



## **Central Bank of Nigeria Communiqué No. 82 of the Monetary Policy Committee Meeting of Monday and Tuesday March 19 and 20, 2012**

The Monetary Policy Committee (MPC) met on March 19 and 20, 2012 with 10 members in attendance to review domestic and international economic and financial conditions with a view to addressing monetary policy challenges in the short-to medium-term.

### **The International Economic Situation**

The outlook of the international economic environment has improved slightly, when compared with 2011. The U.S. economy is showing signs of recovery and is expected to post over 2 per cent growth in 2012 compared with 1.7 per cent in 2011. There are, however, lingering global security concerns, particularly with respect to the face-off between the Iranian authorities on the one hand and the governments of the U.S., Europe and Israel on the other. An escalation of conflict may threaten global energy supplies and introduce shocks into the current environment. The Eurozone countries' economic outlook remained uncertain, particularly owing to the loss of momentum in growth by the end of 2011. The Eurozone countries posted a negative growth of 0.3 per cent in Q4 compared

with gains of 0.2 per cent and 0.1 per cent in the preceding two quarters. The recent estimate indicated that the Euro area may post a negative growth of 0.3 per cent in 2012 against the estimated 1.4 per cent in 2011. The sovereign debt problem of the highly-indebted countries of the Eurozone, however, seems to be coming under control with supportive actions from creditors, in particular the European Central Bank (ECB) and the IMF, which also boosted liquidity and sentiment in the financial markets. The economic prospects of the United Kingdom also seem to have improved recently partly owing to the financial support given by the ECB to the financial markets and partly due to news of the incipient signs of improvement in the economy of the U.S. The changed monetary stance of the ECB has clearly provided the short term support needed to restore confidence and kick-start recovery subject to improvements in fiscal balance sheets and competitiveness in the European periphery.

In emerging economies, there is clear evidence of a slowdown. China posted 8.9 per cent growth in Q4 2011, the lowest since Q2 2009. It is expected that China's growth will slow down further in the current quarter going by the weak industrial production gains in January and February and the low retail sales. Consequently, China has revised its growth target for 2012 downward from 8.0 per cent to 7.5 per cent. In India, growth in the quarter ending December 2011 was lower at 6.1 per cent compared with 6.9 per cent in the

preceding quarter. Inflation rose in February 2012 with the result that inflation in 2011-12 could well be slightly above 7 per cent. However, the latest official estimate of growth for 2012-13 is 7.6 per cent. This is partly attributed to expected improvement in the fiscal position and somewhat relaxed monetary policy. Brazil's growth in Q4 of 2011 was 2.47 per cent and is expected to slow down further in 2012. For the year as a whole, Brazil recorded a mere 2.7 per cent as against 7.5 per cent in 2010. Inflation was 5.8 per cent in February 2012. The concerns around slowdown in the growth of these leading emerging market economies are however mitigated by the relatively positive outlook in the advanced economies.

The Committee noted that oil prices are likely to be stable in the short-to medium term, with a possibility of volatility induced by any deterioration of peace conditions in the Middle East. The risk of a sharp decline in oil price is significantly lower today than it was at the last MPC. However, there is a need to guard against complacency.

## **Domestic Economic and Financial Developments**

### **Output**

The National Bureau of Statistics (NBS) has revised the data on national accounts for 2010 and 2011. In Quarter 4 of 2011, real GDP grew by 7.68 per cent, higher than 7.30 per cent in the preceding quarter but lower than the 8.60 per cent of the corresponding quarter of 2010. For the year as a whole, real GDP growth has been

lower for all the quarters in 2011 than in the corresponding quarters of 2010. The Committee noted that real non-oil GDP recorded a robust growth of 8.85 per cent in 2011 as against 8.51 per cent in 2010. Crude oil output growth recorded a decline of 0.57 per cent in 2011. In the non-oil sector, agriculture decelerated mildly: its growth was 5.71 per cent in 2011 compared with the growth of 5.82 per cent in 2010. The main contributions to non-oil growth in 2011 were wholesale and retail trade, services, building and construction, and minerals and manufacturing. In general, the negative growth in the oil and gas and slowdown in agriculture are pointers to the need for implementation of the appropriate reforms in the agricultural and petroleum sectors.

## **Prices**

The Committee noted the resurgence of inflationary threat starting in January after it had moderated towards the end of 2011. The NBS data on prices shows that the headline inflation in February 2012 stood at 11.9 per cent, lower than 12.6 per cent in January but higher than 10.3 per cent in December 2011. Food inflation on year on year basis was 12.9 per cent in February compared with 13.1 per cent in January and 11.0 per cent in December. The year-on-year core inflation was high at 13.5 per cent in February relative to 12.7 per cent in January and 10.8 per cent in December. The

moderation in food inflation has helped to lower headline inflation. The rise in core inflation, however, must be kept in view in the formation of inflationary expectations. Given the partial removal of fuel subsidy in January the moderation in inflation in February is probably attributable to a number of variables including: reallocation of spending by consumers due to higher expenditure on transport and fuel; the slowdown in monetary aggregates and fiscal spending; the stable and strengthening exchange rate of the naira; seasonal effect of food prices and statistical base effects.

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

The provisional data on broad money supply (M2) for February shows that it grew by 13.4 per cent on year on year basis compared with 15.4 per cent in 2011. M1 grew at a faster pace of 19.1 per cent on year on year basis mainly owing to the strong growth of demand deposits. However, relative to December 2011 levels, both broad money (M2) and narrow money (M1) declined. Foreign assets (net) and domestic credit (net) both increased on year-on-year basis. However, over the December level, net foreign assets grew modestly by 1.15 per cent whereas the domestic credit declined by 1.9 per cent. The Committee urged the Central Bank of Nigeria to monitor closely the credit developments and ensure that the private sector gets adequate credit from deposit money banks so that the current growth momentum is not impeded by lack of adequate finance.

The Committee noted that money market rates have been moving around the upper limit of the corridor. The average OBB rate was 13.91 per cent in January and 13.64 per cent in February. The average call rates in January and February months were 14.18 per cent and 14.29 per cent, respectively. The overall stability in the money market rates was essentially a reflection of the effectiveness of monetary policy implementation. The spread between the average maximum lending rates and the weighted average rate on all categories of deposits fell marginally from 20.12 percentage points in December 2011 to 19.94 percentage points in January and further to 19.70 percentage points in February 2012.

