short-term money market interest rates.

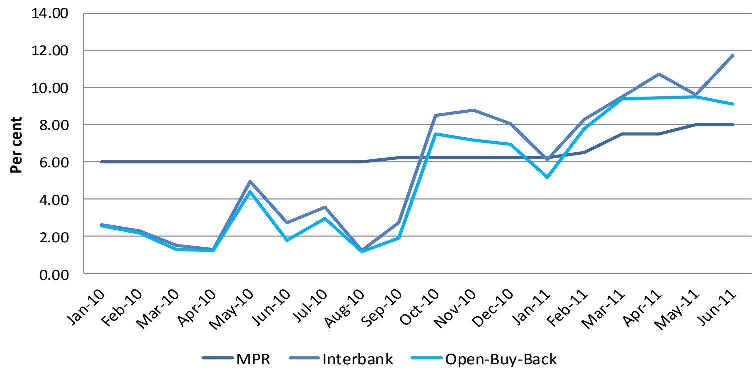
Short-term interest rates generally rose during the first half of 2011 in line with the monetary policy stance. Obviously, the placement guarantee had downplayed the counter-party risk factor, thereby ensuring robust market activity and keeping the rates active. A key challenge to monetary management during the period was therefore, to contain and stabilize the volatile and the upward trending short-term money market interest rates. Movements in call and OBB rates, the key measures of short-term interest rates, were largely dictated by the level of liquidity in the market which in turn, was influenced by the monthly Federal Accounts Allocation Committee (FAAC) disbursements to the various tiers of government and the release of intervention funds

Table 4.1
Weighted Average Money Market Interest Rates (per cent)
(Jan 2010 – June 2011)

Period	Monetary Policy Rate	Overnight Interest		NIBOR	
		Interbank	Open-Buy-Back	7-Day	30-Day
Jan-10	6.00	2.61	2.59	6.39	12.42
Feb-10	6.00	2.27	2.20	5.11	10.60
Mar-10	6.00	1.50	1.28	2.79	5.74
Apr-10	6.00	1.27	1.24	2.46	5.10
May-10	6.00	4.94	4.39	6.16	8.03
Jun-10	6.00	2.73	1.80	3.35	5.71
Jul-10	6.00	3.59	2.98	4.45	6.57
Aug-10	6.00	1.26	1.20	2.05	4.66
Sep-10	6.25	2.71	1.92	3.81	5.48
Oct-10	6.25	8.50	7.48	9.67	11.10
Nov-10	6.25	8.79	7.19	9.13	11.67
Dec-10	6.25	8.03	6.93	9.31	11.50
Jan-11	6.25	6.10	5.17	7.21	9.92
Feb-11	6.50	8.30	7.80	9.13	10.75
Mar-11	7.50	9.50	9.39	11.44	12.63
Apr-11	7.50	10.70	9.44	11.29	12.29
May-11	8.00	9.60	9.47	11.33	12.40
Jun-11	8.00	11.70	9.11	11.75	12.83

Source: Central Bank of Nigeria

Figure 4.1
Trend in Money Market Rates (January 2010 - June 2011)



Source: Central Bank of Nigeria

(i) Interbank Interest Rate

Market sentiments in most part of June suggested illiquidity

I During the first quarter, the weighted average interbank rate in the call market was 9.5 per cent at end-March, 2011 compared with 1.5 per cent in the corresponding period of 2010. The rates inched further to 10.7 per cent in April 2011 and continued on this path in view of the restrictive stance of monetary policy. Thus, interbank interest rates closed at 11.7 per cent at end-June 2011 compared with 2.73 per cent recorded in June 2010. Market sentiments in most part of June suggested illiquidity thus pushing the average rates to skew towards the SLF rate.

The major challenge in the interbank money market during the first half of 2011 was the need to address the lingering effects of the short-term interest rates to levels that would allow for market competitiveness. Monetary stimulus in 2010 helped to increase the liquidity of the banking system coupled with the extension of the interbank guarantee which eased pressure in the money market during the period. The CBN also encouraged banks to take-on cost-cutting measures like shared facilities to bring down the cost of operations and thus, lending rates.

…containment of inflation risk posed by fiscal expansion given concerns about exchange rate stability dominated monetary policy actions

With upward adjustments in the MPR, interbank interest rates rose carrying with it the attendant risk of a sharp correction in bond prices and possible losses on fixed income positions and slowed recovery in the equities market. However, the containment of inflation risk posed by fiscal expansion given concerns about exchange rate stability dominated monetary policy actions (Table 4.1)

(ii) Open Buy-back Rate

…the OBB rate grew by a historically height of 37.52 per cent over the six-month period.

The average weighted open buy-back (OBB) interest rate, which was 9.35 per cent in March 2011, increased to 9.59 per cent at the end of first half of 2011. These represented significantly elevated levels compared with the 1.28 per cent and 1.80 per cent, recorded in the corresponding periods of March and June 2010, respectively. Compared with the end-December 2010 level of 6.93 per cent at end-June 2011, the OBB rate grew by a historical height of 37.52 per cent over the six-month period. This upward trend was attributed to the rise in the monetary policy rate (Figure 4.1).

4.2.2 The Foreign Exchange Market

Spot Rates

The spot rate at the official window of the foreign exchange market, the CBN wholesale dutch auction sales (wDAS), averaged ₦153.21/US$ in the first half of 2011 compared with ₦150.61/US$ at end-December 2010 and ₦150.04/US$ in the corresponding period of 2010 representing a depreciation of 1.70 and 2.07 per cent, respectively.

.. depreciation in the spot rates across all segments of the foreign exchange market was attributed to demand pressure

The interbank exchange rate averaged ₦154.49/US$ as at end-June 2011 compared with ₦151.43/US$ at end-December 2010 and ₦150.75/US$ at end-June 2010, representing a depreciation of 1.99 and 2.42 per cent, respectively. Similarly, bureaux-de-change (BDC) rates averaged ₦156.95/US$ in the first half of 2011 compared with ₦153.35/US$ at end-December 2010 and ₦152.77/US$ at end-June 2010, representing a depreciation of 2.29 and 2.66 per cent, respectively.

The depreciation in the spot rates across all segments of the foreign exchange market was attributed to demand pressure occasioned by election related activities in the first half of the year, pronounced purchases to hedge against the exchange rate depreciation, repatriation of investment and dividends by foreign investors and multinational corporations as well as the importation of petroleum products and other consumables (Table 4.2)

Table 4.2
Monthly Exchange Rates (N/US$): Jan 2010 - Jun 2011

	CBN	IFEM	BDC
Jan-10	149.81	150.33	153.55
Feb-10	150.22	150.96	152.08
Mar-10	149.83	150.07	151.85
Apr-10	149.88	150.45	152.05
May-10	150.3	151.48	153.26
Jun-10	150.21	151.22	153.82
2010: H1 Average	150.04	150.75	152.77
Jul-10	150.1	150.28	152.41
Aug-10	150.26	150.7	152.23
Sep-10	151.3	152.61	153.8
Oct-10	151.22	151.78	153.98
Nov-10	150.23	150.55	153.13
Dec-10	150.55	152.63	154.57
2010: H2 Average	150.61	151.43	153.35
2010 Average	150.33	151.09	153.06
Jan-11	151.62	152.57	156.08
Feb-11	151.96	152.75	155.11
Mar-11	152.54	155.21	157.09
Apr-11	153.92	154.6	157.05
May-11	154.79	156.17	158.05
Jun-11	154.45	155.65	158.32
2011: H1 Average	153.21	154.49	156.95

Source: Central Bank of Nigeria

End-Period Exchange Rate

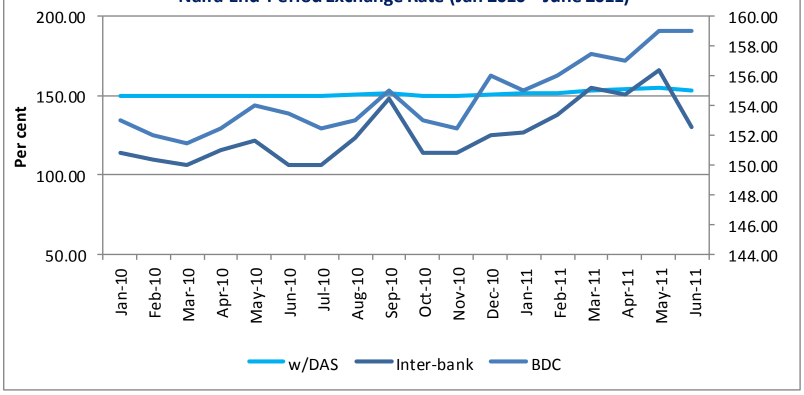
The exchange rate of the naira at the wDAS depreciated by 1.73 per cent from ₦150.66/US$ at end-December 2010 to ₦153.31/US$ at end-June 2011. Over the one year period, the

Naira depreciated by 2.17 per cent from 149.99/US$ at end-June 2010 to 153.31 at end-June 2011 (Table 4.3).

At the BDC and interbank segments of the market, the naira depreciated by 1.89 and 0.34 per cent, respectively, or from ₦156.00/US$ to ₦159.00/US$ and ₦152.00/US$ to ₦152.50/US$ between end-December 2010 and end-June, 2011 (Table 4.4). Thus, the Naira depreciated by 3.46 and 1.65 per cent, respectively, from 153.50/US$ and 150.00/US$ at end-June 2010 to 159.00/US$ and 152.52/US$ at end-June 2011, respectively. The naira depreciated in all segments of the market due largely to the reasons aforementioned.

Figure 4.2

Naira End-Period Exchange Rate (Jan 2010 - June 2011)



Source: Central Bank of Nigeria

Table 4.3
End-Month Exchange Rate Movements at Various Segments of the Market
(Naira per US dollars)

	CBN	IFEM	BDC
Jan-10	149.81	150.33	153.55
Feb-10	150.22	150.96	152.08
Mar-10	149.83	150.07	151.85
Apr-10	149.88	150.45	152.05
May-10	150.3	151.48	153.26
Jun-10	150.21	151.22	153.82
2010: H1 Average	150.04	150.75	152.77
Jul-10	150.1	150.28	152.41
Aug-10	150.26	150.7	152.23
Sep-10	151.3	152.61	153.8
Oct-10	151.22	151.78	153.98
Nov-10	150.23	150.55	153.13
Dec-10	150.55	152.63	154.57
2010: H2 Average	150.61	151.43	153.35
2010 Average	150.33	151.09	153.06
Jan-11	151.62	152.57	156.08
Feb-11	151.96	152.75	155.11
Mar-11	152.54	155.21	157.09
Apr-11	153.92	154.6	157.05
May-11	154.79	156.17	158.05
Jun-11	154.45	155.65	158.32
2011: H1 Average	153.21	154.49	156.95

Source: Central Bank of Nigeria

Nominal and Real Effective Exchange Rates (NEER)

On annual basis, the NEER and REER increased by 7.09 and 7.70 per cent, respectively over their levels in 2010.

