Central Bank of Nigeria Communiqué No. 90 of the Monetary Policy Committee Meeting of Monday and Tuesday, July 22 and 23, 2013

The Monetary Policy Committee met on July 22 and 23, 2013 with 10 out of the 12 members in attendance. A new member, Mr. Stephen O. Oronsaye, who is a Board member, replaced Professor Sam Olofin whose tenure as a Board member had expired. The Committee reviewed the economic conditions and challenges that confronted the domestic economy in the first half of the year, particularly since the last MPC meeting in May 2013. It also re-evaluated the short-to-medium term risks to inflation, domestic output, external balance and financial stability.

International Economic Developments

Global economic recovery remained weak, as new risks have emerged including the possibility of a further slowdown in growth in the emerging market economies. The old risks of a recession in the Eurozone have persisted alongside slowing growth in China and the possibility of tighter financial conditions when central banks gradually exit from their current monetary accommodation stance.

Consequently, global growth prospects have not improved. Blaming weaker domestic demand and slower growth in several key emerging market economies, as well as a more protracted recession in the euro area, the IMF in

July 2013 reviewed downward its global growth forecast. It also reviewed downward its growth forecast for the US and China to 1.7 and 7.8 per cent, from 1.9 and 8.0 per cent in April 2013, respectively, but raised the forecast for the UK from 0.7 per cent to 0.9 per cent in the same period. For the Eurozone which has seen its longest recession since monetary union, the IMF projects a further contraction of 0.6 per cent in 2013, which more or less doubled the earlier forecast in April. The IMF has also cut the growth forecast for Brazil, South Africa, India and Russia to 2.5, 2.0, 5.6 and 2.5 per cent from 3.0, 2.8, 5.8 and 3.4 per cent, respectively. Japan's growth rate forecast is projected at 2.0 per cent, up from a forecast of 1.5 per cent.

The slowdown in global growth is likely to impact on commodity prices and thus, adversely impact oil exporting countries like Nigeria. In addition, continued fragility in financial markets continues to generate bouts of capital flow reversals and inflows that are potentially disruptive to emerging and transition markets.

Domestic Economic and Financial Developments

Output

The National Bureau of Statistics (NBS) estimated the real Gross Domestic Product (GDP) growth at 6.72 per cent for Q2 2013, slightly higher than the 6.56 per cent recorded in Q1, and 6.39 per cent in Q1 of 2012. Overall, GDP growth for fiscal 2013 was projected at 6.91 per cent up from 6.58 per cent in 2012. The non-oil sector remained the major driver of growth recording 7.91 per cent in contrast to the growth rate of -0.68 per cent for the oil sector during the second quarter of 2013. The drivers of the non-oil sector growth remained agriculture; wholesale and retail trade; and services which contributed 1.72, 1.47, and 2.90 per cent, respectively. The Committee noted the continued decline in the contribution of the oil sector to overall GDP and the underlying factors responsible for this state of affairs. These factors include; sustained oil theft which has led to a decline in output volumes in the face of an uncertain international oil market and price signals, weak infrastructure, and downside risks due to discovery of shale oil and the emergence of other African oil exporters competing for Nigeria's traditional oil market.

Prices

Inflationary pressures continued to moderate partly in response to the tight monetary policy and base effect. The year-on-year headline inflation decelerated to 8.4 per cent in June from 9.0 per cent in May. Also, core inflation declined significantly to 5.5 per cent in June from 6.2 per cent in May and 6.9 per cent in April. Food inflation, however, rose to 9.6 per cent in June from 9.3 per cent in May 2013. Notwithstanding the moderation in headline inflation, there are benign risks on the horizon, including the possibility of accelerated fiscal releases in the later part of the year and the effects of the upward review in electricity tariffs in line with the MYTO following the implementation of the full deregulation of the energy sector.

The six-month inflation outlook indicates that inflation would remain within single digit territory due to base effect and tight monetary policy. However, the current state of government finances is likely to generate increased borrowing. The key risks to the outlook, therefore, remain fiscal operations, increased pressure on the exchange rate due to excess structural liquidity in the banking system and the possibility of a capital flow reversal in the medium term.

Monetary, Credit and Financial Market Developments

Broad money supply (M2) grew by 0.71 per cent as at end-June 2013 over the level at end-December 2012. When annualized, M2 grew by 1.42 per cent, compared with the growth of 2.70 per cent in the corresponding period of 2012. Thus, M2 growth was also significantly below the growth benchmark of 15.20 per cent for 2013 and 7.60 per cent for Q2 of 2013.