### **External Sector Developments**

Foreign exchange reserves amounted to US\$35.43 billion as at March 14, 2012. This is an improvement over the level of US\$ 32.64 billion at end-December 2011. The exchange rate at the wDAS auctions moved from US\$/N158.6205 at the end of January 2012 to US\$/N157.6206 as on March 14, 2012. This partly reflected the moderation in the demand for foreign exchange due to increased inflows and reduced demand. The exchange rate at the inter-bank market appreciated significantly from US\$/N161.60 as at end January to US\$/N157.70 as at March 14, 2012. The rate charged by BDCs also appreciated from US\$/N163.00 to US\$/N160.00 during the same period. As a result, the premium between the wDAS rate and

the rates in the other segments of the market declined substantially over the period.

The Committee held the view that the improvement in the inflow of foreign exchange partly owing to the current high crude oil prices in the international markets and the general improvement in the policy environment to attract capital flows influenced the observed trends in the external sector. It urged the Central Bank of Nigeria to build up adequate external reserves to satisfy the genuine needs for foreign exchange consistent with the increase in the growth in economic activity and the need to conserve resources and to withstand external shocks.

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

The Committee noted that the underlying inflationary pressure from supply shocks would have been more severe had there been no mitigating factors on the demand side. Currently, aggregate credit and broad money (M2) have been on the decline and there are signs of improving fiscal position with some control over expenditure and no imminent increase in wages. The fiscal stance and the absence of second-round effects of fuel subsidy removal have therefore complemented the monetary stance to dampen demand. The situation is further supported by stable exchange rates and stable international commodity prices which combine to moderate imported inflation.

The Committee recognized that in light of increasingly benign global environment, it is imperative to ensure that the current growth path is sustained. It noted the relative stability in the foreign exchange market as well as the modest accretion to external reserves during the period. In view of the poor accretion to reserves in 2011 and the need to continue to build buffers for the economy in an uncertain environment, the Committee strongly endorsed the stance of the Bank to focus on building reserves, defending the stability of the currency and providing conditions that are conducive to the inflow of FDI.

The Committee noted with satisfaction the introduction of some fiscal and structural measures that could improve the revenue base of the government as well as enhance the capacity of the domestic economy to improve the value chain in the production process. Some of these measures include introduction of cost reflective electricity tariffs and progress in agricultural transformation initiatives. Although these measures would have a salutary effect on the fiscal position, they may, in the short run, put pressure on domestic prices. Consequently, it is important for both monetary and fiscal authorities to put in place coordinated measures that would moderate the increase in the general level of domestic prices in the short to medium term. The Committee is also concerned about the rising level of domestic debt and its sustainability, as shown by the average debt service to revenue ratio of 17.6 per cent in the last

three years. This would likely have a negative impact on domestic interest rates and the flow of credit to the core private sector, among others. Although debt to GDP ratio in 2011 stood at 17.8 per cent, the Committee noted that the percentage of debt service to government revenue was a high 19.1 per cent in the same year. In view of the high interest rate environment occasioned by tight monetary policy stance, a moderation in government borrowing would be positive not just for the fiscal position but for access to finance by the private sector. After reviewing the overall fiscal position the committee commended the fiscal authorities for the discipline being introduced into government spending, the tightening of fiscal controls and the renewed focus on spending on capital projects.

In arriving at its decision, the Committee was faced with a choice between two options. One option was to consider, in view of the improving global economic environment, a moderation in headline inflation, slowdown in monetary aggregates and fiscal spending and the crowding out effects of high interest rates, a reduction in the policy rate. This argument was considered but rejected on the basis of a number of factors. These included persistent underlying core inflationary pressures, the need to continue supporting the naira and build up external reserves, the necessity for attracting and retaining foreign investment and the need for consistency and stability in the macroeconomic environment. The Bank also needs to maintain its

clear focus on price stability and it is not evident that a moderation in February is sufficient to establish a trend, and warrant a reversal of monetary tightening.

**Decisions:**

In the light of the above, and considering the clear impact of previous tightening on the rate of inflation and exchange rates up to February 2012, the Committee unanimously decided as follows:

1. Retain MPR at 12.0 per cent with interest rate corridor of +/- 200 basis points;
2. Retain CRR at 8.0 per cent;
3. Retain minimum liquidity Ratio of 30.0 per cent; and

The Committee also resolved to watch closely developments with respect to the fiscal stance and to respond appropriately if, and when, the need arises.

**Sanusi Lamido Sanusi, CON**  
Governor  
Central Bank of Nigeria

**March 20, 2012**

## PERSONAL STATEMENTS BY MPC MEMBERS:

### 1.0 ALADE, SARAH

*Although headline inflation moderated to 11.9 percent in February 2012, down from 12.6 percent recorded in January 2012, inflation still remains a threat as the full effect of the subsidy removal has not worked its way through the economy. GDP growth in the last quarter of 2011 was lower than expected at 7.68 percent against the estimated 8.46 percent, suggesting a moderation in economic activities. Money market rates indicate tight liquidity conditions as interbank rates and other interest rates have trended upwards, constraining private sector growth and hampering job creation. All these would suggest monetary easing. However, inflation remains a threat as both core and food inflation rose and further increase is expected as the planting season is about to commence. In addition, tight monetary policy has contributed to attracting foreign inflow and created stability in foreign exchange rate market. Therefore, given these developments I will support a “no change” in monetary policy rate.*

**Headline inflation decreased slightly in February, although inflation remains a threat.** Inflation stood at 11.9 in February 2012 as against 12.6 percent recorded in January 2012. This decline in headline inflation suggests that the initial effect of the partial oil subsidy removal is weaning, therefore foreclosing the fear of second-round inflationary effect resulting from the policy. Food inflation

increased slightly to 6.3 percent in February from 5.6 percent in January 2012, reflecting the seasonal effect of food prices in Nigeria. Staff projections indicate a rise in inflation in the near term due to seasonality in food supply/prices, consequently, the preemptive tightening stance adopted by the Bank in 2011 calls for a continued pause to allow for the full effect of the policy and to address declining growth concerns. However, as planting season commence, the threat of expected heightened inflation should not be overlooked.

