

Central Bank of Nigeria Communiqué No. 85 of the Monetary Policy Committee Meeting of Monday and Tuesday, September 17 and 18, 2012

The Monetary Policy Committee (MPC) met on September 17 and 18, 2012, with 10 out of the 12 members in attendance. The Committee reviewed the conditions and challenges that confronted the domestic economy during the first eight months of 2012 against the backdrop of international economic and financial developments with a view to reassessing monetary policy options in the short-to- medium term.

The International Economic Developments

The Committee noted that the global economy showed signs of further weakness in the last three months, with the latest data not showing any evidence of improvement up to the beginning of the third quarter of 2012. The Committee also observed that the weak growth resulted from considerable financial market fragilities in the euro area with resultant negative spillover effects to other regions, uncertainty resulting from the Eurozone crisis as well as poor

macroeconomic performance in other advanced economies. Rising food and energy prices is also a contributory factor.

In July 2012 IMF World Economic Outlook (WEO) update projected that global output would moderate to 3.5 per cent in 2012, which is 0.1 percentage point lower than the forecast of April 2012. Growth in advanced economies was projected to decline from 1.6 per cent in 2011 to 1.4 per cent in 2012, with the slowdown being most severe in the peripheral economies, where the dampening effects and uncertainty from tighter financial conditions are strongest.

In the US, real GDP grew at an annualized rate of 1.5 per cent in Q2 of 2012, down by 0.5 percentage point from 2.0 per cent in Q1. The sluggish growth was primarily due to declining aggregate consumption, government spending, and negative terms of trade.

The euro zone is on the brink of a double-dip recession following the contraction in output between April and June. Real output across the 17-nation bloc fell by 0.2 per cent in Q2 of 2012 while signs of further contraction are in the horizon. Rising unemployment and large scale fiscal retrenchment coupled with increased taxes in a

number of countries constrained aggregate demand leading to cut-back on investment and low export growth. Unemployment level across the zone has attained a record high of 11.3 per cent, the highest since 1995, with Spain recording the highest level and Austria the least. Weak financial markets and the persisting sovereign debt crisis as well as rising energy prices led the European Central Bank (ECB) to retain its main refinancing interest rate at 0.75 per cent. EU members remain cautious about the ECB's Outright Monetary Transactions scheme, which is based on strict adherence to austerity measures and fiscal consolidation pact.

In Asia, most economies recorded significant slowdown in economic activity up to Q2 of 2012, mainly on account of weakening exports and investment. Export growth has moderated, reflecting the sluggish demand from Europe while investment remained weak due to heightened volatility of capital flows and the lagged effects of tighter domestic monetary policies. China's real GDP growth slowed to 7.6 per cent in Q2 from 8.1 per cent in Q1 due mainly to decline in net exports. Growth moderated in Japan especially in Q3 due to

softening in manufacturing activity. India's real GDP, year-on-year, moderated to 5.5 per cent in Q2 of 2012 from 6.1 per cent in Q4 of 2011, mainly as a result of deceleration in private consumption. Overall, the growth trajectory for the remainder of the year tends toward a downturn, as downside risks, including weak external demand, elevated price levels, widening twin deficits, falling investments, and rising interest rates, remain heightened.

Robust economic activities in the MENA and Sub-Saharan Africa regions would partly offset the declining output growth in the advanced and emerging markets in 2012. Real GDP growth was projected at 5.0 per cent in each of the regions, underpinned by strong natural resources prices, new natural resources exploration and production in several countries, recovery from drought in the Sahel and parts of Eastern Africa, strong post-conflict recovery in some countries, improved governance practices and growing disposable income. Despite these developments, growth in the regions faces significant downside risks on the back of increased global uncertainties.

The Committee believes that the recent quantitative easing measures by the European Central Bank and the US Federal Reserve System could be responsible for the high crude oil prices in the international market. It highlighted the possible increase in carry trade and the risk of a bubble in the domestic capital market.

Domestic Economic and Financial Developments

Output

Recent macroeconomic data indicates that the economy is performing better than forecasts although growth in the first two quarters of 2012 has remained consistently below the corresponding growth rates in 2011. The provisional real GDP growth rate from the National Bureau of Statistics stood at 6.28 per cent in Q2 of 2012, up from 6.17 per cent in Q1 2012 but lower than the 7.61 per cent recorded in the corresponding period of 2011. The non-oil sector remained the major driver of growth recording a 7.50 per cent increase in contrast to the oil sector, which contracted by 0.73 per cent during the period. Overall GDP growth for fiscal 2012 has been revised upwards to 6.77 per cent from the earlier projection of 6.50

per cent. The Committee welcomed the promising growth performance although it expressed concern that the overall output growth projection for 2012 is still lower than the 7.45 per cent recorded in 2011.

The growth drivers within the non-oil sector remained agriculture; wholesale and retail trade; and services; which contributed 1.94, 1.69, and 3.16 per cent, respectively. The Committee noted that the relatively robust growth projections despite the slowing global economy reflected the continuing favorable conditions for increased agricultural production, improved security situation and power supply.

