Central Bank of Nigeria Communiqué No. 88 of the Monetary Policy Committee Meeting of Monday and Tuesday, March 18 and 19, 2013

The Monetary Policy Committee met on March 18 and 19, 2013 with all the 12 members in attendance. The Committee reviewed the conditions and challenges that confronted the domestic economy in the first quarter of 2013 against the backdrop of current international economic and financial developments with a view to reassessing the monetary policy options in the short-to-medium term.

International Economic Developments

At the outset, the Committee observed that global growth remained subdued throughout 2012 due to the softer than expected level of activities in the euro area and the slipping of Japan into recession during the second half of the year. Weak and fragmented growth was also recorded across major economies and regions including the US. The emerging market economies, however, showed a fair degree of resilience.

The growth outlook, however, appears promising. The IMF January 2013 WEO Update, projected a global output growth of 3.5 per cent in 2013 compared with the 3.2 per cent achieved in 2012. In the Advanced Economies, output was estimated at 1.4 per cent for 2013 compared with the 1.3 per cent achieved in 2012.

Recession is expected to continue in the euro area although the magnitude of the contraction, estimated at 0.2 per cent in 2013, represents an improvement over the 0.4 per cent contraction in 2012. A slowdown in growth is also expected in the US in 2013, as output is projected to decline by 2.0 per cent from 2.3 per cent in 2012, owing largely to the short term effects of its fiscal consolidation regime as well as the weaknesses in the labor and housing markets.

The emerging Asian economies were projected to post a gradual recovery that would propel global output growth in 2013. China, which previously recorded a slowdown over seven consecutive quarters to Q3 2012, witnessed improved activity in Q4 2012; confirming that an upswing in growth was underway. The recent fiscal and monetary easing operations of the Peoples Bank of China led to increased tempo of investment in infrastructure with indications of further public spending in fiscal 2013. Thus, the economy is expected to grow strongly in 2013 amid gradual improvements in the external environment. Japan returned to growth in the fourth quarter of 2012, raising hopes of an end to the 15-year deflation. The major setback in the region is expected from India, with real GDP growth of 5.4 per cent in 2012 on account of the poor performance of the manufacturing, agriculture and service sectors.

The Committee noted that growth in Sub-Saharan Africa was still robust, although real output growth dropped to 4.8 per cent in 2012 from 5.3 per cent in 2011. The performance of Sub-Saharan Africa during 2013 would partly depend on developments in the euro area as well as the extent of recovery in China. With policy buffers weaker than they were prior to the 2008 crisis, the ability of governments to implement countercyclical fiscal policy may be constrained.

Domestic Economic and Financial Developments

Output

The Committee was satisfied with the relatively robust output growth projections for 2013 despite the slowing global economy, on the back of favorable conditions for increased agricultural production, the outcome of banking sector reforms, as well as other initiatives by government to stimulate the real economy. The National Bureau of Statistics (NBS) reported that the real GDP growth rate declined from 7.43 per cent in 2011 to 6.58 per cent in 2012. The decline was partly driven by the oil sector which contracted by 0.91 per cent. The major driver of overall growth, therefore, remained the non-oil sector, with agriculture; wholesale and retail trade; and services contributing 1.37, 2.19 and 2.10 percentage points, respectively.

The Committee was concerned that the declining contribution of the oil sector to growth, which became apparent in the second half of 2011, continued in Q4 2012. Crude oil production, including condensates and natural gas liquids, decreased by 37,000 barrels per day (bpd) in February

2013 to 2.035m bpd compared with the level of 2.072m bpd attained in December 2012. Oil theft in the Niger-Delta remained a source of concern. The Committee was also concerned that the decline in the growth rate of agricultural output which started in the 4th quarter of 2011 continued up to the end of 2012.

The Committee was of the view that although the GDP growth projection remained high, there were a number of risk factors that were likely to affect output performance. These include perception of increased levels of corruption and impunity in the country, insecurity particularly in the northern part of the country, as well as mixed signals from power and petroleum sector reforms.