**The 2012 budget passed by the National Assembly although higher than the proposed budget submitted by the Executive, still maintained deficit financing of less than 3 percent of GDP.** The 2012 budget passed recently by the joint session of the National Assembly has a budget deficit of 2.96 percent of GDP still within the threshold of 3 percent of GDP stipulated in the Fiscal Responsibility Act of 2007. It also has the crude oil production target of 2.48 bpd, and oil benchmark of \$72 per barrel. Although the budget passed by the National Assembly is higher than the amount submitted by the Executive, the magnitude of the increase does not justify an increase in monetary policy rate in the face of declining growth, stable exchange rate and tight liquidity conditions in the market. According to World Economic Outlook (WEO), oil price is expected to remain high in international market on the back of disrupted supply in the Middle East and renewed recovery in the United States. If the budget is implemented as passed without further increase, the inflationary pressure coming from the budget implementation will largely be contained.

**Developments in the domestic money market indicate tight liquidity conditions.**

Money market rates continue to trend upwards as interbank lending rate reached 15.97 percent in February 22<sup>nd</sup>, 2012. Similarly, average OBB rate stood at 9.6 percent in June increased to 15.5 percent in February 2012. Although the spread between the average maximum lending rate and the consolidated

deposit rate narrowed by 23 basis points in February 2012, remain elevated at 19.70 percent. This is as a result of tight liquidity conditions in the market, a consequence of the aggressive monetary tightening stance of the CBN, which started in 2011. In addition, other monetary aggregates (Broad (M2) money and Narrow money (M1)) are declining when compared to end 2011 data. Total credit to the private sector declined by 7.97 percent on an annual basis and credit to the agricultural sector declined by 11.25 percent. Further tightening now could increase lending cost to private sector and further constrain economic activities.

**Tight monetary policy stance has helped the country remain competitive in attracting foreign inflows.** The tight monetary policy stance has been instrumental in attracting foreign exchange inflows and has helped to stabilize the foreign exchange market. As investors look for higher yield, the attractive interest rate in Nigeria has made the country an investment destination in a dry investment climate. Therefore, maintaining the current stance will be helpful in sustaining the inflow.

**Weak growth in Europe is weighing down on global growth.** Growth in advanced economies is projected to decelerate to 1.2 percent in 2012 from 1.6 percent recorded in 2011. While the US economy is showing signs of growth, as February labor report showed solid recovery and rapid job gain in the manufacturing sector with an average of 42, 000 jobs in January-February, against an average of 13,000 in the last quarter of 2011, the story is different in Europe. Although some resolution of the Greece debt crisis is achieved, the ripple effect will linger for a while. In such an uncertain global environment, tightening will not be a good option for now. In the same view, easing monetary policy could reverse some of the important gains made in stabilizing the foreign exchange market.

**Based on the above**, I will recommend a “no change” in monetary policy rate and Cash Reserve Requirement (CRR). The domestic economic growth challenges call for a stay of action on policy stance.

## **2.0 BARAU, SULEIMAN**

A. I today voted for the maintenance of status-quo, in policy (particularly to hold MPR at 12% within the 2% corridor and CRR at 8%).

### **B. Review of Recent Developments**

B.1 Inflation – Year-on-Year (YoY) Headline Inflation (HI) moderated to 11.9% in February compared to 12.5% in January with significant contributions from Transport, Alcoholic Beverages, Tobacco and Kola, and Health segments. YoY Food Inflation (FI) also moderated to 12.9% in February from 13.1% in January. YoY Core Inflation (CI) however increased to 13.5% in February from 12.7% in January with significant contribution from Clothing and Footwear.

B.2 Exchange Rate – we have since the last MPC witnessed the appreciation of the Naira in all segments of the market. In addition, the premium between the Wholesale Dutch Auction System (WDAS) and Bureau De Change (BDC) was reduced significantly to 1.51%.

B.3 Interest rates, particularly money market rates, have been volatile but remained largely within acceptable band. This volatility is largely driven by Governments’ fiscal operations.

B.4 Gross Domestic Product (GDP) – the revised figures from National Bureau of Statistics showed GDP for 2011 at 7.36% compared to 7.98% in 2010. A further review for the two years showed a consistent decline on quarter by

quarter basis in 2010 compared to 2011. Agriculture, Wholesale and Trade, and Services Sectors remained the major drivers. The relative contribution of the Agricultural Sector also shows a decline in 2011 compared to 2010.

B.5 Foreign Reserves – We have recently seen a turn around on the level of our foreign reserves with reserve levels standing at US \$35.44 billion on March 15<sup>th</sup>, 2012 relative to US \$32.65 billion on December 31<sup>st</sup> 2011 or 8.59% increase.

## **C. Comments**

C.1 It is important to observe that the tight monetary regime that we have witnessed helped in containing the inflationary risk that we faced. Even though, this is the case, staff estimates for the next six months forecast increase in HI, CI and FI. In effect, the inflationary pressure is still a risk further down the line.

C.2 The Appropriation Act just passed by the National Assembly has been increased in size from N4.67 trillion to over N4.8 trillion. Considerable improvement has been witnessed in the structure of the budget in efforts to achieve consolidation. While revenues have been enhanced and expenditures streamlined, it is still a deficit budget and therefore expansionary. The risk here is that this may exacerbate the inflationary pressure, forecast for the economy.

C.3 A significant pressure point also stems from the decline in GDP growth rate in 2011. Though I have not seen any strong relationship between interest rate and output growth in Nigeria, the relatively high lending rate occasioned by our tightening stance may be partially accountable. This is in my view the key reason to elicit the easing of policy stance. The real issue however is that GDP growth can only be sustained if we have fundamental reforms that would ease doing business in Nigeria to address infrastructural and power challenges, amongst others.

- C.4 Under the current policy stance, we have witnessed accretion to foreign reserves, stable and appreciating Naira, reduction in exchange rate premium and banking sector stability.
- C.5 In view of the gains made under the current policy stance, threats of inflationary pressures down the line and the fact that growth issues are better addressed by fundamental reforms of the real sector, I am inclined to support the maintenance of status-quo. We should however keep the usual window open for any significant unfavourable development to be addressed through an emergency Monetary Policy Committee meeting.
- D. Recommendation
- Keep MPR at 12%
  - Maintain the corridor at plus and minus 2%
  - Keep Cash Reserve Ratio at 8%.

