



Central Bank of Nigeria

Communiqué No. 87 of the Monetary Policy Committee Meeting of Monday, January 21, 2013

The Monetary Policy Committee (MPC) met on, January 21, 2013 with ten (10) out of the twelve (12) members in attendance. The Committee reviewed the domestic economic conditions in 2012 and the challenges therefrom against the backdrop of the international financial and economic environment in order to chart the course of monetary policy in 2013.

The International Economic Situation

The Committee noted that global economic growth remained largely uneven and subdued in most economies in 2012. Latest data from the IMF indicate that global output was weaker than previously forecast due to continued contraction in the Euro zone and Japan as well as the less than anticipated growth in Brazil and India. The fragility in the global economy was further compounded by the uncertainties surrounding resolution of the "fiscal cliff" and debt ceiling challenges in the US and the difficulties associated with China's attempts to "rebalance" its growth. These developments adversely affected private sector confidence, worsened the unemployment situation and further tightened financing conditions in both the periphery and core economies. In the euro area, economic and

financial conditions remained severely weak. Although the European Central Bank (ECB) attempted, through its intervention scheme, to halt the downward trend in economic activities in the zone, the effort did not record much success. Overall, global output was estimated to have expanded by 3.2 per cent in 2012 against the earlier projection of 3.3 per cent made in the October 2012 IMF World Economic Outlook.

Growth in the advanced economies was estimated at 1.3 per cent in 2012 and projected at 1.5 per cent in 2013, reflecting an upward revision of 0.2 percentage point, respectively, from the initial estimates. The Committee noted that the decline in global investment was mainly traced to the fiscal standoff in the US and its implications for the paltry expansion in output of 2.0 per cent in Q3, 2012. Emerging European economies, which had previously shown signs of strong rebound from the credit crisis, have now been hit hard by slow exports growth and a halt to real GDP growth. On the whole, the Committee is of the view that while the decisions of the ECB considerably reduced the probability of a Eurozone-wide financial crisis, the condition of country-level financial systems remained difficult and could constitute significant challenge to output expansion in 2013.

Latest data from the Asian economies suggest that a gradual recovery may be underway. China's economy, which had previously recorded a slowdown over seven consecutive quarters to Q3, 2012, witnessed improved economic activity in Q4, 2012. Recent fiscal and monetary easing operations have increased investment in

infrastructure with signals of further spending into 2013. The Indonesian economy, after recovery from the severe flooding in 2011, continued to show resilience against the global slowdown as investment and strong domestic demand contributed more to growth. It is expected that these twin drivers of growth would further sustain output expansion in 2013, although recent reports indicate that severe flooding has once again hit the economy during January 2013. The sub-optimal performance of the Japanese and Indian economies, however, was a major drag on recovery in the region. The Indian economy was hampered by slow approvals for new projects, deterioration in business sentiment largely due to the rising current account deficit, uncertainty over the selling of government stakes in state owned enterprises, fiscal deficits, depreciation of the Rupee and a high debt burden, as well as slow implementation of structural reforms. Japan's drawback was largely due to a combination of declining exports and sluggish domestic demand. There are, however, expectations that the growth decline would bottom-out in 2013 as anticipated rebound in major trading partner economies like China and the US would translate to a recovery in the demand for Japanese goods and services.

The Middle East and North Africa (MENA) region continued to record mixed performance, evidenced by the divergence between the economies of oil-exporting and oil-importing countries. Oil-importing countries experienced subdued economic performance with an estimated growth of 2.0 per cent in 2012 while the oil-exporting countries grew at an average rate of 6.6 per cent. Growth in oil-exporting

countries was driven largely by high oil output and prices coupled with the early post-conflict recovery of Libya. Growth for the entire region in 2013 has been projected at 3.75 per cent, which is 1.35 percentage points below the estimate for 2012. The Committee noted that the challenges confronting these countries is how to strengthen the resilience of their fragile economies against major oil price shocks through diversification and expansion of the private sector.

Economic conditions in sub-Saharan Africa remained generally robust despite the sluggish growth in the global economy. Prudent policies and improved fundamentals in most countries provided additional impetus for increased economic activity in the region. The Committee noted that the main risks to the outlook for the region come from their trading partners including the possible intensification of the financial stress in the euro zone and a sharp fiscal adjustment in the US.

In light of the uncertainty about the direction of fiscal policy in the US, particularly with regard to the yet to be resolved issue of debt ceiling, and the persisting euro zone financial and economic crises, the Committee was of the view that the global economic environment was still fragile and highly vulnerable to a further contraction, although the downside risks appeared to be less severe relative to conditions in the last two years.