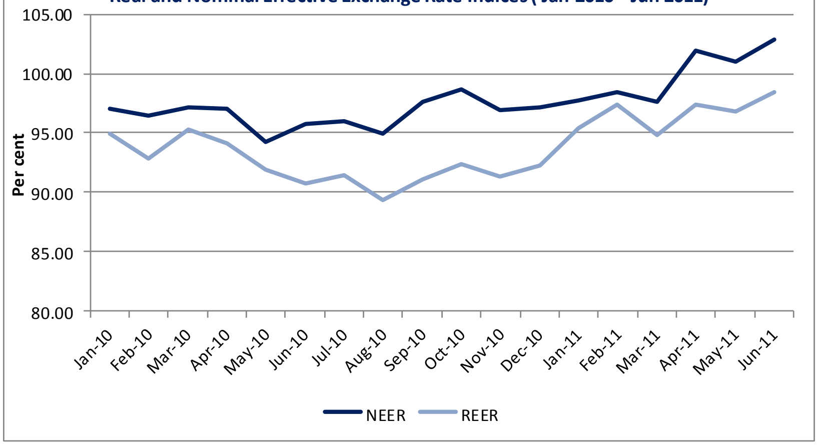
The Nominal Effective Exchange Rate (NEER) index rose by 5.65 to 102.85 recorded at end-June 2011 from the level of 97.20 at end-December 2010. Also, the Real Effective Exchange Rate (REER) index rose by 6.27 to 98.48 at end-June 2011, from 92.21 at end-December 2010. On annual basis, the NEER and REER increased by 7.09 and 7.70 per cent, respectively over their levels in 2010 (Table 4.4 and Figure 4.3).

Table 4.4
Nominal and Real Effective Exchange Rate Indices, Jan 2010 to Mar 2011

	REER	NEER
Jan-10	97.05	94.97
Feb-10	96.41	92.89
Mar-10	97.18	95.28
Apr-10	97.03	94.07
May-10	94.21	91.89
Jun-10	95.76	90.78
2010:H1 Average	96.27	93.31
Jul-10	95.93	91.4
Aug-10	94.94	89.36
Sep-10	97.65	91.06
Oct-10	98.62	92.42
Nov-10	96.89	91.35
Dec-10	97.2	92.21
2010:H2 Average	96.87	91.3
Jan-11	97.79	95.36
Feb-11	98.44	97.34
Mar-11	97.59	94.86
Apr-11	101.95	97.33
May-11	100.96	96.79
Jun-11	102.85	98.48
2011:H1 Average	97.94	95.85

Source: Central Bank of Nigeria

Figure 4.3
Real and Nominal Effective Exchange Rate Indices (Jan 2010 - Jun 2011)



Source: Central Bank of Nigeria

Demand and Supply of Foreign Exchange

In the first half of 2011, the demand for foreign exchange at the wDAS increased by 13.25 per cent to US$17,405.43 million from US$15,369.35 million recorded in the second half of 2010. Compared with the corresponding period of 2010, the demand for foreign exchange rose by 20.73 per cent, from US$14,416.43 million demanded in the first half of 2010 to US$17,405.43 million in the first half of 2011.

..CBN responded to persistent demand pressure in the foreign market by matching supply with genuine demand for foreign exchange

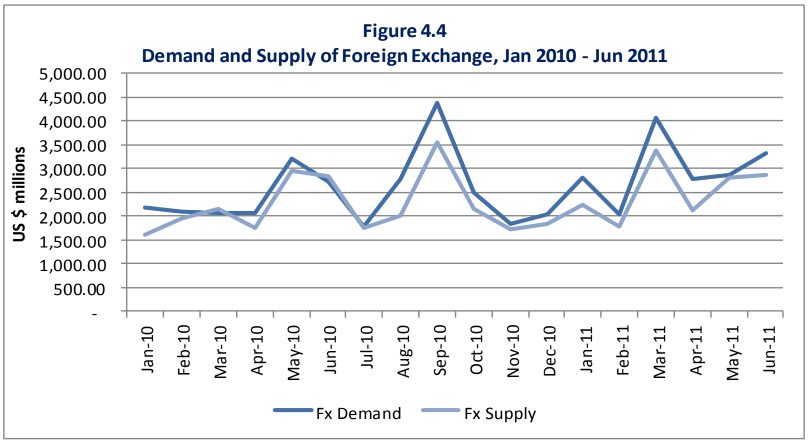
The total volume of foreign exchange supplied at the wDAS amounted to US$15,174.95 million in the first half of 2011, from US$12,990.23 million recorded in the second half of 2010. This shows an increase of 16.82 per cent. On an annual basis, the total foreign exchange supplied increased by 24.61 per cent, from the US$12,177.66 million recorded in the first half of 2010 to US$15,174.95 million supplied in the second half of 2011 (Table 4.5).

The CBN responded to persistent demand pressure in the foreign exchange market by matching supply with genuine demand for foreign exchange. To reduce the impact of the demand pressure on the level of foreign reserves and to protect the market participant from rate volatility, the foreign exchange wDAS forward market was introduced on 23rd March 2011.

Table 4.5
Total Foreign Exchange Demand and Supply
(US Dollar Million)

	WDAS Demand	WDAS Sales
Jan-10	2,199.15	1,522.05
Feb-10	2,110.77	1,874.35
Mar-10	2,081.23	1,742.79
Apr-10	2,068.61	1,693.52
May-10	3,214.82	2,761.13
Jun-10	2,741.85	2,583.82
2010: H1 Total	**14,416.43**	**12,177.66**
Jul-10	1,795.82	1,612.49
Aug-10	2,789.10	1,948.52
Sep-10	4,392.27	3,626.87
Oct-10	2,503.67	2,375.75
Nov-10	1,853.37	1,576.60
Dec-10	2,035.12	1,850.00
2010: H2 Total	**15,369.35**	**12,990.23**
2010 Total	**29,785.78**	**25,167.89**
Jan-11	2,800.42	2,000.00
Feb-11	2,041.09	1,794.85
Mar-11	3,612.36	3,274.38
Apr-11	2,780.41	2,385.58
May-11	2,845.62	2,825.19
Jun-11	3,325.53	2,894.95
2011:H1 Total	**17,405.43**	**15,174.95**

Source: Central Bank of Nigeria



Source: Central Bank of Nigeria

Foreign Exchange Inflow and Outflow

Inflow

Gross foreign exchange inflow of US$19,574.33 million was recorded in the first half of 2011, compared with US$12,892.08 million and US$14,894.96 million in the corresponding period of 2010 and the second half of 2010, representing an increase of 50.78 and 31.68 per cent, respectively (Figure 4.4).

Outflow

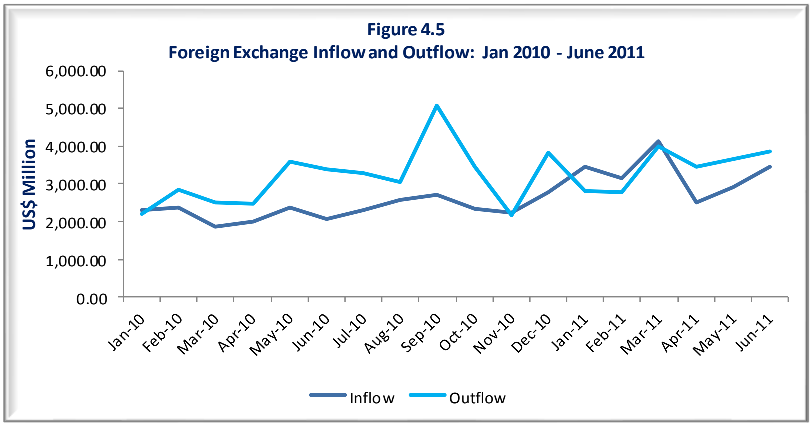
.. high volume of foreign exchange outflow was mainly due to the financing of imports of goods and services, and repatriation of proceeds of investment

Foreign exchange outflow in the first half of 2011 was US$20,530.92 million compared with the total outflow of US$17,027.91 million in the first half of 2010 and US$20,891.28 million in the second half of 2010, The high volume of foreign exchange outflow was mainly due to the financing of imports of goods and services, and repatriation of proceeds of investment and dividends by foreign investors and multinational companies. However, the net flow was US$956.6 million in the first half of 2011, much lower than the net outflow of US4045.83 million in the corresponding period of 2010 and the US$6,026.24 million in the second half of 2010 (Table 4.6)

Table 4.6
CBN Monthly Foreign Exchange Flows
(US $ Million)

	INFLOW	OUTFLOW	NET FLOW
Jan-10	2,302.51	2,197.05	105.46
Feb-10	2,369.22	2,860.35	-491.13
Mar-10	1,849.40	2,512.78	-663.38
Apr-10	2,016.92	2,481.53	-464.61
May-10	2,381.63	3,590.39	-1,208.76
Jun-10	2,062.40	3,385.81	-1,323.41
2010: H1	**12,982.08**	**17,027.91**	**-4,045.83**
Jul-10	2,289.00	3,282.56	-993.56
Aug-10	2,564.49	3,061.05	-496.56
Sep-10	2,701.52	5,078.74	-2,377.22
Oct-10	2,339.28	3,463.47	-1,124.19
Nov-10	2,209.35	2,169.84	39.51
Dec-10	2,761.40	3,835.62	-1,074.22
2010: H2	**14,865.04**	**20,891.28**	**-6,026.24**
Total	27,847.12	37,919.19	-10,072.07
Jan-11	3,435.55	2,805.78	629.77
Feb-11	3,164.68	2,768.68	396
Mar-11	4,119.17	3,985.95	133.22
Apr-11	2,495.61	3,439.70	-944.1
May-11	2,896.12	3,657.16	-761.04
Jun-11	3,463.20	3,873.65	-410.45
2011: H1	**19,574.33**	**20,530.92**	**-956.6**

Source: Central Bank of Nigeria



Source: Central Bank of Nigeria

4.3 Capital Market

.. Nigerian stock market in the first half of 2011 continued to be bearish.....

The Nigerian stock market in the first half of 2011 continued to be bearish reminiscent of the trends throughout the preceding year. The market was characterized by low liquidity and mixed performance of the quoted companies. Strong signs of liquidity preference owning to the April general election had moved the traditional investors away from the market. Capital outflows attributed mainly to pre and post-election security challenges further dented the quantum of liquidity required for growth of the market. The release of improved end-of- the-year financial results by some quoted companies, especially the deposit money banks (DMBs), did not have insignificant impact on the market as investor confidence had significantly been eroded by them.

Market Turnover

Aggregate stock market turnover during the first half of 2011 was 49.52 billion shares valued at N372.7 billion exchanged in 733,762 deals. In the comparable period of 2010, the market recorded a turnover of 54.83 billion shares valued at N436.97 billion exchanged in 1,174,481 deals. In the second half of 2010, the stock market recorded a turnover of 38.55 billion shares valued at N360.6 billion.

4.3.1 Equities Market

The All-Share Index (ASI) rose marginally by 0.8 per cent to 24,980.20 at end-June, 2011, from its level of 24,770.52 at end-

… All-Share Index (ASI) rose marginally by 0.8 per cent …….at end-June, 2011,

Dec, 2010, compared with the 21.9 per cent increase in the first half of 2010. On a year-on-year basis, the ASI decreased by 1.6 per cent over the level at end-June, 2010. Market Capitalization (MC) increased by 1.0 per cent to N7.99 trillion at end-June, 2011 from the level of N7.91 trillion at end-Dec 2010, compared with the increase of 23.6 per cent in the first half of 2010 and 29.5 per cent, over the end-June, 2010 level.