Prices

The Committee observed that the inflationary pressures experienced during the first half of 2012 appear to be moderating in the third quarter. The year-on-year headline inflation declined to 11.7 per cent in August 2012 from 12.8 per cent in July while core inflation decelerated to 14.7 from 15.0 per cent during the same period. Also, food inflation declined sharply to 9.9 per cent in August 2012 from

12.1 per cent in July. The significant decline in year-on-year food inflation was attributed to the decrease in prices of both processed foods (from 4.2 to 3.6 per cent) and farm produce (from 7.9 to 6.4 per cent). The Committee observed that the inflationary pressures from the partial removal of petroleum subsidy in January, 2012 appear to have waned in Q3, 2012, and that given the relatively stable exchange rate regime, the pass-through to domestic prices was low during the period. The Committee, however, recognized the upside risk to inflation in the near-term to include increased spending in the fourth quarter and monetized capital flows following the US QE3.

Monetary, Credit and Financial Markets' Developments

Broad money supply (M2) grew by 3.50 per cent in August 2012 over the level at end-December, 2011, which annualized to 5.25 per cent. The annualized growth rate is significantly lower than the growth rate of 15.43 per cent recorded in 2011. Aggregate domestic credit (net) declined by 3.82 per cent in August 2012, annualized to a decline of 5.73 per cent from the level at end-December 2011 level. The

decline in aggregate domestic credit (net) in August 2012 was due to a huge fall in credit to Government (net), which declined by 246.47 per cent or 369.71 per cent on annualized basis. This development reflected the combined effects of the significant growth in Federal Government deposits with the banking system and contraction on claims to government. The introduction of a Treasury Single Account (TSA) appeared to have had the desired effect of reducing government borrowing.

Interest rates in all segments of the money markets rose initially, in response to the increase in the Cash Reserve Requirement (CRR) by 400 basis points at the MPC meeting of July 23 and 24, 2012. The rates, however, trended downwards toward the end of the review period. The inter-bank call and OBB rates, which opened at 17.85 and 14.99 per cent, closed at 14.19 and 13.56 per cent, respectively, during the review period. Developments in the interest rate structure indicated that the retail lending rates remained high in August 2012. The average maximum lending rate increased marginally to 23.76 per cent in August 2012 from 23.45 per cent in July. However, the

average interest bearing deposit rate declined to 6.24 per cent in August 2012 from 6.64 per cent in July. Thus, the spread between the average maximum lending rate and the average interest-bearing deposit rate widened to 17.53 per cent in August 2012 from 16.81 per cent in July. The Committee expressed concerns that lending rates have remained high and enjoined the Bank to sustain its efforts towards the reduction in interest rate spread, while stabilizing interbank rates to sustain liquidity and facilitate intermediation in the banking system. The Committee noted that this can only be achieved by sustaining the current efforts at reducing overheads in the banking industry and deepening capital market reforms to diversify sources of finance for the real economy, and complement bank loans.

The Committee observed that the recovery in the Nigerian capital market continued during the review period, as equities market indicators were positive. The All-Share Index (ASI) increased by 9.96 per cent between June 29, 2012 and August 31, 2012, while Market Capitalization (MC) increased by 9.64 per cent during the same

period. Equity Market Median PE ratios at 9.86 in August 2012, fell below the long-run median of 10.77 by 0.91 or 8.44 per cent, suggesting bargain valuations and an imminent rebound. The Committee observed that the performance of the NSE during the period was consistent with the global trends, especially in the wake of monetary expansion.

External Sector Developments

At the Wholesale Dutch Auction System (WDAS), the exchange rate during the period, July 25 – August 31, 2012, opened at N157.40/US\$ and closed at N157.36/US\$, representing an appreciation of N0.04k. The appreciation was due to the combined effects of the increase in Cash Reserve Requirement, reduction in the Net open position and the policy barring DMBs/Discount Houses from accessing Lending windows (SLF and Repo) and WDAS simultaneously. At the interbank segment, the selling rate opened at N160.05/US\$ and closed at N158.15/US\$, representing an appreciation of N1.90 or 0.01 per cent. The appreciation experienced in this segment was due to increased supply of foreign exchange by oil companies to the interbank

market. At the BDC segment of the foreign exchange market, the selling rate opened at N163.00/US\$ and closed at N161.00/US\$, representing an appreciation of N2.00k or 0.01 per cent for the period. The appreciation recorded in this segment was traced to the low demand of foreign exchange by end users vis-à-vis the high supply of foreign exchange at the interbank market and the apparent taming of speculative activities.

The Committee noted with satisfaction that 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, and therefore encouraged the Bank to sustain and complement existing measures to discourage speculative demand in the market. In general, the Committee noted that the decisions taken at the last meeting of the MPC had produced the desired result.

In the same vein, the Committee expressed satisfaction with the significant accretion to external reserves during the period. Gross external reserves as at September 5, 2012 stood at US\$ 41.81 billion, representing an increase of US\$ 6.40 billion or 18.07 per cent above

the level of US\$35.41 billion at end-June 2012. External reserves increased by US\$ 8.88 billion or 27.0 per cent on a year-on-year basis compared with US\$ 32.93 billion at end- August 2011. The increase in the reserve level was driven mainly by proceeds from crude oil and gas sales and crude oil related taxes. The foreign reserves level could finance over seven months of imports.