Prices

Headline inflation which had decreased to a four-year low of 9.0 per cent in January 2013 inched up to 9.5 per cent in February, driven largely by the food component. Food inflation, which was 10.1 per cent in January 2013, increased by 0.87 percentage point in February due mainly to increases in the prices of farm produce and imported food items. Core inflation, however, moderated slightly between January and February 2013. The Committee noted that the sharp drop in inflation in early 2013 compared with early 2012 is largely a result of the base effect of the partial removal of fuel subsidy in January 2012. With the tapering off of the first and second round effects of the increase, the prudent monetary policy stance and stable exchange rates are yielding lower headline inflation figures.

Monetary, Credit and Financial Market Developments

Broad money supply (M2) grew by 2.86 per cent in February 2013 over the level at end-December 2012, which annualizes to 17.16 per cent. Aggregate domestic credit (net) grew by 10.17 per cent over the same period (an annualized rate of 61.02 per cent). The significant growth in net credit in the period was due to the huge increase in credit to government (net), which rose by 108.18 per cent.

Interest rates in the interbank money market declined between January 21 and March 14, 2013 owing to liquidity surfeit in the banking system. The interbank call and the OBB rates, which opened at 10.35 and 10.33 per cent on January 21, closed at 10.29 and 10.28 per cent, respectively, on March 15, 2013. The average interbank call and OBB rates for the period were 11.38 and 11.23 per cent, respectively. The average prime lending rate inched up slightly from 16.54 per cent in December 2012 to 16.56 in February 2013, while the maximum lending rate more or less remained flat at 24.60 per cent during the period. The weighted average deposit rate, however, increased from 3.77 to 5.37 per cent during the review period.

The Committee noted the upswing in activities in the capital market, as equities market indicators all trended upwards in the review period. The All-Share Index (ASI) increased by 17.3 per cent from 28,078.81 on December 31, 2012 to 32, 950.08 on March 15, 2013 while Market Capitalization (MC) rose by 17.5 per cent, from N8.97 trillion to N10.54 trillion. The Committee, however, observed that the improved performance was largely induced by the substantial portfolio inflows, as foreign investors took advantage of the favourable domestic environment brought about by the high yield on government debt instruments, and stability in the naira exchange rate.

External Sector Developments

At the Wholesale Dutch Auction System (wDAS), interbank and the BDC segments of the foreign exchange market, the exchange rate opened at N157.29/US$, N157.10/US$, and N159.00/US$ on 22nd January 2013 and closed at N157.32/US$, N158.65/US$, and N160.00/US$, respectively, on March 15, 2013. The average wDAS, interbank and BDC exchange rate during the period was N157.30/US$, N157.65/US$, and N158.94/US$, respectively. The Committee noted the slight depreciation in the exchange rate at the wDAS and interbank segments of the foreign exchange market. The BDC segment, however, appreciated during the period due to the low patronage by speculators on account of the improved supply of foreign exchange by oil companies, increased inflow from portfolio investors, and the effect of the prohibition of the simultaneous access to the CBN window (Repo and Standing Lending Facility) and wDAS transactions by DMBs. The Committee expressed satisfaction with the significant accretion to external reserves which stood at US$49.38 billion as at March 14, 2013, representing an increase of US$ 5.5 billion or 12.68 per cent over the level of US$43.83 billion at end-December 2012. The increase in reserves was driven largely by the proceeds from crude oil and gas sales and crude oil-related taxes, as well as reduced funding of the wDAS. The reserves level could finance over 13 months of imports. The Committee urged the Bank to continue the monitoring of portfolio and foreign direct investment flows, while being conscious of the risks to financial stability of a rapid outflow of hot money.