Table 4.7
NSE All Share Index (MC) and Market Capitalization (MC)
January 2010 - June, 2011

Date	All Share Index (ASI)	Market Capitalization (Equities) (N' Trillion)*
Dec -9	20,827.17	4.99
Jan-10	22,594.90	5.44
Feb-10	22,985.00	5.53
Mar-10	25,966.25	6.28
Apr-10	26,453.20	6.39
May-10	26,183.21	6.36
Jun-10	25,384.14	6.17
Jul-10	25,844.18	6.32
Aug-10	24,268.24	5.94
Sep-10	23,050.59	5.65
Oct-10	25,042.16	7.98
Nov-10	24,764.65	7.91
Dec-10	24,770.52	7.91
Jan-11	26,830.67	8.58
Feb-11	26,016.84	8.32
Mar-11	24,621.21	7.87
Apr-11	25,041.68	8
May-11	25,866.62	8.27
Jun-11	24,980.20	7.99

Source: Central Bank of Nigeria

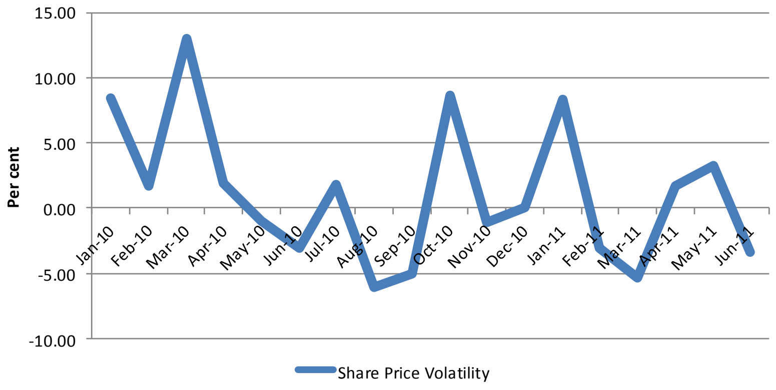
Figure 4.6
Nigerian Stock Exchnage ASI and MC

Source: Central Bank of Nigeria

..sluggish performance of the equities market was traceable to the withdrawal of funds by foreign investors who were concerned about political-risk...

The sluggish performance of the equities market was traceable to the withdrawal of funds by foreign investors who were concerned about political-risk in the run-up to the April 2011 general elections, high level of uncertainty over getting the right strategic partners for the intervened banks and the lackluster earnings of listed companies, including relatively attractive yields in the fixed income market (which encouraged portfolio switching from equities to the fixed income securities). By the end of the first half, the equities market was fully priced from the earnings point of view. As such, a substantial appreciation in equity prices in the second half would depend mainly on significant improvement in earnings or sentiments.

Figure 4.7
Share Price Volatility, January 2010 - June 2011



Source: Nigerian Stock Exchange

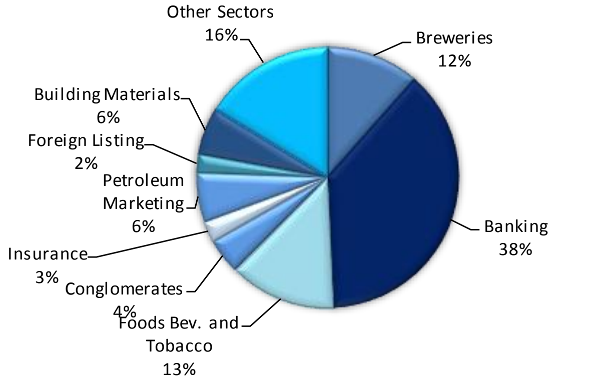
.. drop in dominance of the banking sector was attributable to portfolio switching,.......

Sectoral Contribution to Market Capitalization

In the first half of the year, the banking sector was the most active sector. The sector's share of overall market capitalization fell to 30.0 per cent as at end-June, 2011, down from 38.0 and 36.0 per cent at end-June, 2010 and end-December of 2010, respectively. The sector recorded transactions of 26.6 billion shares valued at N228.2 billion traded in 412,233 deals. As a result, the sector accounted for 54.0 per cent of the volume of equities traded (in contrast to the 53.1 per cent recorded in the second half of 2010), 67.0 per cent of the value of equities traded and 60.0 per cent of the number of trades executed. The sector was followed by the conglomerates sector with a traded volume of 7.56 billion shares valued at N20.01 billion in 27,931 trades. The two sectors accounted for 34.14 billion shares valued at N248.2 billion traded in 440,164 deals. The drop in the dominance of banking sector shares is attributable mainly to portfolio switching and a limited recovery from the trends in the preceeding year.

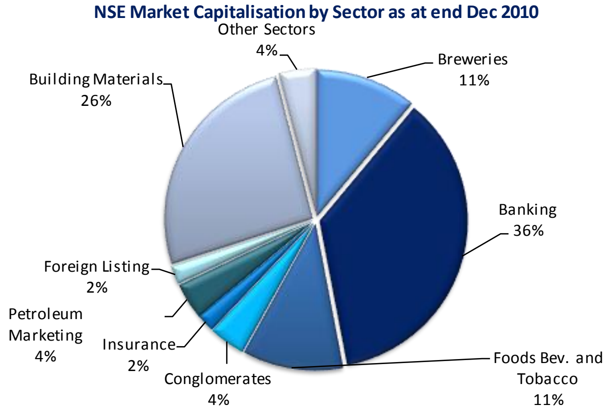
The shares of other sectors too dropped, except that of Building Materials, whose percentage share rose from 6.0 to 28.0 per cent, from their levels at the end of June, 2010. The exceptional performance of the Building Materials sub-sector was attributable to the listing of 15.5 billion shares of Dangote Cement at ₦135 apiece, on the floor of the Nigerian Stock Exchange in October, 2010 (Figures 4.8, 4.9 and 4.10). At end-June 2011, Dangote Cement Plc remained the most capitalized listed company with market capitalization of N2.013 trillion, accounting for 25.0 per cent of the equity market capitalization.

Figure 4.8
NSE Market Capitalization by Sector as at end-June, 2010



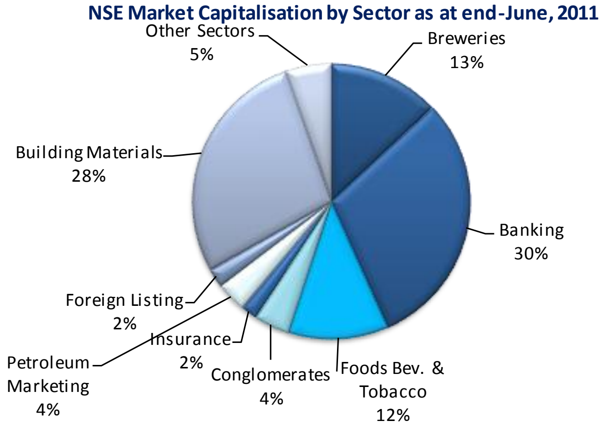
Source: Nigerian Stock Exchange

Figure 4.9
NSE Market Capitalisation by Sector as at end Dec 2010



Source: Nigerian Stock Exchange

Figure 4.10
NSE Market Capitalisation by Sector as at end-June, 2011



Source: Nigerian Stock Exchange

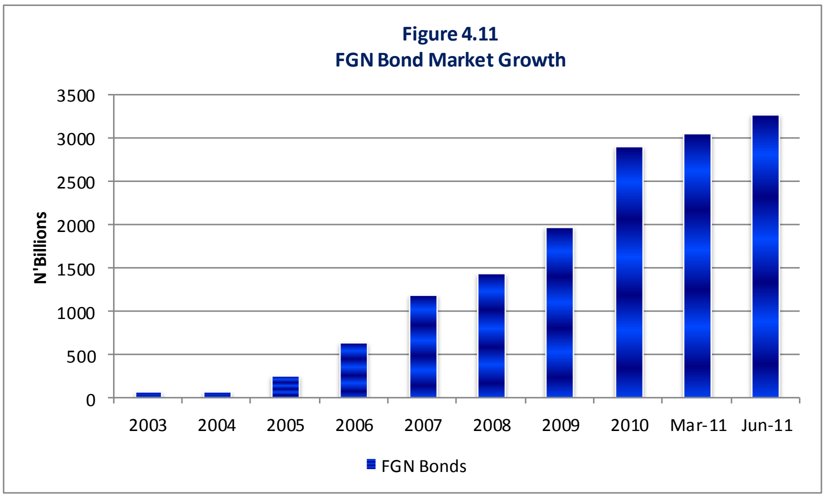
4.3.2 Bond Market

The bond market witnessed significant growth and activity during the first half of 2011. Growth in the market was driven largely by previously initiated reforms that encouraged long-term investments and the need for alternative sources of funds outside the banking system. Consequently, the value of transactions in the bonds market reached ₦15,000 billion at end-December 2010. By end-June 2011, total market value bonds was about N5.8 trillion naira

Despite the stability in the bond prices, the bond market did not outperform the equities market in terms of growth in market capitalization

Federal Government Bonds

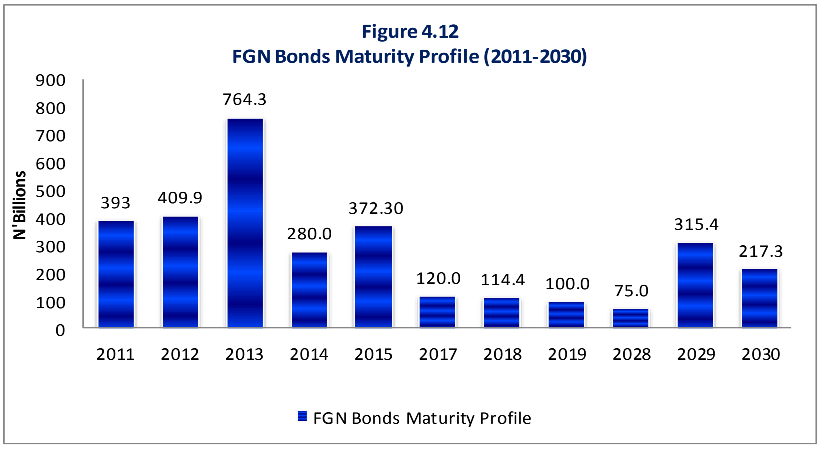
Nigeria's sovereign bonds (debt) have been in existence since the 1970s. However, the purposes for which funds were mobilized in the market were left ambiguous till 2003, when the Federal government entered the market actively to mobilize funds for long-term capital projects for furthering long-term growth. The bonds issued till 2003 had been illiquid and redeemable only upon maturity by the CBN. The bonds market is largely dominated by FGN Bonds accounted for 95.0 per cent of outstanding total domestic bonds with face value of N4,000 billion at end-December 2010. All the bonds issued thus far, had a minimum tenor of 2 years. In the last 3 years, the FGN bonds market recorded a cumulative gain of 49.0 per cent, compared with the stock market's loss of 38.0 per cent over the same period. Yet, the bond market did not outperform the equities market in terms of growth in market capitalization. The market also lagged behind other markets, both in terms of market depth and product diversity.



Source: Debt Management Office, 2011.