The Committee's Considerations

Given developments in the global and domestic economy and the financial markets, the Committee noted that the weak global growth indices called for cautious optimism by policymakers. The resolution of the euro area debt crises remains a major concern even with the approval of the efforts of the European Central Bank to address the debt crises in the euro area by the German Constitutional Court. It further noted that its decisions at the July MPC Meeting appeared to have had some positive impact in a number of areas, namely: a deceleration in year-on-year inflation in August 2012, stability of short term interest rates around the Monetary Policy Rate (MPR), buildup in external reserves and stability in the

exchange rate. However, core inflation is still high at 14.7 per cent in August. The threat of increased inflow of hot money arising from the actions of the US Fed to further stimulate the economy through its QE3 activities and its capital reversal implications were noted.

The Committee noted the rise in oil prices but cautioned against a hasty deployment of the windfall to immediate consumption as the trend could be reversed. Monetary policy could not, therefore, under the circumstance, react to what may be purely temporary developments.

Despite the threats from a combination of global and domestic factors, the Committee noted that the level of economic growth in the third quarter of 2012 remained robust and the year-end forecast would likely be met owing largely to the improvements in power supply and the steady progress of reforms, actions in respect of the alleged fraud in the petroleum subsidy regime and improved fiscal operations. The Committee noted that these measures, generally take time to impact the real economy.

With this development, the Committee observed that the inflation outcome for the remaining period of the year is likely to be lower than the initial forecast of 14.7 per cent. The Committee would continue to monitor developments in the price level, and remain firm in its commitment to price stability as its mandate. The Committee also noted that the growth rate of real output, though impressive by global trends, was on the downward trend since Q1 2010 most especially in the agricultural sector. It was of concern to the Committee that the declining output in the agricultural sector was traceable to the security challenges and high intensity of rainfall which has led to flooding in several parts of the country. It noted that the measures taken at the last MPC meeting have succeeded in stabilizing the foreign exchange market as well as enhancing the build up in external reserves.

Overall, the MPC believes that the current rise in crude oil prices and the tight monetary policy regime presented an opportunity for building reserve buffers in the light of the uncertainties surrounding the global economy.

The Committee, therefore, identified the key policy challenges to include:

1. Protecting the domestic economy and building external reserves buffer;
2. Potential large inflow of “hot money” resulting from further monetary easing in the US and Europe and improved yield on fixed income instruments;
3. Persisting high core inflation rates;

The Committee noted that this moderation in headline inflation has not been accompanied by a significant decline in core inflation. Given the unpredictability of food prices, there is a need to watch this trend as we approach year-end before altering the present monetary stance.

Decisions:

In view of the foregoing, the Committee by a unanimous vote decided as follows:

1. Retain the Monetary Policy Rate (MPR) at 12 per cent with +/- 200 basis points corridor;
2. Retain the Cash Reserve Requirement (CRR) at 12.0 per cent.
3. Retain the Net Open Position at 1.0 per cent.

Thank you.

Sanusi Lamido Sanusi, CON

Governor

Central Bank of Nigeria

18th September, 2012

PERSONAL STATEMENTS BY MPC MEMBERS:

1.0 ALADE, SARAH

*Headline inflation decreased to 11.7 percent in August from 12.8 percent recorded in July. This decline is driven generally by decrease in food inflation which dropped to 9.9 in August from 12.1 recorded in the previous month, as the harvest season commenced. In the international scene, while growth prospects remain subdued, the announcement by the Federal Reserve of third round of Quantitative Easing measures and effort by the Eurozone ministers to tackle the Euro area debt problems all point to positive developments. On the domestic front, second quarter GDP growth remain robust at 6.28 percent although lower than recorded at the corresponding period of the previous year. Inflation is on a downward trend and international oil prices remain stable. Monetary policy should adopt a gradual approach to monitor the channel of transmissions of the events in the Euro area and the US in the coming months before taking further actions. Based on this, I will support a **no change** in monetary policy rate and Cash Reserve Requirement (CRR).*

Headline inflation dropped to 11.7 percent in August from 12.8 percent recorded in the previous month. Domestic inflation has continued to trend down after a persistent and sustained inflationary pressure, beating most analysts' expectation. This can be mainly attributable to the commencement of harvest which resulted in the availability of locally produced food products at lower rate. Staff projections suggest a

temporary easing in inflation for the next two months during the peak of the harvest season before edging up again by the end of the year.

Gross Domestic Product (GDP) is revised upwards and is projected to grow by 6.77 percent in 2012. Second quarter GDP growth edged up to 6.28 percent an increased from the 6.17 percent recorded in the first quarter of the year. The non-oil sector remained the major driver of growth recording 7.50 per cent increase in contrast to the oil sector which contracted by 0.24 per cent during the same period, with agriculture, wholesale and retail trade, and services as the major contributors.

In the money market, rates responded to the decisions taken at the last MPC meeting. Inter-bank call and OBB rates which averaged around 15.20 and 14.72 percent respectively, before the last MPC, lowered to an average of 13.99 and 12.99 percent respectively during the month of September. The decrease in the OBB and inter-bank rates can be attributed more to the last monetary policy decisions which increase the Cash Reserve Requirement (CRR) by 400 basis points. In the Nigerian stock exchange, activities remain bearish as a result of domestic confidence in the market.

Policy decision at the last MPC resulted in stability at the foreign exchange market and buildup of reserve. The additional measures introduced at the last MPC, brought stability at the foreign exchange market and reduced speculative demand. The decision also aided capital inflows to the

economy, resulting in buildup of foreign exchange reserves. The impact of the Federal Reserve quantitative easing measures, could further increase capital inflows into the economy as capital go after high interest rate.

