Central Bank of Nigeria Communiqué No. 89 of the Monetary Policy Committee Meeting of Monday and Tuesday, May 20 and 21, 2013

The Monetary Policy Committee met on May 20 and 21, 2013 with 10 out of the 11 members in attendance. The Committee reviewed the conditions and challenges that confronted the domestic economy in the first five months of 2013, and reassessed the short-to-medium term monetary policy options in the light of the fragile global economic and financial environment. The Committee noted that one of the members, Professor Sam Olofin has left the Board of the Central Bank and, therefore, ceases to be a member of the MPC. The Committee recognized his tremendous contributions to its deliberations over the years and thanked him for his services.

International Economic Developments

Global economic recovery continues to be fragile due to suppressed growth and weakness in key financial markets, including the euro area and Japan. However, the emerging market economies and Sub-Sahara African (SSA) countries continued to show resilience.

Global growth outlook remains subdued but promising. It is forecast to average 3.2 per cent in 2013. In the advanced economies, output is estimated to grow by 1.2 per cent in 2013 compared with 1.3 per cent in 2012. In the US, budget deficit figures are better than projections due to automatic spending cuts and improved revenues boosted by dividend payments to the Treasury from mortgage banks bailed out during the crisis. Unemployment figures are also improving. Although the European Central Bank has commenced a wave of monetary easing, the euro area is expected to remain in recession with output contracting by 0.3 per cent compared with a contraction of 0.6 per cent in

2012. The EU made steady progress in establishing a Banking Union, pursuing a three-pronged initiative of the Single Supervisory Mechanism; Deposit Guarantee System; and a Recovery and Resolution Scheme. The development has been adjudged as an important step towards recovery. The regime of quantitative easing commenced by the Bank of Japan holds prospects for Japanese recovery arising from a weaker Yen and improved competitiveness of Japanese exports. However, the downside risk lies in Japan's demographics whose key feature is a low propensity to consume, given its large population of pensioners-about 30 per cent. With slowing growth momentum in the emerging markets, global output is forecast to remain around the 2012 level.

The emerging and developing economies as a group are forecast to grow by 5.3 per cent in 2013, with SSA growing at 5.6 per cent. These economies have continued to face the challenge of adjusting macroeconomic policy to compensate for the weak external environment, particularly shocks induced by developments in the advanced economies. The IMF suggests that with the prospects of improvements in the global economy, policy recalibration in a number of emerging market economies should address risks from sustained rapid credit expansion and high asset prices. Growth in these economies has somewhat moderated compared with last year. The strong GDP growth rate of 7.7 per cent recorded in the first quarter of 2013 for China was countered by weaker rates in the other economies.

Domestic Economic and Financial Developments

Output

The National Bureau of Statistics (NBS) forecasts real GDP growth rate of 6.72 per cent for Q2, 2013, an improvement over the Q1 estimate of 6.58 per cent. The major driver of overall growth remains the non-oil sector led by services; agriculture; and wholesale and retail trade. The Committee noted that the relatively robust output growth projection for 2013 was hinged on expected favourable conditions for increased agricultural production and other policy initiatives aimed at stimulating the economy. However, the Committee noted with caution, the high GDP growth projection in view of the extant risk factors such as widespread insecurity, weak infrastructure and probable flooding from the projected heavy rains in some parts of the country. In addition, the state of emergency in the North East and the accompanying military operations in that axis have the potential to adversely affect economic activities generally, including agricultural production and food prices, as well as consumer demand. The Committee also noted that although most sectors of the economy showed improved growth performance in Q1 of 2013 when compared with Q1 2012, this was not the case with respect to the key sectors like agriculture, telecommunications and distributive trade. Concern was also expressed over short-term prospects in the oil sector, mainly around possible reduction in oil prices and continuing leakages in oil production due to bunkering and other illegal activities.

Prices

Headline inflation increased from 8.6 per cent in March to 9.1 per cent in April, remaining within the target range for the fourth consecutive month. Food inflation was 10.0 per cent year-on-year in April compared with 9.5 per cent in March, while core inflation declined further to 6.9 per cent from 7.2 per cent in March. On a month-on-month basis, inflation showed broad-based moderation across almost all components with the exception of imported food which may be largely a reflection of the new tariff regime.

The inflation outlook remains relatively benign with projections of headline inflation remaining in the single digit range for the next six months. This result reflects a combination of base effect and the success of tight monetary policy leading to muted growth in the monetary aggregates and exchange rate stability. The principal risks to the outlook remain fiscal spending and possible pressures on the exchange rate from any attrition to reserves caused by declining revenues as a result of output leakages.

Monetary, Credit and Financial Market Developments

Broad money supply (M2) grew by 4.44 per cent in April 2013 over the level at end-December 2012. When annualised, M2 grew by 13.3 per cent, compared with the contraction of 0.03 per cent in the corresponding period of 2012. The growth in M2 was slightly below the growth benchmark of 15.2 per cent for 2013. Aggregate domestic credit (net) grew by 17.46 per cent in April 2013 which annualized to a growth rate of 52.38 per cent over the end-December 2012 level, compared with the contraction of 6.12 per cent recorded in the corresponding period of 2012.

Interest rates in the interbank money market moved in tandem with the level of liquidity in the banking system. The average inter-bank call and OBB rates which opened at 10.21 and 10.23 per cent on March 19 closed at 10.86 and 10.91 per cent, respectively, on May 16, 2013. The average maximum lending rate rose marginally to 24.53 per cent in April, 2013 from 24.49 per cent in March, 2013. Similarly, the average prime lending rate, rose to 16.65 per cent in April 2013, from 16.61 per cent in March.