FGN bond issuance during the first half of 2011 fell from the levels recorded in the preceding year in view of government's effort to initiate fiscal consolidation and diversify its sources of funding away from the domestic market. However, the Debt Management Office (DMO) was set to re-open the 10-year bond during the second half of 2011 as per its issuance calendar in order to promote liquidity for the mid and long dated securities.

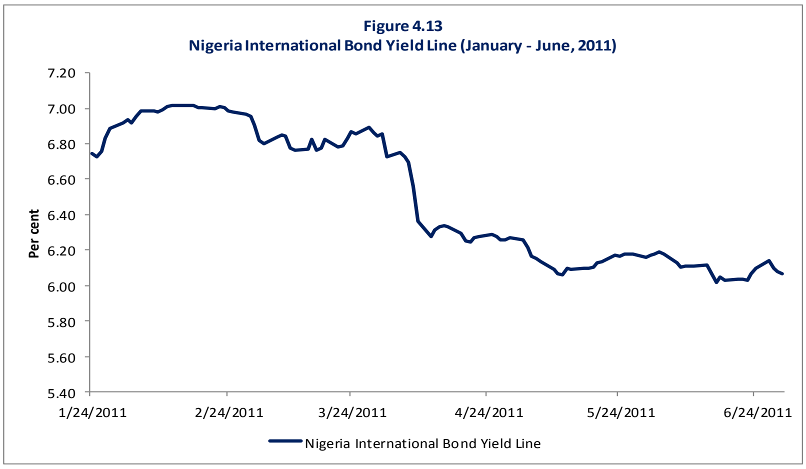
Total transactions in FGN Bonds through the Over-the-Counter (OTC) market in the first half of 2011 was 5 billion units valued at N4.44 trillion in 37,053 deals. During the same period in 2010, total transactions on FGN Bonds through the OTC were 8.1 billion units valued at N9.7 trillion in 88,398 deals, while in the second half of 2010; a turnover of 5.6 billion units worth N5.6 trillion in 48,682 deals was recorded.



Source: Debt Management Office, 2011

Sovereign Bonds

Nigeria is among many emerging economies that have issued bonds in the international bond market; this is done to diversify funding sources from the domestic market. A US$500 million five-year Eurobond was issued in 2010 as part of measures to fund the 2010 budget deficit. Analysis of recent issuances in the international market by countries of similar rating, and following an assessment of the risks inherent in the Nigerian economy at present, indicated that the required yield for successful international offering may be more expensive than those obtainable locally.



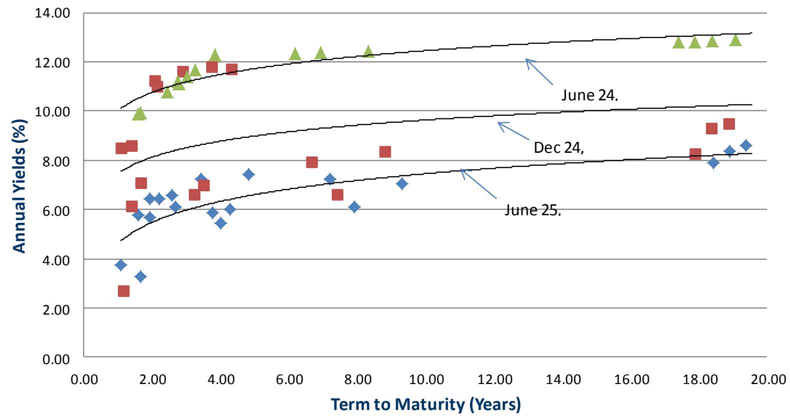
Source: Bloomberg, June 30, 2011.

.. yields on long-tenored FGN bonds remained below the end-December 2010 inflation level of 11.8 per cent....

Yields on Federal Government Bonds

The yield on FGN bonds for June 24, 2011 shifted upwards by 540 basis points compared with that of June 25, 2010. The yield curve for June 24, 2011 also shifted upward by 298 basis points compared with that of December 24, 2010 (Figure 4.13). This upward shift implies higher yield across the various maturities reflecting higher risk across board.

Figure 4.14
FGN Bonds yield curves 25th Jun 10 vs 24th Dec 10 vs 24th Jun 11



Source: Data obtained from Financial Markets Dealers Association

.. By end-June 2011, eight states had raised a total of N245.5 billion from the market ...

State Government Bonds

The re-emergence of the bond market since 2003 offered sub-national governments an option for financing their budget deficits as well as investing in numerous long term capital projects at comparatively low cost. State government or municipal bonds were in recent times issued for the purpose of financing their infrastructure needs. By end-June 2011, eight states had raised a total of N245.5 billion from the market, with more of such issuances scheduled for the later part of 2011. The States are Lagos (Series 1, N50.0billion; Series 2, N57.0billion), Ebonyi (N16.5billion), Benue (N13.0billion), Kwara (N17.0billion), Bayelsa (N50.0billion), Kaduna (N8.5billion), Imo (N18.5billion) and Niger (N9.0billion and N6.0billion). The proposal of N28.0, N15.0, N20.0, N50.0, N25.0 and N25.0 billion bond offer from Ogun, Abia, Bauchi, Delta, Ekiti and Zamfara State were still awaiting approval. State bonds constitute 5.48 per cent of total bonds market value at end-June 2011.) .

.. financing needs by states and local governments could quadruple over the next decade

Bond Market Outlook

On the domestic side, borrowing from the bond market by sub-national governments is set to dominate the market in the very near future. Between 2009 and 2010 alone, about eight states issued bonds. Already, States like Lagos are bracing up for another offer while others like Abia, Bauchi, Delta, Ekiti, Ogun and Zamfara are gearing up to make their debut. The rising share of state government bonds since 2009 may be partly explained by the need to improve infrastructure especially in the transport and power sectors. Going forward, the cost of issuing state government bonds may likely become more expensive, as market sentiment may set in when investors express cautious optimism in taking up some of these bonds. Thus, a more thorough evaluation and scrutiny of the credibility of the bond issuer would be the main determinant in the future, as well as determine demand in this market, especially, attractive yields on treasury bills and their lower duration risk, coupled with the current bond yield in the market and the outlook for a tighter monetary policy will require higher premium on any new issuances to make them attractive. On the foreign side, the quest to diversify funding away from domestic sources would make this source still attractive

low volume of corporate bonds in the economy reflects the inability of corporate organizations to issue bonds or debentures, secured by their .

Corporate Bonds

Corporate bonds accounted for a mere 5.6 per cent of total new issuances between January 2010 and June 2011. The banking sector (GTBank, UBA, First Bank, Access Bank and Diamond Bank) provided the lead in corporate bond offerings seeking to raise N1,800.0 billion over the next few years. In particular, the GTBank recently concluded a N13,165.0 billion (US$90 million) bond placement, being Nigeria's first corporate issue in many years.

.. The challenges remain fundamentally the need for price discovery, use of repos to facilitate funding and liquidity..

The total amount of corporate bonds issued was over N2,000.0 billion, as against N87.17 billion (US$581.0 million) in 2010. It is expected to increase to N3,000.0 billion (US$1.28 billion) by end-December 2011. The expected growth in corporate bonds issuance in 2011 is likely to be driven by considerations such as the successes recorded in the Federal and State Government bonds, government's desire to reinforce the corporate bond market through the granting of tax waivers and revision of guidelines on pension funds to accommodate corporate bonds, among other measures. Nonetheless, there are challenges relating to the need for price discovery, the use of repos to facilitate funding and liquidity, using derivatives to manage portfolio exposure to risks, product innovation and diversity and the development of a robust trading platform, among others. The lack of a secondary market trading platform for most State and corporate bonds also poses a severe challenge.

.

4.3.3 Commodities' Market

Trading in the commodities' market consists of direct physical trading and derivatives trading where participants could undertake multi-commodity trades. Globally, the volume of commodities' contracts traded on exchanges increased by a fifth in 2010 to around 2.5 billion million contracts valued at nearly $380bn. In particular, trading on exchanges in China and India has been gaining importance in recent years due to their emergence as significant consumers of commodities. China alone accounted for more than 60 per cent of exchange-traded commodities in 2010. Commodity assets under management more than doubled with the bulk of funds going into precious metals and energy products. The growth in prices of many commodities in 2010 contributed to the increase in the value of commodities' funds under management during the review period.

In terms of size, commodities' trading in Nigeria is still relatively small. Exchange traded commodities have seen an upturn in the volume of trading since the start of the Abuja Security Commodity Exchange (ASCE). This was largely a result of the growing attraction of commodities as an asset class and a proliferation of investment options which has made it easier to access this market. During the review period, trading in such agricultural commodities like cowpea, sesame seeds, sorghum, cotton, ginger, palm produce and cassava was undertaken. Again, the emergence of the non-interest banking system in Nigeria would further boost activities at the exchange by creating trading platform for trading in solid minerals and agricultural commodities in the form of *Murabahah* to organized *Tawarruq* to address the lack of money market instruments to facilitate liquidity management and investment purposes under non-interest banking. It is expected that the volumes can be higher during syndication and *sukuk* issues.

Although no derivatives were currently being traded outside the OTC framework, the ongoing reforms in the Nigeria banking sector exposed players to the enormous untapped potentials in the market...

4.3.4 Derivatives Market

During the review period, the Bank issued out guidelines for trading in foreign exchange derivatives. The objective was to provide a platform for market players in Nigeria to be competitive with their peers elsewhere, consistent with the aspiration of the Vision 2020 . The Guidelines first issued in January 2011, were revised in March to accommodate some new challenges that emerged. Although no derivatives were currently being traded outside the OTC framework, the ongoing reforms in the Nigerian banking sector exposed players to the enormous untapped potential in the market, particularly in derivatives trading. The reforms are expected to position Nigeria as a destination for discerning investors interested in derivatives trading in view of the need to tap into the higher returns on investment available in the market and the need for diversification of risks.

However, some critical regulatory and operational challenges remain to be tackled to achieve that purpose. The main issues concern the need to build capacity in derivatives trading so as to have an excellent pool of human resources, developing the legal instruments for the market and the need to develop an Exchange for trading *Futures* since *Forwards* could be traded on Over the Counter (OTC) basis. More importantly, was the need to firmly establish the underlying market. The fast growing Abuja Commodities Exchange could be the entity to support the development of the derivatives market in Nigeria for the country to strictly become a regional financial centre.

New Listings and De-listings

The NSE delisted 11 equities in the first half of 2011 and 4 matured FGN stocks. Overall, 5 corporate bonds, which included the N1,675,294,718,000 zero coupon 2013 Series 1 bonds (Tranches 1-3), being part of a N3,000.0 billion debt issuance programme in favour of AMCON were admitted.

There were 11 supplementary listings and no transactions on sub-national bonds in the review period.

Chapter 5
DOMESTIC PRICE DEVELOPMENTS AND THE REAL ECONOMY

5.1 Introduction

Headline inflation trended upwards during the period...

Price stability was the key thrust of monetary policy in the first half of 2011. Inflationary pressures, which started to build up in the second half of 2010 continued during the review period. Headline inflation trended upwards during the period driven mainly by increased government spending and liquidity injections by the AMCON. In addition, the global rise in food and energy prices and the hang-on effects of months of monetary easing stoked inflationary pressure in 2011.