The global economic environment remains fragile and weak and needs to be closely monitored. Events in the economies of Nigeria's trading partners remain weak and if this condition persists could lead to a softening in demand for and price of oil with negative impact for oil revenues. While oil prices have remained high and stable, the supply side factors such as geo-political tension in the Middle East (Iran) that is driving the price increase may soften in the medium term. The fallout will be the reduction in foreign exchange earnings, weakening of the naira, and pressure on exchange rate. This may further lead to increase budget deficit and public sector borrowing to finance the expenditure outlays. Therefore, it is important that a tight monetary stance is maintained to forestall major downside risk to the economy.

Based on the above, I am inclined to tilt my decision to balance both global risks and national vulnerabilities. Consequently, I will support a no increase in monetary policy rate and Cash Reserve Requirement (CRR).

2.0 BARAU, SULEIMAN

A. Review of developments since the last MPC

A.1 The following developments very clearly reveal that the various measures taken as part of overall tightening stance on policy have produced expected results;

- Year on Year (YoY) Headline Inflation (HI) trended down from 12.80% (July) to 11.69% (August). Month on Month (MoM) HI has however, increased by 0.24% to 0.67%, respectively.
- YoY Food Inflation (FI) has decreased from 12.09 (July) to 9.91% (August). MoM (FI) increased from 0.31 (July) to 0.72% (August).
- Core Inflation (CI) similarly declined from 15.04% (July) to 14.71% (August). MoM Core Inflation however, increased from 0.11% (July) to 0.62% in August.
- The Naira appreciated in all segments of the foreign exchange market. In addition, the premium between WDAS and BDC rates narrowed to 1.69%.
- External reserves peaked at a two year record of US\$42.13 billion.
- Money market rates have stabilized after the expected initial volatility.

A.2 Real Gross Domestic Product (GDP) grew marginally from 6.17 in quarter one (Q1) to 6.28% in (Q2). However, this is a decline when compared to 7.61% recorded in Q2 2011.

A.3 Financial markets in some of the Euro Zone countries continued to be volatile following the sovereign debt crises. Meanwhile, we continue to witness slow growth in China and other emerging market economies.

B. Discussion/Pressure Points

- The successive tightening measures we have taken recently have very clearly produced the desired results. The issue facing the MPC today is whether in the light of this development, we should hold tighten or loosen the stance in policy.
- In the first place, even though we were not operating an inflation targeting framework, the MPC has expressed the desire to bring inflation to single digit. At 11.7% the YoY Headline Inflation though far below forecast is in the double digit arena. Besides, both the MoM Inflation measures and outlook indicate upside risk. In addition, as we move towards fiscal year end, public and consumer spending due to festivities could increase, which largely support this outlook.
- We have witnessed appreciation in all segments of the foreign exchange market. While our objective is to allow the exchange

rate to be mobile within a target band, it is significant to observe that the forces that have tended to put pressure on the Naira recently are speculative rather than fundamental. These forces have been supported by the observed huge liquidity in the system driven by substantial government spending. This makes a compelling case for continuation of the current policy stance.

- The substantial accretion to our foreign reserves is a very good development. This has changed market sentiment and has supported the recent appreciation of the Naira. The pass-through effect of exchange rate on inflation makes it an important variable in our inflation management equation. This supports our argument in favour of the maintenance of current policy stance.
- After the initial shock in the money market rates have largely stabilized following the measures taken at the last MPC meeting. There is the need to maintain the stability.

C. Decision

In the light of the need to maintain stability in the money and foreign exchange markets, the upside risk to inflation and the need to sustain accretion to reserves, I voted in favour of maintaining the measures taken at the last MPC as follows:

- Maintain MPR at 12%

- Maintain the corridor at plus and minus 2% around the MPR (for SLF and SDP, respectively)
- Maintain the Net Open Limit for Banks at 1%
- Maintain CRR at 12%

3.0 GARBA, ABDUL-GANIYU

General Observation

1. The **timely** implementation of the decisions on CRR (from 8% to 12%), Net Foreign Exchange Open Position (NOP) [from 3% to 1% with effect from July 24th, 2012] and the circulars that **changed the arbitrage game** have helped to significantly (a) moderate the pressures on the Naira and (b) put economic players on notice that a new era of creative rationality and creative mix of policies and institutional changes has begun in the MPC.
2. The forward looking actions by the MPIC in the first two weeks after the July MPC is also highly commendable: it helped to achieve the desired result which was to change the game and align choices open to players and associated payoffs to national macroeconomic goals. It very important that forward looking actions are sustained.

Outstanding Structural and Institutional Issues Pre-dating Last MPC

3. The slowing growth from 1st quarter of 2010; the high unemployment (23.9% and average of 1.8 million adding to the

pool each year); high poverty rates (112.5 Million in 2011) and the insecurities that have heightened uncertainties and risks.