The Committee's Considerations

The Committee was pleased with the prevailing macroeconomic stability despite shocks from both external and domestic environments; a development which informed the tightening stance of monetary policy since the third quarter of 2010. Having achieved a reasonable degree of moderation in the rate of inflation, there were compelling arguments to consider easing monetary policy, at least from the perspective of stimulating growth in the real sector. Given the slowdown in overall GDP and agricultural GDP growth, inability of the SMEs to borrow at the current lending rates, and crowding out effects that may require monetary easing. The Committee carefully weighed the option of relaxing monetary policy against the likely risks in the near-to-medium term, noting that reversing the current stance of monetary policy was not likely to produce a neutral outcome, as it may signal the preference for a higher inflation rate on the part of the CBN.

At 9.0 and 9.5 per cent in January and February, respectively, the price data, which largely reflected the base effect of the first and second round impact of the fuel subsidy removal in January 2012, sends a clear signal that there was still an upside risk to inflation in the near-to-medium term. Furthermore, yields on FGN bonds have been declining steadily, signalling the impact of increased inflows while equity prices have been trending upwards. Quantitative easing, especially in the US and the EU is already creating a potential new round of asset bubbles globally. The Committee was of the view that the growth in the domestic capital market was driven largely by the huge capital inflows. The principal risk to stability in the medium-to-long-term can be addressed through diligent implementation of sound policies of fiscal consolidation and structural reforms. Without these, the economy will not be able to attract long term foreign capital inflow that makes the gains of monetary policy sustainable and insulate the economy from the risks associated with external shocks and capital flow reversals. Monetary policy will, therefore, seek to preserve the current gains of macroeconomic stability in the short term, while fiscal and structural reforms kick in.

The Committee also noted the wide spread between deposits and lending rates, which it attributed to the inefficiencies in the market requiring institutional and structural reforms that would enforce behavioural change on the market, consistent with the long term needs of the economy.

The Committee was of the view that sustainable low lending rates, could be achieved if the necessary infrastructure such as stable power and good roads, amongst others, were put in place. The Committee noted that the present infrastructural condition has always provided an incentive for asymmetric response on the part of the banks to the policy rate in a manner that was not always beneficial to the small and medium customers. With respect to the price level, the Committee observed that the rising pressure in February after a significant moderation in January, was indicative of the fact that there were some underlying factors that could constitute a threat to inflation in the medium term.

The Committee noted the 2013 Federal Government Budget of N4.9 trillion, passed by the National Assembly and signed into law by the President, which represents an increase of about 5 per cent. Furthermore, the budget, predicated on an oil benchmark price of US$79/barrel as against US$75/barrel, proposed by the Executive, potentially slows down the pace of fiscal consolidation with implications for accretion to the Excess Crude Account and gross external reserves. In addition, the Committee observed that the foreign exchange market has started experiencing pressure in March 2013, mainly reflecting compression of yields in the fixed income market as well as outflows to pay dividends by multinational corporations. However, the Committee noted that the exchange rate has remained within the target range and also that the current monetary conditions are conducive to further tightening using Open Market Operations without recourse to an increase in the MPR.

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

(i) An increase in rates in response to the uptick in headline and food inflation; and pressure on exchange rates;

(ii) A reduction in rates in view of declining core inflation and GDP growth;

(iii) Retaining current monetary policy stance to sustain the gains of monetary policy while utilizing the existing space in the corridor to influence yields and exchange rates in the short term.

The Committee's Decisions

The Committee considered and rejected option 1 as being unnecessary since there are no major inflationary concerns at this time. While acknowledging the merit of the arguments in favour of option 2, it was also rejected by the majority because it could send wrong signals of a premature termination of an appropriately tight monetary stance. The Committee, therefore, decided by a majority vote of 9:3 to accept option 3 and maintain the current policy stance i.e. to retain the MPR at 12 per cent with a corridor of +/- 200 basis points around the midpoint; retain the Cash Reserve Requirement at 12 per cent and Liquidity Ratio at 30 per cent with the Net Open Position at 1 per cent.

Thank you.

Sanusi Lamido Sanusi, *CON*

Governor

Central Bank of Nigeria

19th March 2013