### 3.0 GARBA, ABDUL GANIYU

#### Decision

I vote for:

1. Holding the MPR at 12%
2. Maintaining the subsisting Corridor for SLF and SDF
3. Holding CRR at 8%

#### Background

At the January MPC, I voted to hold MPR at 12%; CRR at 8% and to maintain the symmetric corridor for SDF and SLF at ~~±2%~~ to:

1. allow the menu of tightening policies of 2011 to work through the economic system;
2. provide investors **policy stability** as they plan their investment strategies for 2012 and beyond; and

3. incentivize the fiscal authorities to undertake the fiscal and associated fundamental reforms required to change the incentive system, begin to build the infrastructural system that will make the economy competitive in oil and gas, solid minerals, industry and agriculture so as to create the jobs needed to reverse the trend of unemployment.

I also expressed concern about:

1. The growing levels of unemployment from 12.3% in 2006 to 23.9% in 2011 even when GDP growth averaged 6.8% in the period.
2. The persistent hemorrhaging of investible capital through rising net outflows to pay for foreign services and net payments of investment incomes. As a result, the economy on aggregate under invests and under consumes to pay for foreign services and to pay foreign investors in flows that significantly exceed inflows of portfolio and FDI investments.
3. The structural and competitiveness failures linked to (1) the composition of output and exports that are dominated by primary products and (2) the misalignment of Nigeria's aggregate demand to its aggregate supply.
4. The size of the fiscal deficit and public debt and its crowding-out effects on credit to the private/real sectors of the economy.
5. The persistence of the episodic "FAAC effect" which unsettles the money market causing the MPC operating targets (obb and interbank rates) to exhibit FAAC related volatilities.
6. The poor performance of the capital market exemplified by a loss of N2.2 Trillion Naira in 2011 with Banking Stocks the worse hit.

### **Developments in the Economy**

Since the January 2012 MPC Meeting:

1. Recent sets of data released by the National Bureau of Statistics (NBS) indicate:
  - i. An unexpected decline in month of month headline inflation from 3.35% in January to 0.28% in February that suggests among other things that the real budget effects of the PMS Price shock in January may have counteracted the aggregate supply effects.
  - ii. A significant rise in the incidence of poverty from 54.4% in 2004 to 69% in 2010 indicating that 112.47 million Nigerians were living under \$1 a day in 2010. In addition, the NBS projected arise to 71% in 2011

and growth in income inequalities (class, state and regional). These data reinforce a view that the budget effects of the PMS Price shock moderated the inflationary effects but, most likely at the cost of forgone living standards of more than 69% of Nigerians.

- iii. The GDP slowed in 2011 (7.38%) relative 2010(7.98%) with the contributions of agriculture and manufacturing also significantly lower in 2011 relative to 2010. A slowing down of growth does not augur well for job creation and a reduction in unemployment which was already almost a quarter of the workforce.
2. The key monetary aggregates (M1, Demand Deposit, Savings Deposit, Time Deposit, M2, Net Domestic Credit and Credit to the Private Sector) all contracted significantly in February continuing a trend from January for most. The operating targets (obb and call rates) were volatile around the target rates of 14% with the usual "FAAC Effect" a strong causal force. The prime (16.92%) and maximum (23.32%) lending rates remained high interest while the savings deposit rate remained very low at 1.43%. As a result, the interest rate spread remained very wide: averaging 6.28% between maximum and prime and, between 17.5% and 21.1% for maximum relative to savings deposit rate. The structure of banking system loan portfolio remains highly concentrated and biased against agriculture and other real activity and significant exposure to FGN Bonds and Treasury Bills.
  3. The forex market was relatively stable as demand slowed significantly most likely, a fallout of the public hearings on subsidy programme by the National Assembly. The decline in demand has the beneficial effects of stabilizing the exchange rate also, enabling a buildup of external reserves.
  4. The capital market continued its downward trend in 2012 with a loss of 0.45% and 0.6% in the All Share Index and Market Capitalization respectively by March 16, 2012 relative to December 2011.
  5. The data on Federal Fiscal operations indicated a sharp fall in revenue (48.3%) and expenditure (76%) generating a surplus of N106.76 in January. Though "unusual circumstances" including the "subsidy strike' may explain the fiscal performance in January. It does show that the scope for expenditure reduction and, for a more efficient deployment of national revenue is significant.
  6. Finally, the data on the external account indicates a continuing of the hemorrhaging of investment capital in the form of net outflows on services and investment income in the fourth quarter of 2011 to the tune of 1.638

Trillion compared to net inflows of portfolio and FDI of 415.6 billion Naira. In 2011, the sum of the net outflow on the services and investment income accounts was 6.37 Trillion. Just a 10% decline in the outflow (637 billion) would have built at least four \$1billion cement plants!

## Deciding Issues

1. I gave greater weights to the domestic developments and, evidence on the asymmetrical nature of rate cuts and rate increases in reaching my decision to hold.
2. The data indicating slowdown in GDP, rising unemployment, declining and concentrated structure of credit to the private sector, under-performance of the Capital market and, poverty on the one hand and, the goals of the 2012 Federal Budget (fiscal consolidation, inclusive growth and job) on the other, make a powerful case for easing.
3. The deciding argument against a rate cut at this point are:
  - a. unless fiscal responsibility measures become effective, reduce government spending, deficit and public debt particularly, treasury bonds and treasury bills significantly, deposit money banks will have no incentive to lend to the real economy when rates are cut; hence,
  - b. the pass through effects of rate cuts will neither be instantaneous nor significant to achieve desired reallocation in net domestic credit to real activity (agriculture, manufacturing, exports and public utilities) which accounted for only 17.8% of total credit to the private sector.
4. Holding gives the fiscal authorities the opportunity to accelerate the process of full compliance with FRA 2007 and to enhance the productivity of government spending, reduce spending, deficit, borrowing and the public debt. It also gives the fiscal authorities an incentive to accelerate what they call fiscal consolidation because it (fiscal consolidation if it means more efficient allocation, reduction in wasteful expenditure, deficit and public debt) is; a precondition for inclusive growth and job creation. This is because the evidence is very strong that government debt crowds out the type of private investment that adds values, creates jobs and includes more people in the growth or value creating processes. It is also

important to begin to wind down the entrenched system of financial subsidy through appropriate administrative actions.