4. Destructive rationalism in the financial system linked to perverse incentives and manifesting in (i) high costs, rent appropriation and allocative inefficiencies, (ii) exposures of DMBs to FGN Bonds; high market concentration (deposit, credit and capital) and;(iii) the crowding-out of credit to the real sector.
5. Weak institutions that embed the perverse incentives.
6. Unsustainable growth in public debt, public debt service and high opportunity costs of current structures of public expenditures.
7. Trends and structures of the money survey in the first three quarters of 2012:
 - a.The M1 and Net Domestic Credit (NDC) have trended downwards in the first eight months with average monthly growths of -3.6% and -2.0% respectively. These have adverse effects on private investments and growth.
 - b.In contrast, Net Foreign Assets (NFA) grown at an average monthly rate of 6.9% which is good for accumulation of foreign reserves.
 - c.It would seem that the increase in NFA is neutralized by a combination of decline in M1 and NDC . The neutralization of the positive growth of NFA is necessary to complement the tight monetary policy of the MPC. But it comes at a cost: higher interest rates and negative growth of NDC. It may be

important to quantify the opportunity costs in terms of forgone investment, employment and growth.

d. The three components of Quasi Money (QM) – Savings Deposit (SD); Time Deposit (TD) and Foreign Currency Deposit (FCD) have shown different patterns of growth. On average Savings Deposit averaged 0.7% growth between January to August 2012 compared to 1.7% for Time Deposit and 3.3% for Foreign Currency Deposit. After the last MPC in July, FCD rose sharply by 17.4% and TD rose by 5.9% while SD fell by -0.2%. It is important to look more closely at the trend and structure of the money survey to ensure consistency with macroeconomic goals.

Outlook: Inflation and Global Economic Challenges and Policy Responses

8. Headline inflation trended downwards from 15% in April 2010 to 9.3% in August 2011 and 10.3% at end of 2011. However, the two supply shocks of 2012 (rise in PMS in January and electricity in June 2012) altered the path of inflation in 2012. After the spike in January to 12.6%, it fell to 11.9% in February most likely as the combination of tightening and the budget effects of the supply shock induced some moderation. However, the dip in headline inflation in February was not sustained through March to July (it averaged 12.7%). **It is therefore not yet clear if the decline in**

headline inflation in August to 11.69% is the beginning of a downward trend.

9. The global outlook on growth, inflation and resolution to the sovereign debt crisis in the EU and, the decision of the US Federal Reserve to proceed to QE3, calls for (i) close monitoring of financial flows into and out of the Money, Bond and Capital markets to limit the dangers of hot money flows and (ii) caution in projecting future inflation.

Decision

10. I vote to hold. The decision is informed by:
 - a. A **cautionary interpretation** of the global economic and policy outlook (growth, inflation, unemployment, sovereign debts and policy responses in the EU and the US) as well a cautious approach to inflation forecasting in the light of the uncertainties and risks in the global economic environments.
 - b. Institutional analysis which gives greater weight to institutional changes as the more effective means for improving cost competitiveness and allocative efficiencies in the Nigerian financial markets. Without such improvements, the pass through effects of rate cuts will be limited and slow. In the meantime, the institutional changes through the administrative tools that are being deployed are already changing the rules of the financial game complemented by the single treasury account (STA) recently adopted by the fiscal authorities. As (i) the STA

expands and credit to government turns negative;(ii) FGN Bonds matures and (iii) as the capital market is watched closely to plug the types of loopholes encouraged unwise margin loans; the DMBs would have to become more creative and seek returns from lending to the real sector and other value-adding and job creating activities. I am also convinced that creatively by-passing malfunctioning markets offer a potentially better alternative to rate cuts now.

- c. The observed progress being made towards the policy goals of the July MPC call for staying the course: sustaining and improving on implementation of policy and the complementary **game changing** institutional and administrative changes.

4.0 LEMO, TUNDE

The issue before the Committee is whether to relax the current tightened stance or hold. Having maintained a restrictive monetary stance since the third quarter of 2011, there are arguments that the real sector is being penalized with high interest thus constraining real output growth. As convincing as this argument may sound, there is a need to guide against knee-jerk reaction as more time is needed to monitor the full impact of the earlier policy actions.

The inflation level, though recorded appreciable moderation between July and August, is still not in a comfortable zone particularly with core inflation currently at 14.7 per cent. Inflation slipped into double digit region in 2008, as in most comparable economies, consequent upon the expansionary stance of monetary policy in response to the global financial crisis. We need to note that most other jurisdictions have reverted to single digit. Furthermore, the inflation outcome in August may not be as benign as we would think in view of the masking effect of seasonality factor. The effect of significant decline in food inflation accounted for the substantial reduction in headline inflation. Consequently, supply shocks like flood or drought, which are gradually becoming permanent features of our economy, could take inflation level to a higher trajectory.

Furthermore, the outcome of fiscal operations as at July 2012 constitute a potential upside risk to inflation. Actual capital expenditure at end-July was N293.63 billion, representing about 22 per cent implementation. With the recent pressure on the executive by the National Assembly, it is expected that a significant proportion of the outstanding balance would be spent in the remaining period of the year. Such a huge injection within a space of about three months is expected to put additional pressure on price level.

It is equally expedient that we consider the conventional savings-investment argument. The average consolidated deposit rate at 3.48 per cent in August 2012 reflects high negative real interest rate. This

could only fuel consumption with adverse implication for future investment and employment. The economy cannot perpetually depend on foreign capital for domestic investment when consideration is given to the risk of reverse flow during periods of shocks. One of the best means to sustainable capital formation for investment is domestic resource mobilization.