The Committee noted the continued recovery in the Nigerian capital market as equities market indicators were positive in the review period. The All-Share Index (ASI) increased by 31.4 per cent from 28,078.81 on December 31, 2012 to 36,907.81 on May 17, 2013. Market Capitalization (MC) also increased by 31.5 per cent from N8.97 trillion to N11.80 trillion during the same period. Improved earnings, increased capital inflow and portfolio investments as well as investor confidence in the economy contributed to the up-swing in stock prices. The

Committee also noted the reported increase in the share of domestic players in the capital market, thus reducing the risk of major shocks due to slowdown in foreign participation.

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 N157.32/US$, N158.70/US$, and N160.00/US$ on 20th March 2013 and closed at N157.30/US$, N158.33/US$, and N159.50/US$, respectively, on May 18, 2013. In all three segments, the naira exchange rate appreciated in the review period. This development reflected the effects of improved supply of foreign exchange to the market. Both the average and monthly premia for the review period remained insignificant, indicating the effectiveness of current policy measures.

The Committee also expressed satisfaction with the significant accretion to external reserves which stood at US$49.13 billion as at May 16, 2013. This represents an increase of US$5.3 billion or 12.1 per cent above the level of US$43.83 billion at end-December 2012. This level of reserves could finance approximately 13 months of import.

The Committee's Considerations

The Committee was pleased with the prevailing macroeconomic stability-moderation in all measures of inflation on month-on-month basis; stable banking system and exchange rate and robust external reserves. It commended the agreement reached between the CBN and AMCON on the settlement of outstanding AMCON obligations to all private sector investors by December 2014 and to repay the N3.6 trillion debts held by the CBN under a new refinancing and restructuring arrangement within a period not exceeding ten years at single-digit interest rate. The Committee noted that the repayments and refinancing arrangements would have no adverse monetary policy implications; but rather increase confidence in the financial system. Also, under this arrangement, it is unlikely that banks will be required to contribute more than 0.5 per cent of their Balance Sheets annually to the sinking fund. By October 2014, the CBN will be the sole creditor to AMCON, holding bonds guaranteed by the Federal Government of Nigeria. The Federal Government will therefore have no contingent liability to any party other than the CBN, and the Bank will recover its debt from AMCON recoveries and contributions to the Sinking Fund by the banks. Since the CBN supervises and regulates the banks and AMCON, this exposure is considered a fair risk.

The Committee was concerned about the threat posed by developments in the oil sector arising from uncertain oil market environment, high output leakages arising from oil theft which has negatively affected the oil sector's contribution to GDP and the prospects for declining output if the state of affairs continues. The Committee observed that the accretion to reserves resulted principally from increased portfolio capital inflows. The Committee noted the potential effect of this development on exchange rates, reserves and the capital account in the event of capital flow reversal, and thus stressed the need to maintain stability and retain confidence of investors in the consistency of monetary policy.

The Committee also expressed concern over the low level of credit growth to the private sector and traced this to the crowding out effect of high growth in credit to the public sector. The Committee noted the N1.02 trillion increase in claims on government and the N1.11 trillion drawdown on savings between January and April 2013 and particularly the monetization of US$1 billion in April 2013, being proceeds of the Excess Crude Account. The combined effect of new borrowings and reduced savings was an increase in net credit to the central government of over N2 trillion in the first four months of 2013. The evidence points to an increase in the rate of government expenditure in 2013 when compared with 2012. In addition, the recent military action in the North-East will result in additional spending. Although the Government has announced that there will be no supplementary budget, the Coordinating Minister for the Economy and Honorable Minister of Finance has already announced that there will be a drawdown on a Contingency Vote embedded in the 2013 Budget to cover emergencies. Overall, the Committee is of the view that government spending will constitute a major risk to the inflation and exchange rate outlook, thus advising prudence in monetary policy action at this time.

The Committee further noted that in spite of increased borrowings, yields on FGN bonds have been declining steadily, signaling the impact of increased inflows while equity prices have been trending upwards. The evidence does not, therefore, support claims of monetary policy being too tight. The Committee was of the view that the principal risks to long-term stability can be addressed through diligent implementation of sound policies of fiscal consolidation and efficient sectoral policies underpinned by structural reforms. These are required to attract long term foreign capital inflow that would make the gains of monetary policy sustainable, and also support credit extension to the private sector players.

Consequently, the Committee weighed the following options:

(i) A reduction in rates in view of declining core inflation, stable exchange rates and relative reserve accretion. Against the backdrop of sustained pressure to ease the stance of monetary policy, the Committee considered the imperative of signaling its sensitivity to the concerns expressed about high lending rates in the economy;

(ii) Retaining current monetary policy stance to sustain the macroeconomic gains of tight monetary policy and to continue to rein-in inflationary expectations.

The Committee's Decisions

The Committee considered and acknowledged the merits of option 1 but rejected it as being premature in view of the potential risk factors in the horizon posed by recent developments which would necessitate increased fiscal expenditure in the short-to-medium term, resulting in a resurgence of inflationary pressures. The Committee considered and decided by a majority of 7 votes to hold and 3 votes to reduce the MPR by 50 basis points. Thus, by a majority vote of 7 members to 3, the MPC voted to maintain the current policy stance i.e. retain the MPR at 12 per cent with a corridor of +/-200 basis points around the MPR; retain the Cash Reserve Requirement at 12 per cent and Liquidity Ratio at 30 per cent; with the Net Open Position at 1.0 per cent.

In the final analysis, the Committee was convinced that in view of the successes achieved in all fronts -banking stability, low inflation, exchange rate stability, strong reserve buffers and recovery in the equities market, there is no reason at this point to change a policy that has worked so well.

Thank you.

Sanusi Lamido Sanusi, *CON*

Governor

Central Bank of Nigeria

21st May 2013