The argument for sustaining the January 2012 trend of fiscal operations throughout 2012 through a greater compliance with the fiscal rules in the Fiscal Responsibility Act 2007 including that on Borrowing is very compelling. This is because at 6.5 Trillion Naira, the total Federal Debt is already 0.3 Trillion Naira higher than the pre-Paris Club level in 2004 and 4.1 Trillion Naira above the post-Paris Club level in 2006 suggesting that in just five year, the total debt had tripled! The idea that the debt to GDP ratio is below some arbitrary threshold is a very bad and unwise idea. Two of the key principles in economics are (a) the trade-off principle and (b) that **rational** decisions are made on the margin. At 19% of total revenue in 2011, the debt service to revenue ratio is already too high in terms of the opportunity costs (forgone infrastructures and, education and health capacities and so on). **Rationally or wisely thinking** at the margin requires a case by case economic evaluation of borrowing plans as provided for in the FRA 2007. The idea that government debt should be used to deepen the bond market is also, a very bad and a most unwise decision especially in the context of the sovereign debt crisis in Europe.

5. Holding also gives the forward looking monetary policies of 2011 time to work through the economic system. This is necessary particularly, because the factors that caused headline inflation to ease in February and, forex demand to ease in January and February such as the contraction in spending and in monetary aggregates may not be sustained in the second quarter.
6. Finally, holding reinforces the commitment to price and exchange rate stability and, to a stable policy environment for more effective business planning in 2012.

#### 4.0 LEMO, TUNDE

Macroeconomic outcomes have been mixed between January and March 14, 2012 (Review period). Headline inflation, which moderated to 10.3 per cent at end-December 2011 from 11.80 per cent at the comparable period of 2010, increased to 12.6 per cent in January 2012, before moderating to 11.9 per cent at end-February 2012. Projections indicate that it would still continue in the

upward direction in the next couple of months in response to the partial removal of subsidy on PMS and some other upside risks, including seasonal factors. On the positive side, however, estimated growth in output at 7.68 per cent in the fourth quarter of 2011 could be adjudged robust enough in the face of the security challenges and weakened public infrastructure. Projection on output for the review period is in a similar trajectory, despite the loss of output to national strike in January.

On the external sector, there are quite a number of cheering news. First, there was a modest appreciation of the naira exchange rate in all the segments of the foreign exchange market during the review period. Second, the premia between the rates at the WDAS and the interbank and between the WDAS and the BDCs narrowed towards the end of the review period, suggesting, among others, reduction in speculative demand in the market. Third, there was a modest accretion to external reserves, rising by US\$2.8 billion during the review period, with reserve level currently above US\$36 billion.

Given the fact that the positive outcomes seem to outweigh the negative ones and against the background that the MPC has pursued aggressive tightening measures over a period of about six quarters, it could be a little bit safe to commence expansionary stance, at least in the light of procyclical nature of policy. Furthermore, it could also be argued that there is a need to strike appropriate balance between immediate monetary policy goal of moderating inflation and some other long-term developmental objectives such as reduction of unemployment and alleviation of poverty. A survey by the National Bureau of Statistics (NBS) estimated the national poverty rate to be 71.5 per cent in 2011 from 69.0 and 54.4 per cent in 2010 and 2004, respectively. Monetary policy should be seen to contribute to the goal of fighting this hydra-headed scourge by reducing the cost of credit with a view to promoting investment and employment over the medium- to-long term.

More importantly, the global economy remains fragile in spite of the intervention of the European Central Bank in lending long-term funds to the financial institutions as well as USA's slight increase in GDP growth. The global economy still expects major growth from most of the emerging markets.

The foregoing notwithstanding, I think there are still some major considerations which need to be put in the front burner before making our decision. First, in the light of various structural rigidities in our domestic economy, monetary policy impulses take about 18-24 months lag to transmit to the real economy. Pursuing monetary easing at this point may look counterproductive as the effects of the tightening measures adopted in the last one and half year are yet to be fully transmitted to the economy. Second, there are still some other serious pressure points in the course of the year. Although the fiscal authority has announced commitment to fiscal retrenchment and consolidation, the budget of about N4.8 trillion recently passed by the National Assembly is still expansionary. The states might mount additional pressure to deplete excess crude account as their budgets are based on US\$75 per barrel.

In addition, despite the high lending rates, the real rate of interest on savings deposit is still negative, thereby acting as a disincentive to long term saving deposit mobilization and by extension, funds for long term investment. An expansionary monetary stance would exacerbate the problem and make Nigeria less competitive for the much needed foreign capital inflow.

Finally, there is a need to sustain the present gain in the foreign exchange market particularly with respect to building robust external reserves. Relaxing monetary policy stance could provide avenue of arbitrage activities in the money market in which the foreign exchange market could be at the receiving end.

In the light of the above, I propose that the existing monetary policy measures should be retained by holding MPR at 12.0 per cent.

## **5.0 MOGHALU, KINGSLEY CHIEDU**

The policy options before this meeting of the Monetary Policy Committee are to hold the Monetary Policy Rate steady at 12% or to reduce the MPR. I vote to hold the MPR at the present 12%, and as well to maintain the current interest rate corridor and the Cash Reserve Ratio.

That headline inflation in February 2012 has reduced to 11.9% year-on-year from 12.6% in January is significant. A combination of sustained, aggressive tightening by the MPC and the contractionary impact of the partial fuel subsidy removal (FSR) on disposable income is without doubt a major contributory factor to this situation.

While this is a welcome development indicating that the inflationary impact of the FSR ultimately might not be as large as has been feared – and here one must take some comfort in the evident efficacy of the work of the MPC – it does not predict the future and thus should not form a basis for a premature rate cut. Staff estimates show that core inflation grew 1.5% month-on-month in February, and that more broadly, underlying inflationary pressures remain.

Furthermore, the inflation expectations of consumers remain significant, largely as a result of the FSR. While it is important to manage these expectations based on rational projections of monetary policy makers, it is also a wiser course of action to hold the MPR steady for now – and, in fact, for the near to medium term – while the year 2012 runs its course and the monetary policy measures adopted by the MPC continue to work their way into the economy. Moreover, the MPC should be mindful of the stated intention of the political authorities to complete the removal of subsidy on Premium Motor Spirit (PMS).