Finally, significant dark cloud still exists in the global economy as most developed and emerging economies have revised downward their growth projections for 2012. The priority of monetary policy at this period should include protecting the economy from uncertainty by building external reserve buffer. The prevailing tightening stance most especially the recent upward adjustment to the CRR and reduction in the NOP have considerably helped in not only managing the demand side of the foreign exchange market, it has also boosted the supply end through improvement in remittances.

In the light of foregoing, I propose that the current tightening stance of monetary policy should be maintained by holding both MPR and CRR at 12 per cent.

5.0 MOGHALU, KINGSLEY CHIEDU

Unlike the situation at the meeting of the Monetary Policy Committee in July 2012, we are faced with one today in which the decision the MPC should take appears obvious. With headline

inflation having declined to 11.7 per cent in August 2012 from 12.8 per cent in July, and food inflation having declined markedly from 12.1 per cent in July 2012 to 9.9 per cent in August, and considering the MPC's decision in July to raise the Cash Reserve Ratio to 12 per cent and reduce banks' Net Open Position to 1 per cent, there is no real impetus to increase the MPR at this time.

This is all the more so considering that the decisions of the July 2012 MPC have contributed significantly to reduced inflation rates, the full impact of those decisions may not yet have fully passed through into the economy, and staff projections of inflation for the rest of the year are trending downward. Gross Domestic Product growth rate at 6.28 per cent in Quarter 2 of 2012, is lower than the 7.61 per cent recorded in the corresponding period in 2011. In these circumstances, further raising the MPR or the CRR at this point could contribute to instability in the economy.

But there is no compelling argument to reduce rates either. Although core inflation figures were lower in August 2012 at 14.7 per cent, down from 15 per cent in July 2012, those figures remain high enough for the MPC to maintain a cautious stance at this point. There are several other arguments for maintaining the MPR, the CRR, and the NOP at their present levels. The impact of the quantitative easing policy (QE3) of the United States Federal Reserve Bank, which will herald another round of money creation and bond purchases in order to stimulate growth in the U.S economy, will lead to increased

inflows of U.S dollars into frontier markets such as Nigeria in search of higher investment yields. This development will likely be positive for the stability of the exchange rate of the naira and for Nigeria's foreign reserves, but it could create bubbles and must be monitored closely.

Foreign reserves have recently crossed the \$40 billion mark, but the need remains high to build Nigeria's buffers for the rainy day. We have not arrived at a time or situation when the MPC can logically contemplate reducing monetary rates. We are now in positive real interest territory relative to inflation, and it remains necessary to promote domestic savings and reduce the gap between low deposit and high lending rates. While I agree that reducing the overhead costs of banks is an important path to reducing this disparity, it is my view, especially given the clearly exploitative levels of charges imposed on bank customers, that more should be done by banks to review their risk-based pricing models to reduce the wide gap between deposit and lending rates. The failure to narrow this gap remains one of the challenges of monetary policy transmission and banking regulation considering the prevailing MPR of 12 per cent.

The argument for reducing monetary rates in order to improve access to credit is constrained by a number of factors. The discussion needs to be taken beyond access to credit because the evidence that access to *productive* credit would improve

significantly if rates are reduced is not compelling – if the experience we have had with the wide divergence between deposit and lending rates despite higher interest rates is anything to go by.

There are structural factors other than the MPR or CRR that would ease access to credit but are as yet not in place. These include the need to reduce the dominance of commercial banks in the nation's financial sector, with banks providing over 90 per cent of credit. Without effective competition in financial intermediation, banks have a monopolistic position and a captive market in which they inevitably weigh the creation of credit (in a system in which they can increase their profits through other means such as investing in Federal Government of Nigeria Treasury Bills) against other factors such as credit risk and returns to shareholders. All of this in an economy that has been liberalized and in which state-directed lending to preferred sectors of the economy in past years did not deliver the desired results. Other factors affecting credit creation include the absorptive capacity of the real sector in the face of weak electric power infrastructure. Fundamental structural reforms need to become evident in order to create a pull factor for increased bank lending to the real economy.

For all these reasons, including anticipated fiscal injections in Q4 of 2012, the MPC will have to maintain a tight monetary policy stance in the near to medium term. It is also important to avoid policy summersaults in the management of monetary policy, especially as

the evidence of the efficiency of the MPC's policy measures has been steadily on the increase.

Against the foregoing background, I vote to:

- (i) Maintain the MPR at 12 per cent with the prevailing corridor of plus or minus 2 per cent;
- (ii) Maintain the CRR at 12 per cent;
- (iii) Maintain the NOP limit for banks at 1 per cent of shareholders' funds.

6.0 OLOFIN, SAM

At our last meeting we took the bold step of introducing further tightening measures against market expectations, as part of our proactive measures to protect the economy against any possible major external shocks. Judging by the preliminary evaluations of the impact of these measures in our staff report, they appear to be yielding the desired results. Crucially, there has been a significant boost to the rate of accretion to foreign reserves, and headline inflation in conformity with model forecasts earlier in the year appear to be trending downwards. While it may be too early to draw major conclusions from these outcomes, there is no doubt that by biting the bullet as it were at the last meeting, we may have succeeded in sending a very strong signal of disapproving, (in the face of current

challenges), the continued channeling of excess liquidity into speculative demand at the foreign exchange market window to run down reserves and weaken the Naira. It has been reasonably established that what we need is to stabilize the markets and build up reserves. This however leaves little or no room for complacency for as long as structural constraints hamper growth in the real sector. There is also the continued challenge of achieving in the medium term, the diversification of the economy from dependence on a single major export commodity and undue reliance on imports.