Domestic Economic and Financial Developments Output

The National Bureau of Statistics (NBS) estimated real Gross Domestic Product (GDP) growth rate at 6.61 per cent for 2012, which is lower than the level recorded in 2011 by 0.84 per cent. The estimated real GDP growth rate at 7.09 per cent in the fourth quarter of 2012 was higher than the 6.48 per cent in the third quarter but lower than the 7.68 per cent recorded in the corresponding period of 2011. The non-oil sector remained the major driver of growth recording 8.23 per cent increase in contrast to the oil sector, which contracted by 0.17 per cent during the period. The Committee expressed concern about the continued decline in the contribution of the oil sector to growth due to lower production relative to the corresponding period of 2011 and enjoined the Federal Government to fast track the passage of the Petroleum Industry Bill to halt the trend.

The relatively robust growth projections despite the slowing global economy reflected the relatively favourable performance of wholesale and retail trade; the services sectors; outcome of banking sector reforms; and initiatives by government to stimulate the real economy. Despite the developments in the international oil market where the US is now the second largest oil producer, the Committee observed that the growth projection remained promising, anchored on the recent improvements in power supply. The Committee noted with satisfaction the Federal Government's efforts to sustain the current initiatives to boost power generation, particularly the progress made in reforming the power sector.

The Committee, however, observed that the severe flooding in several parts of the country in 2012, which damaged housing, agricultural and oil assets, could pose

downside risks to growth and feed into food supply deficits and inflation in the near term. Also, the continuing security challenges as well as delays in reform of the oil sector could undermine investor-confidence and output growth in the near-term.

Prices

The Committee observed that, on the average, inflationary pressure was elevated in 2012. The year-on-year average headline inflation rate in 2012 stood at 12.24 per cent, while the average core and food inflation year-on-year stood at 13.87 and 11.32 per cent, respectively. The major drivers of headline inflation in December 2012 included food and non-alcoholic beverages, housing, water, electricity and transport. The pickup in food inflation in the later part of 2012 was accounted for by imported food items and food shortages due to the impact of flood on farmlands along the major agricultural belt of the country. However, the Committee was of the view that the pass-through effects of imported food inflation to domestic prices may have been subdued owing to the relatively stable exchange rate during the period under review.

Monetary, Credit and Financial Markets Developments

Broad money supply (M2) grew by 13.72 per cent in December 2012 over the level at end-December 2011. Aggregate domestic credit (net) grew by 1.98 per cent in December 2012, which was substantially below the benchmark of 52.17 per cent for the year. Credit to Government contracted between September and December 2012; occasioned by the sustenance of government as a net creditor to the banking system,

reflecting more prudent fiscal measures, including the introduction of the Treasury Single Account.

Interest rates in all segments of the money market moderated between 19th November 2012 and 3rd January, 2013. This reflected in increased liquidity in the banking system including the release of statutory revenue to sub-national governments, absence of repo transaction during the review period, repayments of matured CBN Bills and banks' desire to maintain optimum liquidity position on their balance sheets at the end of their common financial year. The interbank call and OBB rates, which opened at 13.99 and 13.95 per cent on November 19, 2012, closed at 10.32 and 10.45 per cent, respectively, on January 3, 2013. The average interbank call and OBB rates for the period were 11.09 and 11.03 per cent, respectively. The average prime lending rate increased slightly to 16.54 per cent in December 2012 from 16.48 and 16. 51 per cent in October and November 2012, respectively. In contrast, the average maximum lending rate fell marginally to 24.61 per cent in December 2012 from 24.65 and 24.70 per cent, respectively, in October and November, respectively while the weighted average savings and term deposits rate decreased to 5.50 per cent in December from 5.57 per cent in the preceding month. The Committee, therefore, encouraged the Bank to fast track the financial inclusion strategy to improve financial intermediation and the effectiveness of the transmission mechanism of monetary policy and to adopt ways of moderating the high spread between deposit and lending rates.

The Committee observed that the rally in the Nigerian capital market continued as equities market indicators trended upwards in the review period. The All-Share Index (ASI) increased by 35.45 per cent from 20,730.63 to 28,078.80 between December 30, 2011 and December 31, 2012. Market Capitalization (MC) also increased, by 37.38 per cent, from N6.53 trillion to N8.97 trillion during the same period. The positive performance of the ASI and MC was due to the sustained increase in the demand for blue-chip stocks particularly in the banking and consumer goods sectors following improvements in earnings and growing investor-confidence. The Committee, however, noted that the significant factor responsible for the recovery was strong portfolio flows and cautioned that the capital market remained structurally vulnerable to external shocks until its funding basis was changed.

External Sector Developments

At the Wholesale Dutch Auction System (wDAS), the exchange rate opened at N157.31/US\$ on November 20, 2012 and closed at N157.33/US\$ on December 31, 2012 representing a depreciation of N0.02 or 0.01 per cent. The average wDAS exchange rate during the period was N157.32/US\$. At the BDC segment of the foreign exchange market, the selling rate opened at N160.00/US\$ on November 20, 2012 and closed at N159.50/US\$ on December 31, 2012, representing an appreciation of N0.50 or 0.31 per cent for the period. At the interbank segment, the selling rate opened at N157.95/US\$ on November 20, 2012 and closed at N156.25/US\$ on December 31, 2012, representing an appreciation of N1.70 or 1.08 per cent. Overall, the relative stability recorded in the foreign

exchange market could be attributed to the combined effects of improved supply of foreign exchange by the oil companies and enhanced capital inflows from portfolio investors during the period under review. Also, oil revenue increased at an average of 2.73 per cent monthly throughout 2012. In the first eleven months of 2012, oil receipts totaled US\$40.087 billion.