Finally, we should note the significance of market expectations that the MPC will maintain the MPR at 12% at this meeting. While market expectations are not a decisive factor for this Committee, where they align with the preponderance of

economic indicators, as in the present case, both market stability and policy consistency will be enhanced by holding the policy rate steady at this time. It would be counter-productive to reduce rates at this time only to increase them again in the short term in response to inflationary or other pressures. This is especially so when the evidence points to the likelihood that such a rate cut will not necessarily make more credit available to the real sector in the short term owing to factors such as the crowding-out effect of increasing domestic borrowing by the Government, and the fact that needed structural economic reforms are still at a nascent stage.

For these reasons, in addition to others advanced by several other members of the Committee, I believe we should maintain the current position on our MPR.

## **6.0 OLOFIN, SAM**

The newly released figures on headline, core and food inflation for the month of February by the National Bureau of Statistics are reassuring. Even though the noticeable decline in level of inflation may not be trending towards single digit levels, it is indicative of the fact that inflationary impact of the partial removal of subsidy on PMS undertaken in January may not be significantly different from the trend pattern observable in the past. The usual pattern has always been for an initial spike in general level of prices to be followed by a tapering off effect in the medium term, rather than resulting in sustained inflationary pressure. While this may be welcome development, staff reports indicate that the observed decline may be a temporary phenomenon especially in respect of decline in food inflation, made possible by various factors including weak demand occasioned by the partial subsidy removal and the usual seasonal favourable factors among others. The threat to the realization of single digit inflation on the fiscal side may still be very much with us due to a number of reasons. Most important among these is the fact that as much as the fiscal authorities appear determined to pursue the path of fiscal prudence, and shifting emphasis from recurrent to capital expenditure, the N4.88 trillion 2012 budget may still be inflationary in several respects. In addition, the long awaited new electricity tariffs are yet to come into effect and further upward adjustment in PMS price in pursuit of zero subsidy policy cannot be totally ruled out.

As far developments in the external sector are concerned, the gradual recovery in the US economy and the definite moves towards further enhancement of fiscal policy coordination in Europe have considerably reduced the risk of double dip global recession. These measures have also brightened the prospects of a recovery that may strengthen the demand from the country's major trading partners, and sustain current levels of earnings from oil exports. There are also strong indications that the new Petroleum Industry bill may soon be passed, further enhancing the prospects of increased revenue from oil. As much as it may be difficult to predict what impact the Iranian factor may have on oil prices, in the worst case scenario of the breaking out of hostilities, there appears to be no strong basis for expecting that this would harm the prospects of stable government oil revenue significantly. If anything at all it may result in some measure of windfall gains.

Our policy of maintaining a stable exchange rate continues to hold. Speculative demand for foreign exchange has been significantly reduced by the high cost of borrowing for this purpose, as well as the reduction in the level of demand for foreign exchange for subsidized import of petroleum products. There has also been noticeable accretion in the level of foreign reserves. The current level of positive interest rates may still not be as competitive enough as to result in significant increases in net inflow of FDI. However there are noticeable improvements in the level of inflow of portfolio investment.

The projection in overall GDP growth rate though still robust suggest some measure of decline in 2011 and 2012 compared with 2010. There are however no strong indications that this is attributable to decline in the level of activity in the real sector particularly in manufacturing. Structural constraints appear to be more limiting to growth prospects in the productive sectors of the economy than the high cost of borrowing. Consequently an accommodating policy by way of reduction of the MPR may not necessarily impact significantly on the amount of credit flowing to the real sector.

In view of the foregoing developments, it would therefore appear that there are no immediate compelling reasons for the committee to relax its monetary policy tightening stance adopted over the last couple of meetings. This was meant to proactively tackle whatever inflationary pressures might result from various ongoing fiscal policy measures and those that are yet to materialize. While weak arguments can be made for some measure of quantitative easing to boost

output, a stronger case can be made for maintaining the status quo, and watching for any domestic or external developments that may warrant appropriate policy interventions in the short to medium term. There is however the need to further tighten the various administrative measures that have been put in place to discourage speculative demand and running down of foreign reserves. A healthy level of foreign reserves remains the country's major defense mechanism against any exogenous disturbances in a global economy that is still fragile and only beginning to show signs of slow and weak recovery.

## **7.0 OSHILAJA, JOHN**

I voted at the conclusion of today's meeting to keep the Monetary Policy Rate at 12% pa with a symmetric 2% pa band for the Central Bank's Standing Deposit and Lending rates, for retention of the Cash Reserve Requirement at 8%, and for continuation of the current +/- 3% band around the CBN's targeted mid-point exchange rate of N 155.00/USD. This represents no change in Policy adopted since last November, and I see no justifiable reasons for policy modifications at this time.

Recall that the MPC decided in January not to react to first-order effects of recent sharp increases in domestic petrol prices; in order to take the full measure of market supply and demand adjustments before contemplating corrective actions. These adjustments appear to be still playing out, principally through an attendant shock to aggregate demand being transmitted to the economy through fiscal and bank credit channels.

On the fiscal side it is encouraging to note that Government's share of Net Domestic Credit has been dropping quite impressively, against a tight money background with attendant CBN liquidity management operations. I believe the decline in the Federal Government's use of short term credit for fiscal operations signals auspicious beginnings on redoubled efforts on Fiscal Consolidation, and an earnest attempt to more credibly align fiscal and monetary policies with oft-stated development objectives of the country; notably maintaining macroeconomic stability, while promoting job-growth and income diversification. However, notwithstanding an emerging shift in emphasis

from Consumption to Investment spending, the FGN's rationalization of its borrowing needs also appears to be having a dampening effect on aggregate Demand. In retrospect, this should be expected – in the short term. It remains to be seen how effectively the nation's supposedly highly liquid banks react to the larger credit spaces being created. Thus far, observed behavior leaves much room for improvements.

The anemic growth in credit to the Private Sector, experienced over the period 2010-11 figuratively fell off a cliff in January 2012, and is now squarely in contraction territory. Simply stated, other than lending to Government, Nigerian banks simply aren't lending in meaningful ways to other entities. It is perhaps also no coincidence that exchange rates for the Naira have been strengthening on the back of lower aggregate demand, driven by fiscal and banking sector retrenchment. Recent GDP growth trends would appear to corroborate such developments. Available credit data shows a flurry of activity amounting to an increase in Net Private Credit of N2.4 Trillion in the 4<sup>th</sup> Quarter. However this appears to be explained by Central Bank actions taken to release liquidity trapped in bank holdings of government securities, notably AMCON bonds. Such action was understandably critical in underpinning money market stability; especially ahead of the expiration of the CBN's blanket guarantees of the settlement of all interbank transactions on December 31.