Global economic recovery remains fragile, with further accentuation of the downside risks associated with slowing down of U.S. output growth from 2.5% in Q2 2011 to 1.7% in Q2 2012, and less than expected contribution from private sector inventory investments. In the Euro area, real GDP growth is estimated to slow down from 1.5% in 2011 to -0.3 in 2012. Similarly, China's real GDP growth rate is shown to have gone down from 8.1% in Q1 2012 to 7.6% in Q2, 2012, due mainly to decline in net exports. What appears to have been a positive development in the U.S. economy since we last met, that has potential beneficial effects on the domestic economy is not without its major downside risks. This is the possibility of having large portfolio capital inflows that may result from the Fed's QE3. As desirable as this might be, its downside risk of reverse flow of hot money in response to the slightest domestic or exogenous disturbances, limits the extent to which this may be seen as a positive

development. Consequently the country is still likely to be confronted with the challenges that may arise from stagnating demand for, and decline in oil prices in the medium term, the rise of about 8.8% in spot prices in August notwithstanding. There is also the likelihood of inflationary pressures resulting from imported food whose prices have been estimated to have risen by 10% in July 2012.

Going back to the domestic front there is evidence of slowing but still robust growth in output with overall GDP growth being estimated at 6.28 in Q2 2012 compared with a 3-year average (2009-2011) of 7.46%. Headline inflation has further declined to 11.70% in August 2012 compared with previous period 3-year average of 12.0%. However core inflation still remains high at 14.70 % compared with previous period 3 –year average of 10.97%. The Naira exchange rate has appreciated at the wDAS by 0.04% from N157.40:1\$ to N157.34: 1\$ U.S as at Sep.14 2012, due to policy measures adopted at the July 2012 meeting. Most remarkably external reserves have risen from US\$32.64 as at December ending 2011, to US\$42.13 as at September 12, 2012 representing an increase of approximately 30%. Even though overall GDP has grown at a decreasing rate, and flooding in parts of the country is likely to negatively impact on agricultural output, there is strong evidence that improvements in electricity supply is beginning to have positive impact on productivity and job creation prospects. Despite anticipated increase in government

expenditure in Q4 2012 staff estimates project stable inflation rate for the second half of the year.

In the light of the foregoing developments, the key risk factors and policy challenges facing the economy remain essentially what they were at the last meeting. These have to do with: (i) Euro zone crisis and global economic slowdown, which are capable of negatively impacting on net capital inflows and government revenue; (ii) likely inflationary pressures from rising global food prices and unresolved fuel subsidy issues; and (iii) continued security challenges in parts of the country. Consequently, there may be no need for any new major policy initiatives at this meeting different from what we were able to put in place at the last meeting. I would therefore vote for maintaining the status quo, while sustaining the build-up of external reserves to insure against rising global uncertainties.

7.0 OSHILAJA, JOHN

The MPC voted today to maintain the status quo following decisions reached mostly in prior meetings of the Committee over the past year. Voting was unanimous; reflecting the consensual view that the few positive turns just recently recorded, in key macroeconomic indicators, do not yet sufficiently warrant substantive changes in the policy stance. The Committee is not unmindful of the Public's ever-present and understandable desire for monetary accommodation. And we are encouraged by continuing efforts, especially at federal

levels of government, to restructure the nation's fundamentally unsustainable public spending profile. Nonetheless, as painful as they have been to achieve, the modest gains evident today (on fiscal and monetary fronts), need to be further consolidated before easing can be realistically contemplated.

Consolidation means that inflation still needs to be decisively wrestled down to single digit figures, so that savings and investment, from domestic and foreign sources respectively, can sustainably finance the rehabilitation and rebuilding of the nation's physical infrastructure. Under such conditions, or even reasonable prospects of the same, we might realistically hope to see productivity gains kicking off virtuous cycles, of secular, high-quality (i.e. job producing) growth. But infrastructure is not the only economic factor presently in need of rebuilding.

Consolidation also means the rebuilding of fiscal and monetary buffers against exogenous, economic shocks; which in Nigeria's case (for widely-understood reasons) tends to spring from local and global market developments impacting oil revenues, and foreign exchange reserves. Let's also try to remember that these buffers (wisely spent, or not) were very substantially depleted by earlier actions intended to cushion the impact, on the nation's economy,

of the Global Financial Crisis, the ensuing Great Recession, Niger Delta regional instabilities, and our own home-grown banking crisis.