5.2 Domestic Economic Activity

Domestic output growth was generally impressive in the first half of 2011 despite the sluggish global economic recovery.

Domestic output growth was generally impressive in the first half of 2011 despite the sluggish global economic recovery. Real GDP growth was 7.3 per cent in the first half of 2011, higher than the 7.69 per cent in the corresponding period of 2010. Overall, real GDP growth was estimated by National Bureau of Statistics at 8.71 per cent for fiscal 2011. The impressive growth recorded during the review period reflected continued favourable conditions for high oil exports and agricultural output, complemented by a stable macroeconomic environment.

.. aggregate index of industrial production recorded some improvements during the first half of 2011.

The non-oil sector remained the major driver of growth in the first half of 2011. Consequently, agriculture and services contributed 2.2 and 2.45 per cent, respectively, to the observed growth. The index of manufacturing production, estimated at 98.88 (1990=100) rose by 6.5 per cent in the first half of 2011, compared with the 5.2 per cent achieved in the corresponding period of 2010. The improved performance of the manufacturing subsector was largely attributed to enhanced business confidence and higher credit delivery traced to the various intervention schemes by the CBN. The aggregate index of industrial production recorded some improvements during the first half of 2011. The index of industrial production at 128.8 (1990=100) rose by 3.0 per cent when compared with the level in the corresponding period of

2010. The increase in output relative to the first half of 2010 was attributed to improvement in activities in all the subsectors including manufacturing, mining and electricity consumption which rose by 1.7, 2.4, and 5.9, respectively, notwithstanding, the continuing challenges to output growth , infrastructural bottlenecks and security concerns.

5.3 Trends inflation in the First Half of 2011

Inflationary pressures........continued throughout the first half of 2011.

Pressures on domestic prices which were a major threat in the second half of 2010 continued throughout the first half of 2011. The year-on-year headline inflation which bottomed-out at 11.8 per cent at end-December 2010, rose to 12.8 per cent in March 2011 but declined to 10.2 per cent in June, 2011. The inflation outcome showed significant improvement compared with the 14.90 per cent recorded in the corresponding period of 2010. Food inflation declined from 12.2 per cent in March 2011 to 9.2 per cent in June. Similarly, core inflation fell from 12.1 in January 2011 to 11.5 per cent in June 2011.

The 12-month moving average (headline) inflation rate which stood at 13.7 per cent in December 2010 declined to 12.3 per cent in June 2011. Similarly, the 12-month moving average food inflation declined from 14.70 per cent in December 2010 to 12.70 per cent in June 2011. The downward movement in inflation rate in June 2011 derived mainly from the tight monetary stance of the CBN.

Table 5.1
Measures of Consumer Prices
(July 2008 - June 2011)

	Headline Inflation		Core Inflation		Food Inflation	
Date	Y-Y	12- MMA	Y-Y	12- MMA	Y-Y	12- MMA
Jul-08	14.00	7.80	4.80	5.40	20.90	9.00
Dec-08	15.10	11.60	10.40	5.10	18.00	16.10
Jul-09	11.10	13.40	8.30	8.60	12.90	16.80
Dec-09	13.90	12.50	11.20	9.20	15.50	14.80
Jul-10	13.00	13.30	11.30	11.20	14.00	14.50
Dec-10	11.80	13.70	10.90	12.40	12.70	14.70
Jun-11	10.2	12.30	11.50	12.10	9.20	12.70

Source: National Bureau of Statistics (NBS)

Table 5.2
Inflation Rate

Date	Headline Inflation			Core Inflation			Food Inflation		
	CPI	Y-Y	12-MMA	CPI	Y-Y	12-MMA	CPI	Y-Y	12-MMA
Dec-10	114.20	11.80	13.70	112.60	10.90	12.40	115.40	12.70	14.70
Jan-11	115.60	12.10	13.50	114.50	12.10	12.40	114.30	10.30	14.20
Feb-11	116.70	11.10	13.20	115.50	10.60	12.10	117.70	12.20	13.90
Mar-11	118.30	12.80	13.00	117.50	12.80	12.10	118.10	12.20	13.60
Apr-11	117.70	11.30	12.70	117.90	12.90	12.10	119.00	11.60	13.20
May-11	118.70	12.40	12.60	118.90	13.00	12.20	118.50	12.20	13.20
Jun-11	119.90	10.20	12.30	119.80	11.50	12.10	120.10	9.200	12.70

Source: National Bureau of Statistics (NBS)

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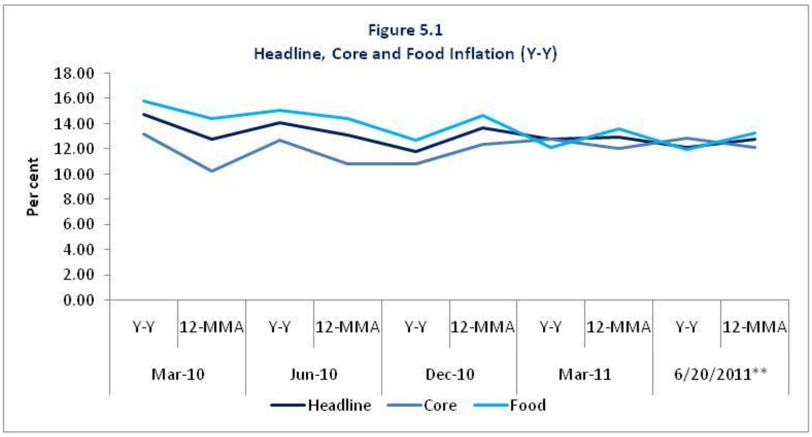
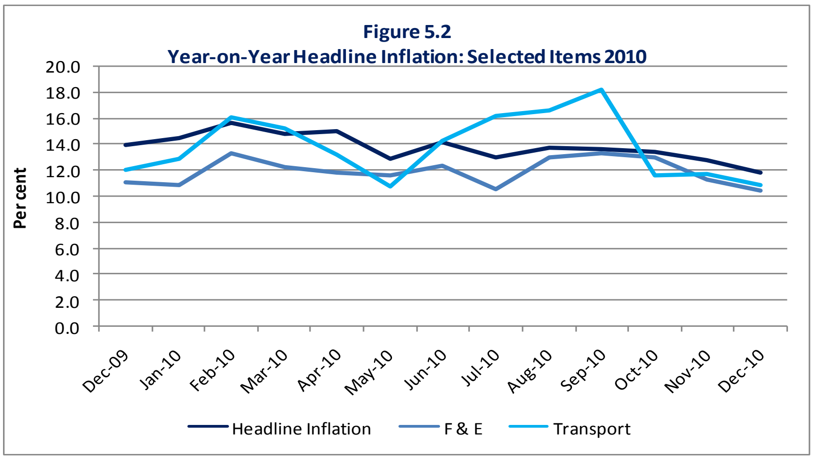


Source: National Bureau of Statistics

Overall, the all items CPI grew by 5.3 per cent in the second half of 2011

The breakdown of the CPI index indicates that housing, water, electricity/gas and other fuel, contributed most to the overall change in prices in the first half of 2011. Specifically, the index declined from 5.9 per cent in April 2011 to 5.8 and 5.2 per cent in May and June 2011, respectively. The 1.4 per cent contribution of transport to core inflation was largely accounted for by motor cars (0.5 percentage point); passenger transport by road (0.4 percentage point); fuels and lubricants for personal transport equipment (0.4 percentage point) the index for food and non-alcoholic beverages rose by 9.06 percentage points in June 2010 compared with 4.8 per cent in December 2010. Overall, the all items CPI grew by 5.3 per cent in the second half of 2011.



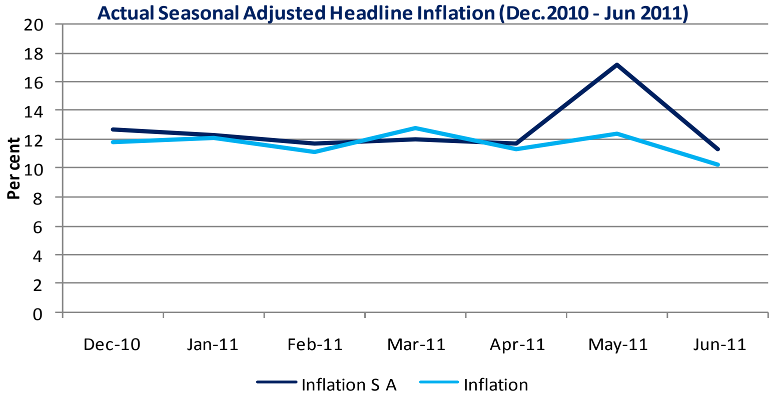
Source: National Bureau of Statistics

Notwithstanding the effects of seasonal factors, inflation remained elevated during most part of the first half of 2011

5.4 Actual and Seasonally Adjusted Headline Inflation

Analysis of inflation developments in the first half of 2011 indicated evidence of seasonality which played a key role in dampening inflationary pressures in the early and later parts of the review period. The release of grains from the strategic reserves during the period (off-farm produce because of the agricultural planting season) may have combined with other policy factors to dampen food prices. Thus, holding seasonal factors constant would have resulted in higher headline inflation during the period. Notwithstanding the effects of seasonal factors, inflation remained elevated during most part of the first half of 2011.

Figure 5.3
Actual Seasonal Adjusted Headline Inflation (Dec.2010 - Jun 2011)



Source: National Bureau of Statistics

5.5 Factors Responsible for Inflationary Pressures

5.5.1 Domestic Aggregate Demand

Growth in domestic aggregate demand was a major factor that contributed to the upward price movements in the review period.

Growth in domestic aggregate demand was a major factor that contributed to the upward price movements in the review period. Although broad money supply grew by 5.66 per cent in the first half of 2011 (when annualized, it is 11.32 per cent against the target growth of 13.75 per cent for fiscal 2011), it was 12.28 per cent above the level in the first half of 2010. Credit to the private sector at 1.45 per cent was 27.33 percentage points below the indicative target of 28.78 per cent for year 2011 while credit to government grew by 5.09 per cent. Thus, government expenditure on petroleum subsidy, local contractor bills, funding of the April 2011 elections, exerted further inflationary pressures on the economy. In addition, rising food and energy prices, especially in an import dependent economy like Nigeria, may have translated to significant pass-through to higher prices of imports.

5.5.2 Government Fiscal Operations

..borrowing to cover the budget deficit constituted a major pressure point for upward price developments

The 2011 budget was ambitious in that the fiscal deficit was planned to be higher. The consequential increase in expenditure placed increased pressure on domestic prices. The attendant borrowing to cover the budget deficit constituted a major pressure point for upward price developments. The fiscal operations of the Federal Government in the first half of 2011 resulted in an overall deficit of N581.64 billion which was higher than the 2011 proportionate budget deficit of N568.21 billion by N13.43 billion or 2.36 per cent. The deficit for the period was to be financed through borrowing from special account worth N95.00 billion and domestic borrowing, with the issuance of FGN Bonds worth N426 billion.