Dramatic reductions in the general availability of credit likely prompted significant degrees of inventory liquidation, especially of perishable and short-lived stock, just as spending capacities of cash-strapped consumers were being reallocated in favor of priority items – notably food, and transportation costs. Since Nigerian inflation indices are heavily weighted by food items, these demand and supply dynamics most likely account for the lower than expected inflation rates observed for February.

## **8.0 SALAMI, ADEDOYIN**

The raft of data published in the run-up to this meeting of the Monetary Policy Committee (MPC) while providing room for optimism about our primary

mandate of inflation management, they also raise concerns which will doubtless require attention by both the Central Bank and the Fiscal Authorities.

Improving optimism about the global economic environment means that the perennial concern about the impact its impact on oil prices has receded. The concern, on this occasion is focused on domestic issues. Reported, by the National Bureau of Statistics (NBS), at 11.9percent, the increase in Headline Inflation rate in February, 2012, was, perhaps unexpectedly, slower than the 12.6 percent increase recorded the previous month. It is noteworthy that unlike Headline Inflation, the rate of increase in the non-food components of consumer basket accelerated – rising 13.5percent in February compared with 12.7percent the previous month. Food constituents of the ‘consumer basket’ rose 12.9percent – lower than the 13.1percent in January, 2012.

The inflation data for February certainly provide a basis for raising and reflecting on whether it is too early to conclude that our fears, expressed in the Communique issued at the end of our last meeting, as to the inflationary impact of higher fuel prices were, perhaps, overstated. In other words, is the inflation rate for February, the proverbial single Swallow which doesn’t make a summer? It is perhaps too early to draw any conclusions – especially as CBN Staff estimate that inflation will, after a further deceleration in March, rise steadily for the rest of the H1 2012. In other words, while the slowdown in the rate of increase in Headline rate of inflation offers only a brief respite and doesn’t constitute a trend.

Available data about other elements of the economy clearly provide a basis for understanding the slower rate of price increase recorded in February. Specifically, 2 factors are worthy of being highlighted: appreciation in the exchange rate; and slower demand.

The appreciation in rates across the various markets for FOREX, ranging from 0.6percent to 2.5percent at the WDAS and the Bureau de Change segments respectively, since the beginning of this year has provided support for moderation of price pressures. The hope with respect to the exchange rate is that

(i) the high opportunity cost of holding US Dollars; (ii) reduced demand for FOREX for importation of petroleum products as demand for petrol eases and malpractices associated with the importation of fuel products are reduced; and (iii) Central Bank action to curb speculative demand will keep exchange rates close to the midpoint of the ‘band’.

Demand is expected to weaken in the aftermath of raised fuel prices. While the absence of Expenditure side data from the National Income Accounts precludes any authoritative comment on demand conditions, Output data for the period pre-dating the reduction in subsidy already points to weakening demand. The NBS shows that growth in non-oil activity rose to 8.85percent in 2011 – an improvement over the 8.51percent the previous year. However, the data also shows that activity in the oil sector shrank in 3 of the 4 quarters in 2011. Furthermore, growth in the output of manufacturing, real estate, building and construction sectors output was lower than in the previous year. The implications of slowing growth in these key sectors – oil and manufacturing – have adverse implications for unemployment, poverty, and government revenue. That Federal Government’s fiscal operations in January 2012 resulted in a surplus – in contrast to a deficit for the same period last year - provides further support of a tightening in fiscal and thus demand conditions.

On the monetary side, credit growth remains anemic. Excluding lending by the Central Bank, which was largely AMCON related, growth in lending by the Deposit Money Banks (DMBs) – measured on a month-on-month basis - in the past 6months has, on average **shrunk** by approximately 1percent each month. In addition to shrinking volume, access to credit is also becoming more difficult as concentration rises.

Whilst it is doubtless tempting to ease Policy interest rates, especially given the sense of weakening demand, it is not clear that such a reduction in interest rates will be transmitted to the ‘real’ sector and not simply end up boosting bank profitability! In addition, there is need to establish a trend for inflationary pressures, it is difficult, on the basis of a single observation, to conclude that inflation is on a downward trajectory – especially as Staff estimates indicate that inflation will pick-up in April. Furthermore, it is noteworthy that despite the passage of the FGN budget for 2012 by the National Assembly, it is not clear how its implementation will affect liquidity. Although at US\$72 per barrel, the budget benchmark price of crude oil is slightly higher than in the budget proposals, this budget represents an attempt at fiscal consolidation when compared with the 2011 budget which was based on US\$75 per barrel. However, the Excess Crude Account remains accessible to the sub-national tier of government.

Given the foregoing, I vote to maintain the status-quo.

## 9.0 UCHE, CHIBUIKE

At the October 10, 2011 emergency meeting of the MPC, the MPR was raised by 275 basis points from 9.25 to 12.0 percent. This hike was, at least in part, a consequence of the speculative attacks on the Naira. It is for instance generally accepted that the promotion of real interest rates deprive currency speculators of cheap funds which can be used to attack currencies purely for speculative gains. The above move, no doubt, is responsible for the current relative stability of the Naira in the foreign exchange market.

Another major argument in favour of such a high MPR is the view that it is needed to counterbalance the inflation rate in order to encourage local and foreign investments in the country. Theoretically, increased capital account inflows should help reduce the pressure on the local currency. While such double digit MPR may be good for the price stability objective of monetary policy, especially in our peculiar context, it also has shortcomings. One major flaw of this policy is that it limits credit to the real sector of our economy. It is for instance generally agreed that high interest rates disadvantage the real sector by making it unprofitable for businesses in this sector to borrow. It is therefore not surprising that the liquidity level in the Nigerian banking system remains high. As at the end of February 2012, for instance, the industry liquidity ratio stood at almost 70 percent. Surplus funds that ideally should be intermediated to help promote growth in the real sector end up being used to fund government fiscal expansion. It is instructive that over 70 percent of the liquid assets of Nigerian commercial banks are invested in Government Treasury Bills, AMCON Bonds and FGN Bonds. The rentier nature of the Nigerian economy has no doubt encouraged the practice of government borrowing purely on the anticipation of future oil rents.