Interest rates in the interbank money market moved in tandem with the level of liquidity conditions in the banking system. The average liquidity ratio was 67.79 per cent compared with the prudential requirement of 30.0 per cent. Thus, the average inter-bank call and open-buy-back (OBB) rates, which opened at 12.07 and 11.91 per cent on May 20, 2013, closed lower at 10.42 and 10.29 per cent, respectively, on June 28, 2013. However, the average inter-bank call and OBB rates for the period were 11.80 and 11.46 per cent, respectively.

The recovery in the Nigerian capital market continued, as equities market indicators were upbeat in the review period. The All-Share Index (ASI) increased by 28.8 per cent from December 2012 to June 2013, while the equities Market Capitalization (MC) increased by 27.3 per cent from N8.97 trillion on December 31, 2012 to N11.43 trillion on June 28, 2013. Improved earnings and investor confidence in the economy contributed to the up-swing in stock prices. The equities market median price-earnings ratio rose above the long-run median by 9.0 per cent in June 2013 indicating that share prices were recovering faster than earnings and investor assessment of future returns was good.

External Sector Developments

At the Wholesale Dutch Auction System (wDAS), interbank and the BDC segments of the foreign exchange market, the exchange rate depreciated to N157.32/US$, N161.25/US$, and N163.00/US$ on July 19, 2013 from N157.30/US$, N158.30/US$, and N159.50/US$ on 21st May, 2013. The Committee noted the depreciation recorded in all segments of the foreign exchange market in the review period on the back of a general sell-off by portfolio investors in emerging and frontier markets following guidance by the US Federal Reserve Bank (FED) with respect to its quantitative easing programs. It also observed that the experience in Nigeria was not unique, as the spike in the US yields negatively impacted financial markets globally. However, calm has since returned to the financial markets following further clarifications by the FED that exit from quantitative easing is not imminent and does not necessarily mean monetary tightening. Thus, the Nigerian capital market has seen a rally, while the demand pressure in the foreign exchange market has somewhat moderated. The

Committee, however, noted the build-up of structural excess liquidity in banks balance sheets, which poses risks to the inflation and exchange rate outlook.

The Committee noted the increase in external reserves to US$47.99 billion as at July 18, 2013 from US$43.83 billion at end-December, 2012, representing a rise of US$4.16 billion or 9.49% year-to-date. This level of reserves provides cover for approximately 11 months of import.

The Committee's Considerations

The Committee was satisfied with the prevailing macroeconomic stability achieved during the period, including the single digit inflation, stable banking system, exchange rate stability, favourable output growth, capital market recovery and growth in external reserves, thus sustaining internal balance and external viability. The Committee also noted the recent volatility in the foreign exchange market and also recognized that the commitment of the Bank to defend the currency in the face of capital flow reversal and significant revenue attrition has stemmed the depreciation of the naira. Consequently, the Bank has been able to sustain the objectives of financial and price stability.

The Committee observed the build-up in excess liquidity in the banking system, and expressed concern over the rising cost of liquidity management as well as the sluggish growth in private sector credit, which was traced to DMB's appetite for government securities. This situation is made more serious by the perverse incentive structure under which banks source huge amounts of public sector deposits and lend same to the Government (through securities) and the CBN (via OMO bills) at high rates of interest.

The Committee expressed strong concerns about the risks posed to government revenues from oil theft, less than expected production, new discoveries of shale oil, the fast increasing number of African oil exporters, the dwindling market for Nigerian crude as well as the inevitability of a fall in global oil prices as well as capital flow reversal, which may impact the current global (dollar) carry trade, for which Nigeria has been a major beneficiary.

The Committee commended the Federal Government on its sustained efforts towards fiscal consolidation in 2012 and stressed the need to reverse the loose fiscal stance of 2013. The Committee articulated the monetary policy risks of dwindling fiscal revenues to include: the crowding out effect of government borrowing, depletion of excess crude savings and pressure on the exchange rate. Available data indicates that capital expenditure is the first casualty of dwindling government revenues as available resources are channeled into funding non-discretionary recurrent expenditure.

The Committee considered the inflationary outlook for the rest of the year as benign. However, principal risks remain largely due to the loose fiscal stance and rising deficit, excess liquidity in the banking system and risks to the exchange rate due to a combination of revenue shocks and external developments.

Decisions

Having considered all the above factors, the Committee decided:

1. By a vote of 9 to 1 to hold the MPR at 12 per cent. One member voted for a 50 basis points reduction;
2. By a vote of 9 to 1 to maintain the symmetric corridor around the MPR at +/-2 per cent. One member voted for an asymmetric corridor;
3. Unanimity to retain the CRR at 12 per cent; and
4. 9 to 1 to introduce a 50 per cent CRR on public sector deposits. This will be applied on Federal, State and Local Government deposits and all MDAs. For other deposits CRR will remain at 12 per cent

Thank you.

Sanusi Lamido Sanusi, *CON*

Governor

Central Bank of Nigeria

23rd July, 2013