The Committee noted with satisfaction that the premium between wDAS and the interbank rate narrowed towards the end of the review period. However, the premium between the wDAS and BDCs widened towards the end of the review period from N1.682/US\$ to N2.172/US\$ suggesting the need to sustain and further complement existing measures to discourage speculative activities in the foreign exchange market. In general, the Committee noted that decisions at previous MPC meetings were yielding the desired results.

The Committee expressed satisfaction with the sustained accretion to external reserves which stood at US\$43.849 billion as at December 31, 2012, representing an increase of US\$1.682 billion or about 3.98 per cent from the level of US\$42.167 billion at end-October 2012. Relative to the end-December 2011 level of US\$32.915 billion, the external reserves at the end of December 2012, had risen by US\$10.934 billion or 33.21 per cent. The increase in the level of foreign reserves was driven mainly by proceeds from crude oil and gas exports and crude-oil related taxes as well as reduced funding of the wDAS on account of the huge inflow of foreign portfolio investments, which was about 77.0 per cent of total inflows through the CBN. The foreign reserves level could finance about 9 months of imports.

The Committee's Considerations

The Committee observed that the performance of the global economy remained largely subdued and was characterized by uncertainty and contraction in the Euro zone and Japan, as well as lower than expected growth in the large emerging and developing economies. The Committee notes with caution that the partial resolution of the Fiscal Cliff in the US offers some hope for gradual global economic recovery as indicated by the rebound of many global financial markets in the wake of the staving off of automatic tax increases and expenditures cuts on 1st January, 2013. The Committee further observed that the robust prospects for energy independence of the US could pose downside risk for global oil prices in the medium-to-long term which could threaten fiscal sustainability in many oil-dependent economies around the world.

The Committee noted that in spite of the slow progress made in the resolution of the Euro zone crises, the prospect of a deepening recession in the near term has not been completely averted. Developments in the domestic economy in the past three months highlighted some new pressure points to macroeconomic stability. The Committee was of the view that shocks to the economy could come from significant fall in the demand for oil, leading to a fall in oil prices and government revenues, weaker exchange rate, rising inflationary pressures and depletion in external reserves. The Committee also noted the drop in headline inflation in December 2012, although it also recognized that core inflation had risen; driven mainly by cost-push factors even in the face of sluggish growth in the monetary aggregates.

With regard to the budget of the Federal Government, the Committee cautioned against complacency over government revenues; despite the high level of oil prices. The Committee noted uncertainty in global demand and supply of crude oil, and weak performance of non-oil and VAT revenues. The Committee, however, noted with satisfaction the efforts the Federal Government aimed at keeping deficits within the threshold prescribed by the Fiscal Responsibility Act and advocated sustenance of the effort. On expenditure, the Committee noted that there was still the need to continue to drive down recurrent expenditure in favor of capital expenditure in view of the infrastructure deficit that continued to constrain growth performance. The Committee noted that the oil price benchmark for the 2013 budget which was increased from US\$75 to US\$79 may pose downside risk to the inflation objective and, therefore, constituted a pressure point for the low inflation objective and effective monetary policy in 2013. The Committee reaffirmed its commitment to respond appropriately if public spending in 2013 ultimately adds to inflationary pressures.

In view of these developments, the Committee was faced with three choices:

- (i) An increase in the MPR in response to the higher oil price benchmark for fiscal 2013;
- (ii) A reduction in MPR in view of the declining GDP growth trajectory and headline inflation; and
- (iii) Retaining the current monetary policy stance in view of the conflicting price signals, global uncertainties and the need to preserve the stability of the system.

The Committee's Decisions

Given the stability achieved in the last twelve months with average year-on-year headline inflation rate at 12.24 per cent, in 2012, the MPR of 12 per cent was considered to be just about right. The Committee considered the calls for a reduction in the MPR because of the benign inflation outlook other things being equal. However, this may be undermined by the increased sub-national government spending and Federal Government high expenditure in 2013, the higher benchmark oil price in the 2013 budget and the US debt ceiling with possible impact on commodity prices.

In view of the foregoing, the Committee decided that it was prudent to hold and monitor developments between now and the next meeting of the MPC. The Committee, therefore, decided by a majority vote of 8:2 to maintain the current policy stance i.e., to retain the MPR at 12.0 per cent with a corridor of +/- 200 basis points around the midpoint; retain the CRR at 12.0 per cent; and to retain the Liquidity Ratio at 30.0 per cent. Two members voted for a reduction of the MPR by 25 basis points.

Thank you.

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Governor
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21st January, 2013