Box 5.2
Federal Government Fiscal Operations in the First Half of 2011

The fiscal operations of the Federal Government in the first half of 2011, showed that the actual Federal Government retained revenue for January - June, 2011 stood at N1214.74 billion indicating a shortfall of N459.36 billion or 27.44 per cent, when compared with the 2011 proportionate budget estimate of N1,395.08 billion (Table 6) (Please cross-check). The major sources of Federal Government revenue were: FGN share of the Federation Account Allocation Committee (FAAC) N812.44 billion or 82.49 per cent, FGN Independent Revenue N113.97 billion or 11.57 per cent, FGN share of VAT N41.28 billion or 4.18 per cent and 2010 Unspent Balance of N19.89 billion or 2.01 per cent. The revenue shortfall in the period was due to the poor performance of the Federal Government independent revenue collection.

The total expenditure of the Federal Government for the period January - June 2011 amounted to N1, 796.38 billion which was below the 2011 proportionate budget of N2, 315.68 billion by N445.93 billion or 19.89 per cent. The breakdown of the expenditure showed the following: Recurrent (non-debt) Expenditure (N985.04 billion), Capital Expenditure (N189.63 billion), Statutory Transfer (N108.54 billion) and Debt Service (N229.98 billion). In addition, the sum of N108.92 billion, being the extended 2010 capital budget was expended during the period.

Thus, the fiscal operations of the Federal government during January – June, 2011, resulted in a deficit of N581.64 billion, which was higher than the 2011 proportionate budget deficit of N568.21 billion by N13.43 billion or 2.36 per cent. The deficit for the period is expected to be financed through borrowing from special account worth N95.00 billion and domestic borrowing, with the issuance of FGN Bonds worth N426 billion by the Debt Management Office (DMO).

5.5.3 Aggregate Supply Constraints

..raw materials constraints reflected in increased demand pressure in the foreign exchange market,.....

Supply gaps in agriculture in some parts of the country were accounted for by social tensions, floods and planting season related issues which created food shortages that were augmented by the release of grains from the strategic reserves. In addition, raw material constraints reflected in increased demand pressure in the foreign exchange market, which impacted negatively on the exchange rate of the naira. Given the often strong pass-through effect from exchange rate to inflation, the supply constraints and dependence on imports given higher global food, energy and commodity prices, combined to increase the upward pressure on domestic prices.

5.5.4 Exchange Rate Developments

Relatively stable exchange rate impacted positively on the anti-inflation efforts...

The naira/dollar exchange rate remained relatively stable around ₦153.31/US$ in the first half of 2011. The premium between the official and the BDC rates widened to N5.69 or 3.58 per cent compared with ₦3.41 or 2.22 per cent in the first half of 2011, as the interbank and other segments of the market came under severe demand strain, thus inducing upward pressure on the official exchange rate. Stabilizing the exchange rate impacted on the level of external reserves which dropped while the rising price level was contained. The relatively stable exchange rate impacted positively on the anti-inflation efforts by helping to lock-in exchange rate-induced inflation expectations. Although the matching of supply with demand for foreign exchange at the WDAS impacted negatively on external reserves, it nevertheless helped in moderating the growth of liquidity in the banking system, which complemented the tight monetary policy stance of the CBN in the drive to tame inflation.

Table 5.3
FOOD INFLATION

RELATIVE CONTRIBUTION OF FOOD INFLATION COMPONENTS								
Year-on-Year (Food)	Year-On-Year					Month-on-Month		
	Weights	Apr'11	May'11	Jun'11		Apr'11	May'11	Jun'11
Food	507.03	11.60	12.20	9.20		0.70	-0.30	1.30
Processed Food	237.53	8.40	7.80	5.40		1.20	-0.80	0.60
Meat	47.78	0.56	0.47	0.28		0.06	-0.03	0.14
Fish & Sea Food	44.51	1.01	1.02	0.40		0.09	-0.03	0.15
Milk,Cheese & Eggs	12.75	0.31	0.28	0.22		0.01	-0.05	0.11
Oil & Fats	36.33	1.55	1.67	1.42		0.08	-0.02	0.12
Sugar,Jam,Honey,E.T.C	11.10	0.30	0.32	0.32		0.00	-0.04	0.11
Bread Unsliced 500g	9.33	0.72	0.60	0.30		0.07	0.10	-0.15
Cabin Biscuit:Local Manufacture 800g Pack	3.68	0.04	0.05	0.03		0.00	0.00	-0.01
Cassava Flour,Sold Loose	2.47	-0.12	0.05	0.00		0.00	-0.01	-0.03
Corn Flakes 350g	0.68	0.03	0.02	0.02		0.00	0.00	0.00
Corn Flakes 2kg	0.21	0.00	0.00	0.06		-0.01	0.02	0.02
Custard 300g	0.35	-0.01	0.00	0.04		0.00	0.01	0.02
Eko(Agidi/Kafa)	10.12	0.74	0.55	0.94		0.03	-0.02	0.47
Fritters(Puff-Puff)	0.35	-0.03	0.00	0.03		-0.02	0.01	0.03
Gari White,Sold Loose	11.46	0.88	0.65	0.54		0.47	-0.14	0.06
Gari, Yellow,Sold Loose	28.27	1.26	0.82	0.59		1.37	-0.88	0.28
Plantain Flour	3.75	-0.42	-0.14	-0.01		-0.97	0.05	0.09
Pop Corn	0.03	0.00	0.00	0.00		0.00	0.00	0.00
Sausage Beef (Gala)	0.34	0.00	0.00	0.00		0.00	0.00	0.00
Semovita 2kg	0.19	0.01	0.01	0.00		0.00	0.00	0.00
Yam Flour,Sold Loose	6.56	0.89	0.90	-0.14		-0.16	0.21	-0.79
Farm Produce	269.50	3.30	4.30	3.80		-0.50	0.50	0.70
Fruits	22.99	0.36	0.26	0.31		0.03	-0.04	0.11
Vegetables	54.35	1.11	1.17	1.03		0.06	-0.02	0.16
Yam, Potato & Other Tubers	60.56	1.15	1.39	1.15		0.09	0.03	0.14
Maize Grain White Sold Loose	25.01	0.34	0.27	0.21		0.09	0.05	0.02
Millet (Jero or Maiwa)Sold	23.86	-0.08	0.00	0.56		0.10	0.12	0.28

Loose								
Rice Agric Sold Loose	31.17	0.41	0.37	-0.22		-0.54	0.01	-0.03
Rice Local Sold Loose	28.03	-0.90	0.59	0.34		-0.16	0.17	-0.08
Rice/Imported High Quality Sold Loose	1.18	-0.04	0.02	0.00		-0.02	0.00	-0.01
Borghum (Guinea Corn) White or Brown,Sold Loose	22.33	0.22	0.25	0.41		-0.12	0.17	0.13
		11.60	12.20	9.20		0.70	-0.30	1.30

Table 5.4
RELATIVE CONTRIBUTION TO HEADLINE INFLATION
CONSUMER PRICE INDEX (CPI) (2009=100)

COMPONENTS	Weights	June	May	Jun-11	Actual Contribution			Headline	
		2010	2010	2011	June	May	June	Inflation Rate	
		1	2	3	2010	2011	2011	Y-on - Y	M-o M
								Relative Contribution	
A. YEAR-ON-YEAR (HEADLINE)									
ALL ITEMS	------	108.76	118.73	119.89	108.80	118.70	119.90	102.20	0.97
Food & Non-Alcoholic bev.	518.00	110.17	118.65	119.75	57.10	61.50	62.00	4.60	0.50
Alcoholic Bev. Tobacco & Kola	10.87	109.52	122.36	123.99	1.20	1.30	1.30	0.14	0.01
Clothing & Footwear	76.50	109.26	119.25	119.39	8.40	9.10	9.10	0.71	0.01
Housing,Water,Elect. Gas & other fuel	167.34	104.86	121.65	122.22	17.50	20.40	20.50	2.67	0.08
Food & Non-Alcoholic bev.									
Furnishings, Household Equip &HH Maint.	50.27	110.96	118.14	118.42	5.60	5.90	6.00	0.34	0.01
Health	30.04	108.83	119.27	123.39	3.30	3.60	3.70	0.40	0.10
Transport	65.08	107.59	116.96	120.11	7.00	7.60	7.80	0.75	0.17
Communication	6.80	102.08	105.69	105.64	0.70	0.70	0.70	0.02	0.00
Recreation & Culture	6.91	104.24	118.85	123.32	0.70	0.80	0.90	0.12	0.03
Education	39.44	106.55	111.90	112.20	4.20	4.40	4.40	0.20	0.01
Restaurant & Hotels	12.12	107.81	120.31	123.04	1.30	1.50	1.50	0.17	0.03
Miscellaneous Goods & Services	16.63	109.60	115.59	117.93	1.80	1.90	2.00	0.13	0.03

Table 5.5 RELATIVE CONTRIBUTION TO CORE INFLATION										
ALL ITEMS LESS FARM PRODUCE (CPI)(2009=100)										
COMPONENTS	Weights	June	May	June	Actual Contribution			Headline	
		2010	2011	2011	June	May	June	Inflation Rate	
		1	2	3	2010	2011	2011	Y-on-Y	M-on-M
A. YEAR-ON-YEAR(CORE)								Relative Contribution	
All Items Less Farm Produce CPI	512.83	107.41	118.90	119.79	107.40	118.90	119.80	11.50	0.70
Milk, Cheese &eggs	12.75	112.97	124.04	124.93	2.80	3.10	3.10	0.30	0.00
Sugar, Jam,Honey, etc	11.47	105.30	122.63	123.63	2.40	2.70	2.80	0.40	0.00
Coffee, Tea &Cocoa	6.62	107.84	122.95	124.23	1.40	1.60	1.60	0.20	0.00
Alcoholic Bev. Tobacco &Kola	10.87	109.87	121.21	121.01	2.30	2.60	2.60	0.20	0.00
Clothing &footwear	76.50	109.31	118.96	118.96	16.30	17.80	17.70	1.30	0.00
Housing,Water,Elect.Gas &Other Fuel	167.34	104.88	121.58	122.03	34.20	39.70	39.80	5.20	0.10
Furnishing, Household Equip & HH Maint.	50.27	111.04	117.89	117.77	10.90	11.60	11.50	0.60	0.00
Health	30.04	108.95	118.85	122.31	6.40	7.00	7.20	0.70	0.20
Transport	65.08	107.65	116.76	119.61	13.70	14.80	15.20	1.40	0.30
Communication	6.80	102.08	105.69	105.64	1.40	1.40	1.40	0.00	0.00
Recreation & Culture	6.91	104.80	117.03	118.64	1.40	1.60	1.60	0.20	0.00
Education	39.44	106.55	111.90	112.20	8.20	8.60	8.60	0.40	0.00
Restaurant & Hotels	12.12	108.13	119.27	120.37	2.60	2.80	2.80	0.30	0.00
Miscellaneous Goods &Services	16.63	109.60	115.59	117.93	3.60	3.60	3.80	0.30	0.10
Y-on-Y=Year- on Year									
M-on-M= Month-on-Month									

CHAPTER 6
ECONOMIC OUTLOOK

6.1 Overview

Rising food and commodity prices further moderated global output,

Global economic recovery slowed in the first half of 2011 due to a number of unfavorable developments, especially fiscal deterioration in some euro zone countries. In addition, global output growth was moderated by the earthquake and tsunami in Japan and the attendant supply chain disruptions. Some emerging market economies faced various crises such as structural fiscal challenges in Brazil, concerns about real estate bubble in China and mounting inflationary threat in India. Rising food and commodity prices further moderated global output, though, but this development strengthened output growth in countries in Sub-Saharan Africa.