Based on the above, it is not surprising that the Nigerian economy has witnessed little, if any, growth in the real sector. Lack of strategic planning has ensured that most of the economic growth in the country has come from agriculture. The pedestrian view that improvements in rainfall have been the main driver behind the growth in this sector (what I refer to as the "rainfall theory") reign supreme. More troubling however is the fact that there are early signs that even the agricultural sector may have joined some of the other economic sectors in

contracting. In terms of their contribution to GDP, for instance, agriculture, building and construction, wholesale and retail trade and industry all recorded declines across most quarters in 2011 when compared with 2010. Under such a scenario, it is legitimate to argue that the utility value of the foreign investments that these positive interest rates are supposed to attract is at best dubious.

Admittedly, the security situation in the country has not helped matters. The consequences of the decline in the growth of the real sector include rising unemployment and poverty levels. In the light of the above, one is tempted to vote for a reduction in MPR in an attempt to reinvigorate the sagging economy. I have however chosen to be more cautious on this occasion. This is so for two main reasons.

First, I still have inflationary concerns. Although year-on-year headline inflation rate dropped from 12.6 percent in January 2012 to 11.9 percent in February 2012, the projection is that this figure is bound to increase in the coming months. Although there have been a lot of talk about the improving fiscal prudence of government, I choose not to judge until the implementation of the newly approved 2012 budget take off in full force. Furthermore the impact on inflation, of the commitment of the Federal Government to remove the 'remaining subsidy' on petroleum products by the year end, may not be positive.

Secondly, I would like to wait in order to observe if the current down-trending of the economy will continue. My suspicion is that this may well be, at least to a large extent, the consequence of the current security and subsidy withdrawal challenges in the country.

In conclusion, I am of the view that the status quo should be maintained until the next MPC.

## **10.0 SANUSI, LAMIDO SANUSI, CON**

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

We meet today at a time when the global and domestic economic environments have changed noticeably from what they were at our last meeting. In the United States, growth and job numbers are turning out to be

more positive than initial forecasts. In Europe, on the other hand, growth appears to be still some way into the future. Yet, the bold monetary actions taken by ECB Governor Draghi (consistent with what, in our view, the ECB ought to have done over a year ago) have stimulated tentative recovery in the financial markets. Those monetary easing measures, combined with progress on resolution of Greek debt crisis, deep haircuts accepted by Bond-holders, strong fiscal consolidation signals from Spain and Italy and increased bailout funding from EU countries and the IMF have, at least in the short-term, laid the foundation for a way out of recession. Progress will still have to be made on the move to fiscal union or at least a central oversight of the fiscal stance of individual states, as well as in the area of improved competitiveness, especially in the European periphery. It is important, nevertheless, that Europe has finally accepted that half-measures will not work and we are relieved that Governor Draghi has adopted an approach that is radically different from that of his predecessor, Governor Trichet.

The news from Emerging markets is not so good, but also not exactly a disaster. Growth in China and Brazil is expected to slow down in 2012 while India may grow faster but with a risk of higher inflation. It is very likely, however, that recovery in Europe and the US will be positive for Emerging markets and ensure that the BRICS contribute their part in ensuring speedy global recovery.

The principal risk to the Global turnaround seems to be the looming confrontation between Iran on the one hand and the West and Israel, on the other. This has implications for global energy supplies, energy prices and peace and security in the middle-East, especially if Israel carries out its threat to bomb Iranian nuclear facilities.

On the Domestic front, GDP growth rates remain robust even though growth in 2011 was slower than in 2010. Concerns are mainly around Oil and Gas (which declined) and Agriculture (which slowed down). Strong growth in Telecoms, wholesale and Retail Trade and other sectors help push non-oil growth up. Monetary aggregates have been declining or at best growing sluggishly, and fiscal spending has also been weak early in the year. Consequently, it would appear that slackening demand has helped moderate the inflationary impact

of fuel subsidy removal, contributing to the decline in Y-O-Y inflation from 12.6% in December to 11.9% in January.

Slowdown in food inflation was a major contributor to the moderation in headline figures. It appears to me intuitively that the removal of fuel subsidy, without an increase in nominal wages and incomes for the poor, would have not only shifted the budget-line downward but also forced a reallocation of expenditure away from Food. This necessarily serves as check on the rate of increase in food prices and-given the weight of food in the CPI-moderates inflation.

Staff projections indicate further moderation in March before inflation begins to rise again in April due to seasonality. In view of the very strong core inflationary pressures, which are likely to persist with electricity tariff reforms and other policies, it would seem that the outlook for inflation is far from benign. This is especially when we add the likely impact of protective tariffs on rice and wheat which are likely to kick in around July, 2012.

I would be reluctant to support an early and pre-mature easing of monetary stance in spite of the clamour for this by Government and Business. The tight regime we put in place since 2010 has started yielding fruit in the form of reining-in runaway inflation, attracting portfolio inflows, encouraging asset reallocation in favour of naira assets, reducing the pressure on the naira and supporting reserve accretion. These are necessary in order to provide monetary and financial stability conducive to growth. I do recognize that stability on its own will not deliver GDP growth. We need to ensure that the appropriate fiscal and structural policies around energy, agriculture, industry e.t.c are diligently implemented. But in the short-term, we must remain focused on delivering low inflation, stable exchange rates and reserve buffers to absorb external shocks. Lowering rates prematurely sends the wrong signals to the market, may reverse the direction of capital flows, exert pressure on reserves and exchange rates, and undo too quickly everything this Committee has achieved in the past eighteen months.

I also do not believe that the marginal increase in oil price benchmark for the 2012 budget from \$70 to \$72 is significant enough to warrant an immediate response. The increase is largely directed to capital expenditure and there are also revenue measures aimed at reducing fiscal deficit. In addition, the proposed benchmark is still lower than the \$75 benchmark for 2011. There remains the risk of drawdown from the excess crude by the States, but it is better to wait and watch actual developments before considering an appropriate response.

For all the above reasons my vote is for:

1. A retention of MPR and Corridor at  $12\% \pm 2\%$
2. A retention of CRR at 8% and
3. A retention of liquidity ratio at 30%