On the domestic front, the positive effects of the various reforms ...could enhance growth prospects for the rest of the year

The observed level of growth in global output during the review period was driven largely by output expansion in the emerging and developing economies. There were however important risk factors which included financial sector imbalances and fiscal sustainability in many advanced economies, rising volatility in energy and commodity prices and the widespread social and political unrests in the MENA region. These developments continue to threaten global financial and economic stability and growth in the rest of 2011. On the domestic front, the positive effects of the various reforms in the financial sector complemented by targeted expenditure on power, agriculture, and manufacturing sectors could enhance growth prospects for the rest of the year and the medium-term.

6.2 Global Output

Growth in global output in the first half of 2011 moderated to 4.3 per cent from 4.7 per cent recorded in the second half of 2010.

Growth in global output in the first half of 2011 moderated to 4.3 per cent from 4.7 per cent in the second half of 2010. The decline was caused by the devastating earthquake and tsunami, and nuclear plant disaster in Japan which constrained industrial production, greater-than-projected weakness in US growth, sustained sovereign debt crisis in the euro area as well as rising food and commodity prices and political and social unrest in the MENA region. Growth in global output was projected to be sustained at 4.3 per cent in 2011 (Table 6.1).

Growth in the advanced economies in the first half of 2011 moderated to 2.2 per cent from the earlier projection of about 2.7 per cent.

Growth in the advanced economies in the first half of 2011 moderated to 2.2 per cent from the earlier projection of about 2.7 per cent. In the US, real GDP grew at an average of 2.3 per cent in the first half of 2011 and was expected to improve to 2.5 per cent in the second half, buoyed by strong growth in household domestic demand and expected decline in the unemployment rate. This outlook was expected to change if the prolonged deterioration in the US labor market conditions and the Euro debt crisis persisted.

Growth in the emerging and developing economies averaged 6.5 per cent in the first half of 2011 and was projected to improve to an average of 6.6 per cent in the second half of 2011, due largely to improved demand for primary commodities by the emerging market economies in Asia.

Growth in Sub-Saharan Africa was projected to continue strengthening, ...

Growth in Sub-Saharan Africa was projected to continue strengthening, with robust domestic demand and commodity exporters benefiting from rising prices. With the assumption that economic normality could return to some of the currently troubled countries, Sub-Sahara Africa´s average growth is expected to rise to 5.8 per cent in 2012 from the projected level of 5.2 per cent in 2011. In the MENA region, economic activities remained clouded by political and social unrest. However, there was improvement in the outlook of some oil and mineral producing states in the region. In the first half of 2011, growth in the MENA region as well as Sub-Saharan Africa averaged 4.2 and 5.5 per cent, respectively.

...outlook for the second half of 2011 suggested that the advanced, emerging and developing economies..... would witness sustained economic recovery;

In developing Asia, growth decelerated slightly from 9.6 per cent in the second half of 2010 to 8.4 per cent in the first half of 2011. Likewise, in Latin America and the Caribbean countries, output growth decelerated from 6.1 per cent in the second half of 2010 to 4.6 per cent in the first half of 2011 (Table 6.1). Both regions were expected to maintain the growth path for the rest of 2011.

Overall, the outlook for the second half of 2011 suggested that the advanced, emerging and developing economies, especially Sub-Saharan Africa, would witness sustained recovery; while the MENA economies could experience a further slowdown in the rest 0f 2011.

Table 6.1
World Economic Outlook

	2008	2009	2010	2011	2012
A. World Output					
World Output	**2.8**	**-0.7**	**5.1**	**4.0**	**4.0**
Advanced Economies	**0.2**	**-3.7**	**3.1**	**1.6**	**1.9**
USA	0.0	-3.5	3.0	1.5	1.8
Euro Area	0.5	-4.3	1.8	1.6	1.1
Japan	-1.2	-6.3	4.0	-0.5	2.3
UK	-0.1	-4.9	1.4	1.1	1.6
Canada	0.5	-2.8	3.2	2.9	2.6
Other Advanced Economies	1.7	-1.1	5.8	3.6	3.7
Emerging & Developing Economies	**6.0**	**2.8**	**7.3**	**6.4**	**6.1**
Central and Eastern Europe	3.0	-3.6	4.5	4.3	2.7
Commonwealth of Independent States	5.3	-6.4	4.6	4.6	4.4
Developing Asia	7.7	7.2	9.5	8.2	8.0
Latin America and the Caribbean	4.3	-1.7	6.1	4.5	4.0
Middle East and North Africa	5.0	2.6	4.4	4.0	3.6
Sub-Saharan Africa	5.5	2.8	5.4	5.2	5.8
B. Commodity Prices (US' Dollars)					
Oil	36.4	-36.3	27.9	30.6	-3.1
Non-fuel	7.5	-15.7	26.3	21.2	-4.7
C. Consumer Prices					
Advanced Economies	3.4	0.1	1.6	2.6	11.4
Emerging & Developing Economies	9.2	5.2	6.1	7.5	5.9

Sources: IMF World Economic Outlook, April 2011, IMF World Economic Update, June 2011

6.3 Global Inflation

Global inflation accelerated in the first half of 2011, due to the more-than-expected increases in commodity prices. In the advanced economies, inflation averaged 2.6 per cent and was projected to remain within that level to the rest of the year. Inflation in the US averaged 2.4 per cent in the first half of

Global inflation accelerated in the first half of 2011,..... .situation was expected to persist to the rest of the year.

2011 while in Sub-Saharan Africa, strong domestic demand and exchange rate pressures increased upward pressure on prices. The situation was expected to persist for the rest of the year.

6.4 Global Commodity and Energy Prices

World crude oil prices averaged US$116.90 per barrel in the first half of 2011, representing an increase of 46.50 per cent over the average price of US$79.80 per barrel observed in the second half of 2010. Oil prices were projected to remain within the US$100 per barrel region to the rest of 2011, due largely to anticipated rebound in Japan, sluggish supply response and political crises in the MENA countries.

6.5 Outlook for the Domestic Economy

6.5.1 Domestic Output Growth

.growth outlook for the domestic economy is optimistic

The overall growth outlook for the domestic economy is optimistic. Output growth in the first half of 2011 was estimated at 7.72 per cent and projected to rise to 8.71 per cent for the rest of 2011. This was premised on full oil production activities in the Niger Delta, rising oil prices, implementation of Federal Government's Road-map on Power Reforms, increased agricultural production due to interventions in the agriculture sector (such as the Nigerian Incentive-Based Risk Sharing System for Agricultural Lending), improved infrastructure and other initiatives in the first half of 2011.

The non-oil sector was expected to drive growth while the major risk to output was the possibility that slow growth in the US and the euro area and falling domestic aggregate demand in those countries could affect Nigeria's export of crude oil and prospects of higher oil exports.

Table 6.2
Outlook for Key Macroeconomic/Monetary Indicators

	2010*	2011**
Inflation	11.8	12.0
Real GDP	7.84	8.84
M2 Growth (per cent)	6.70	13.75
Income Velocity	2.6	2.8
Reserve Money (N'billion)	1,803.91	1,936.0
Credit to Govt. (per cent)	67.83	29.29
Credit to Private Sector (per cent)	-4.92	23.34

2010* Actual, 2011**CBN Staff Estimates.
Source: Central Bank of Nigeria

6.5.2 Inflation

Inflation pressures persisted throughout the first half of 2011...... forecasts suggested that the downward trend would continue in the second half of 2011

Inflationary pressures persisted throughout the first half of 2011 resulting in an end period level of 10.2 per cent. Current forecasts suggest that inflation may trend downward in the second half of 2011 due to expected favourable macroeconomic factors including good prospects for early and rich harvests to dampen core food inflation. There are however, risks to inflation in the event of drastic changes in the current environment. For example, the anticipated fiscal developments, which include the implementation of the new minimum wage, the unwinding of the quantitative easing initiatives introduced since 2009, higher electricity tariffs and the prospects for the removal of petroleum subsidy could be challenging for liquidity management for the rest of 2011.

6.5.3 The Foreign Exchange Market

High oil exports and prices were expected to result in external reserves buildup in the second half of 2011.

The foreign exchange market witnessed sustained demand pressure, resulting in the depreciation of the naira in all segments of the market. The surge in demand for foreign exchange was mainly on account of foreign portfolio

The foreign exchange market witnessed sustained pressure especially towards the

divestment and rising import demand, especially towards the April general elections. High oil exports and prices were however expected to act as prohibition in external reserves buildup in the second half of 2011.

.capital market witnessed some level of activities in the first half of 2011 ...outlook suggests an upward movement in major market indices in the second half of 2011

6.5.4. The Capital Market

Market indices which closed in the first half of 2011 positively, suggest an upward movement in the second half of 2011. This outlook however, is predicated on a number of factors: positive investor sentiments in the aftermath of a successful general election, reform measures introduced by the Securities and Exchange Commission (SEC), a new management team at the Nigerian Stock Exchange and the cleaning up of the balance sheets of the DMBs by AMCON,

6.5.5 The Money Market

...reforms by the CBN ....were expected to sustain lending to the real sector and stabilize short -term interest rate in the second half of 2011.

Money market interest rates rose and fluctuated at the low end of double digit in the first half of 2011. The increase in the interest rate was as a result of upward adjustment of MPR to rein in inflation expectations. The reforms by the CBN designed to strengthen the banking system and promote good corporate governance, as well as the purchase of the toxic assets of the DMBs by AMCON, were expected to sustain lending to the real sector and stabilize short-term interest rates in the second half of 2011.

On the upside, the performance of the US$500.0 million FGN euro bond at the international market, indicated by a falling yield represented a strong indication of the confidence of international investors in Nigeria's macroeconomic management which could increase capital inflow.

In conclusion, monetary policy is expected to continue its focus on curbing inflationary threats in the rest of the year. The overall outlook for the domestic economy appears brightened by the good prospects for growth and continued policy coordination between the monetary and fiscal authorities.

APPENDICES

Communiqué of the Monetary Policy Committee (January-June 2011)

Central Bank of Nigeria Communiqué No. 74 of the Monetary Policy Committee Meeting, January 24-25, 2011

The Monetary Policy Committee (MPC) met on the 24th and 25th January, 2011 to review domestic and international economic and financial developments in 2010 and the challenges facing the Nigerian economy in the year ahead.

On the global scene, the Committee noted the divergence in the economic performance of advanced and emerging economies in 2010. Economic uncertainties contributed to the weak recovery in advanced economies. As a result, growth was sluggish and concerns about inflation were dominant on account of the rising oil and commodity prices in the international markets and fears of fiscal stress in the years ahead. On the other hand, robust economic growth was recorded in emerging markets based essentially on strong domestic demand which offset weak export demand. Financial market conditions in advanced economies were, however, more stable than in the preceding two years while some emerging economies were confronted with challenges posed by large volatile capital inflows.

With regard to the domestic economy, the Committee noted with satisfaction the impressive economic growth, the continuing recovery of the capital market and the progress made towards restoring stability in the banking sector. It, however, observed that inflation had continued to be relatively high and reiterated the need for it to be reined in and for Government to further strengthen and deepen economic and structural reforms.

Key Domestic Macroeconomic and Financial Developments

Domestic Output

The Committee noted the sustained output growth recorded in 2010. Provisional data from the National Bureau of Statistics (NBS) indicated that real Gross Domestic Product (GDP) grew by 8.29 per cent in the fourth quarter of 2010, up from 7.86 per cent recorded in the third quarter. The overall GDP growth for 2010 was estimated to be 7.85 per cent, compared to the revised 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 outlook for 2011 is projected to be generally favourable in view of the continued improvement in the international oil market and emphasis on the development of the non-oil sector.

Domestic Prices

The year-on-year headline inflation, as measured by the percentage change in the all-items consumer price index (CPI, November 2009=100), trended downwards during most periods of 2010. It declined to 11.8 per cent in December 2010 from 13.6 per cent in September. Similarly, core inflation declined to 10.9 per cent in December 2010 from 12.8 per cent in September. Food inflation also, dropped to 12.7 per cent in December 2010, from 14.6 per cent recorded in September.

The Committee noted that although inflation has been trending downwards, the single digit benchmark was not achieved in 2010, despite the relatively good harvest, improved supply of petroleum products and lower growth in monetary aggregates. This, according to the Committee underscores the need to address both supply and demand side factors that determine inflation dynamics in Nigeria. One of the ways to keep aggregate demand in check is to restrain debt-financed government spending in the medium-term. This calls for a review of subsidies and other recurrent expenditure categories that constitute a drain on the national budget as well as improving the revenue base. However, the Committee commended the government for recognizing the existence of these issues in the 2011 budget proposal especially the reduction in the proposed level of total spending. Although there has been a strong emphasis on capital expenditure and infrastructure development, the Committee noted that recurrent expenditure remained high at over 70 per cent of the total budget. For this reason, the MPC believes that the risk to price stability posed by fiscal operations will need to be constantly monitored if inflation is to be brought down to single digit levels in the short- to medium-term. However, the Committee noted that the general thrust of fiscal policy pronouncements is in the desired direction.

Monetary, Credit and Financial Market Developments

Provisional data showed that the growth in broad measure of money supply (M2) was generally below the indicative benchmark throughout 2010 when compared with the level at end-December 2009. Specifically, at end-December 2010, M2 growth was 6.70 per cent compared with the indicative benchmark of 29 per cent for 2010.

Available data indicated that growth in aggregate credit to the domestic economy (net) was similarly sluggish at 6.13 per cent in December 2010 compared with 59.6 per cent recorded in the corresponding period of 2009. This development is connected to the damaged balance sheets of the DMBs in the wake of the global financial and economic crises. However, aggregate credit to the Federal, as well as State and local governments grew by 67.83 per cent and 19.17 per cent, respectively, in 2010. Credit to the private sector contracted by 4.92 per cent in contrast to the indicative benchmark growth of 31.54 per cent for 2010. However, this outcome would need to be considered in the context of the purchase of non-performing loans with face value of over N 2 trillion from the DMBs by the Asset Management Company of Nigeria (AMCON) in 2010. These loans were purchased at a discount and paid for by AMCON-issued zero-coupon bonds. Adjusting for this factor, growth in credit to the private sector would appear to be positive, since the loans were transferred to the balance sheet of AMCON. The growth in credit to the three tiers of government against the backdrop of the decline in private sector credit is a reflection of the fact that government borrowing had to some extent crowded out private sector credit.

Developments in retail market interest rates indicated that the retail lending rates remained relatively high in 2010. The average maximum lending rate declined from 23.18 per cent in January 2010 to 21.86 per cent in December 2010. The average prime lending rate also declined consistently from 18.38 per cent in January to 15.74 per cent in December 2010.

Inter-bank and OBB rates moderated to 8.06 and 6.86 per cent respectively in December 2010. The weighted average savings rate declined consistently from 3.33 per cent in January 2010 to 1.51 per cent in December 2010. The consolidated deposit rate initially declined from 6.13 per cent in January to 2.07 per cent in September, 2010 but rose marginally to 2.24 per cent in December 2010. Thus, the spread between the average maximum lending rate and the consolidated deposit rate widened from 17.05 percentage points in January to 19.76 percentage points in December 2010. The Committee noted with concern the extremely low returns paid to savers and depositors as this poses a major dis-intermediation risk and is inconsistent with developmental goals of financial inclusion.

The domestic capital market recorded significant recovery in 2010, after the decline associated with the global financial and economic crises in 2008/2009. The All-Share Index (ASI) rose from 20,827.17 points as at end-December 2009 to 24, 770.52 points as at end-December 2010, representing a growth of 18.93 per cent. Market Capitalization (MC) rose from N4.98 trillion as at end-December 2009 to N7.91 trillion as at end-December 2010, representing a growth of 58.83 per cent. For the fourth quarter of 2010, the All-Share Index (ASI) increased by 7.5 per cent from 23,050.59 to 24,770.52 at end-December 2010 while Market Capitalization (MC) increased by 40.1 per cent from N5.65 trillion to N7.91 trillion. However, the number of deals, volume and value of shares traded declined as at December. The increase in ASI and MC was partly due to share price recoveries in the Banking, Food/Beverage, Insurance and Oil & Gas sectors. Nonetheless, the recovery process needs to be sustained through further strengthening of macroeconomic and structural reforms. The Committee noted the major role being played by the Securities and Exchange Commission (SEC) in reforming and improving governance processes in the NSE and encouraged the SEC to continue as this is necessary for restoring confidence in the Nigerian financial system.

External Sector Developments

The foreign exchange market remained relatively stable. Between end-2009 and end-2010, the Naira/Dollar exchange rate depreciated by N1.08 or 0.72 per cent, to N150.66/US$ from N149.58 /US$ at end-2009, as against 15.65 per cent depreciation recorded at the end of 2009. The average premium between the CBN transaction rate and the BDC's as at end-2010, was 1.83 per cent, compared with 8.58 per cent in 2009.

The Committee reaffirmed its conviction that a stable exchange rate regime is critical to maintaining price stability but noted that in the absence of complementary policies the regime is only sustainable at the cost of significant attrition in foreign reserves. The MPC, therefore, continues to emphasize that the solution to reserve depletion lies in the implementation of appropriate reforms with regard to industrial and trade policies aimed at reducing import-dependence, which are beyond the scope of monetary policy. Substantial foreign exchange is expended annually on JVC Cash calls and importation of petroleum products due to the delay in implementing much needed reforms in the oil sector. This is in addition to the huge amounts spent on petroleum subsidies which are likely to increase with higher oil prices. The country is also expending foreign exchange on import of food items such as rice whereas what is needed is the implementation of policies that will lead to food security and total self-sufficiency. The Committee noted that external reserves stood at US$32.32 billion as at end-December 2010. It, however, rose to US$33,26 billion as at 20th January 2011.

In the Committee's view, implementation of these reforms along with the improved outlook for oil price and output should go a long way in reversing the negative trend in our foreign reserves position.

The Committee's Considerations

The considerations of the MPC following from the above review suggest that while the general outlook on growth is highly favourable, it is important to be vigilant on prices and financial market developments. The likelihood of improved oil output and rising oil prices in the international market would contribute to growth and help rebuild external reserves which is vital to sustain consumer and investor confidence in the economy.

The Committee noted that the risk of inflation is on the upward side as a result of the liquidity injections from the likely increase in government spending in the **run up** to the April 2011 elections, and AMCON purchases, as well as rising global energy and food prices and the expected pass-through to the domestic economy. It noted that the existing subsidy regime on petroleum products is not sustainable in view of government's current finances. In view of these factors, the Committee noted, that inflation remains a major concern that cannot be ignored in the short- to medium-term.

The MPC also noted with serious concern the existing low rates of about 1.0 per cent paid on savings deposits and its implications for financial intermediation and the mobilization of long-term funds which is critical for enhancing investment in real sector economic activities, and hence, economic growth. The Committee felt that in preparation for the removal of the CBN guarantee of inter-bank market, banks need to provide reasonable incentives for the mobilization of savings for growth and financial inclusion. The Committee, however, stated its commitment to continue to monitor developments with a view to coming up with appropriate measures to address the issue.

With regard to external reserves, the Committee observed that the fundamental structural problem of the country as an import-dependent economy was largely responsible for the continuing depletion of the external reserves. The continuing decline in reserves was accounted for by the payment for JVC cash calls, amounting to US$6,867 million and US$5,657 million in 2009, funding of the foreign exchange market to the tune of US$24,835.65 million as against US$25,070 million in 2009 in the case of WDAS. Sales to BDCs amounting to US$5,337 million in 2010 compared with US$4,734 million in 2009, in addition to the payment of subsidies on petroleum product as well as other government external payment obligations. The Committee stressed that a significant portion of the foreign exchange outflow will be stemmed with the Petroleum Industry Bill because JVC Cash Calls alone accounted for a large proportion of the total net outflow in 2010. The Committee observed that if exchange rate had not been managed in a stable manner, inflation would not have moderated. The policy thrust on exchange rate stability is informed by the overwhelming impact of exchange rate pass-through on inflation, given the import-dependent nature of the economy.

The MPC identified the greatest challenge facing the economy as the lack of flow of credit to the critical sectors, and the consequent need to unlock the flow of credit for critical investments in agriculture, SMEs and manufacturing sectors. To achieve this, government would need to create the right policy and regulatory environment, including the sustained fight against corruption, strengthening of transparency and institutions, as well as implementing critical reforms. On its part, the CBN will continue to engage banks and take the lead in programmes and interventions to channel credit to the real economy. To this end, the Committee noted the initiatives being pursued by the Bankers' Committee and urged speedy implementation.

The Committee further stated that the economy is affected not only by monetary and fiscal policy measures but also by political risk and concerns about national security which affect investors' confidence in the economy. In this regard, the Committee stressed the need to pay greater attention to the issue of security and how to manage uncertainty in the political environment.

MPC Decisions

In the light of the above considerations, the Committee committed to maintaining price stability by pursuing the current policy thrust of monetary tightening in view of the perceived inflation risks in the near term. The Committee took the decision to further tighten monetary policy. This was a decision taken by a majority of 11:1. The following measures were approved:

1. Raise the MPR by 25 basis points from 6.25 per cent to 6.50 per cent with immediate effect (a majority vote of 11:1);

2. Maintain the symmetric corridor of +/- 200 basis points by 7-5; 4 members voted for asymmetric corridor by 50 basis points increase in Standing Deposit Facility rate;

3. Raise the Cash Reserve Requirement (CRR) Ratio by 100 basis points from 1.00 per cent to 2.00 per cent with effect from February 1, 2011 with a majority vote of 11:1; and

4. With effect from March 1, 2011, raise the Liquidity Ratio (LR) by 500 basis points from 25.00 per cent to 30.00 per cent with a majority vote of 11:1.

Sanusi Lamido Sanusi
Governor,
Central Bank of Nigeria
Abuja
January 25, 2011

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 22nd 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 QI 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 interbank 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, interbank call and OBB rates rose from 4.93 and 4.75 per cent on 26th 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 interbank 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

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 QI 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 22nd 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 ±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
Abuja

May 24, 2011