To give an idea of the challenge of rebuilding monetary buffers, and the levels of effort required, consider just the attrition in foreign exchange reserves since 2007 (\$30 billion). In better global economic circumstances, this could take the CBN just a year to rebuild– given an average accumulation rate of \$2.5 billion a month. Not an unreasonable proposition given Nigeria's \$60-65 billion import bill and annual exports running at around \$90 billion. As it happens, recovering just a third of this historic net outflow has taken the CBN the better part of a year. Because – in addition to responding responsibly to factors beyond its control (e.g. capital repatriations and portfolio liquidations by foreign investors) – foreign reserves also had to be called upon to dampen higher pass-thru costs arising from the Naira's depreciation; itself the result, largely, of fiscally-induced excess liquidity intensifying local demands for hard currency. This is the liquidity that market operations of the Central Bank decisively set out to reign-in this year, and the outcomes of these actions are proving to be constructive on a number of fronts. Inflation has likely peaked below highs forecast for this rate cycle, exchange rates have regained reasonable stability, and borrowing costs are prompting public and private sector managers to evaluate and revalidate their spending and investment priorities. If the

government's transformation agenda is to become rooted in the business culture, this is the sort of constructive behavior that needs to be reinforced at every opportunity – a further rationale for the vote I also cast today.

8.0 SALAMI, ADEDOYIN

The background to this MPC meeting couldn't possibly have offered a greater contrast to the session in July. A marginal, 20bp, increase in Headline inflation to 12.9percent in June provided the backward looking context for the session in July. Concerns about the global environment and the likely implications of emerging downside risks coupled with worries about pressure on the exchange rate dominated discussion. The impact of the decision to tighten monetary policy to avoid further deterioration in cost conditions was compounded by delayed arrival of FAAC allocations. Interest rates rose far sharper than anticipated.

A sharp drop in the rate of price increases in August provided the context for this meeting. All three measures of cost condition to which we pay attention eased – Headline, Food and Core prices rose by 11.7percent, 9.9percent and 14.7percent respectively. The data from the National Bureau of Statistics (NBS) showed Headline, Food and Core Consumer Price inflation to have eased from the 12.8percent, 12.1percent and 15percent reported in July. On these

numbers, inflation, contrary to expectation of increased cost pressure, had eased and rather sharply too.

The NBS attributes the moderation in prices to be the result of aggressive monetary policy initiatives by the Central Bank of Nigeria, base effects and a much lower rise in several food prices such as yams, tubers and vegetables due to the harvest season. Placed in the context of a continuing sharp slowdown– to 3.97percent in Q22012 compared with 4.15percent in Q12012 and 5.54percent and 5.95percent for Q1 2011 and Q2 2011 -, in agricultural sector output growth, occasioned by reduced rainfall and security challenges, slower pace of food price increase ahead, or at the beginning, of the harvest season is a pleasant surprise.

Some will doubtless argue that lower than expected rise in prices combined with an almost 10percent increase in accretion to reserves and appreciation in the value of the Naira vis-à-vis the USD provide a window for easing the stance of Monetary Policy. The argument seems to be strengthened by the improving global economic environment. The announcement of a 3rd round of Quantitative Easing by the US Federal Reserve Bank and the European Central Bank's move to buy Sovereign debt ease downside risks, at least in the short term. Confirmation of slower

output growth in Q2 2012 adds to what appears a strong case for easing policy.

In voting to maintain the current policy stance, I am not persuaded that the latest inflation data establishes a trend – even though I expect food prices to ease in the rest of the year as harvests improve supply. It is also noteworthy that Month-on-Month change in inflation is higher in August for all 3 definitions. Beyond the lack of clarity as to the trend in inflation, data in respect of the fiscal operations of government, which shows that slightly over one-fifth of the capital budget has been implemented, provide a clear indication of an impending release of the funds which will raise liquidity in the final quarter. The anticipated injection of liquidity comes with Core inflation already at 14.7percent and seemingly unyielding to pressure from Monetary Policy.

The sharp spike in short term interest rates which followed the MPC decisions in July could be the beginning of an adjustment by banks to resolve the illiquidity occasioned by their holdings of government securities. In other words, banks may now be forced to offer better rates on savings and tenured deposits as they try to restore liquidity by attracting deposits. This will also have effect of closing the yawning gap between lending and deposit rates. It is noteworthy that almost 48% of bank loans are at rates no higher than 15%. Of

these, slightly over a quarter of all borrowing is contracted at rates less than 10%.

Notwithstanding the improvement in reserves, the structural fragility of the economy suggests that easing of the Policy rate will invite pressure on the Naira and possibly reverse the direction of capital flows. The case for easing the Monetary Policy Rate to provide stimulus for growth through lower cost of borrowing also remains incomplete in the absence of reform which eases the structural bottlenecks which cannot be affected by reducing the cost of credit.

Finally, changing policy at this point, especially given the foregoing may simply serve to increase volatility as economic agents react to the new position.

I thus vote to maintain the status quo.

9.0 UCHE, CHIBUIKE

In July 2012, as a consequence of inflationary concerns, MPC by majority decision further tightened money supply by increasing CRR to 12 percent. Although inflationary pressures have moderated since then, it is important to stress that in a mono-product rentier economy like ours, an equally important reason for the above development

has been the high oil prices. While the reduction in inflation is a welcome development, it is also right to state that thus far this development has also had negative consequences on the development of the real sector. The tightening of money supply has for instance led to increased borrowing costs for businesses. This has consequences for both the bad debt portfolio of banks and the risks associated with the increasingly popular market for government securities. Bluntly put, the current monetary policy stance aids the diversion of savings that should be more productive in the real sector to the government. Adopting market prices for securities without doing same for savings distort development by discouraging bank savings and encouraging the inflow of speculative FDI. Equally troubling is the fact that it is now public knowledge that rising interest rates have ensured that any attempt to mark government bonds to market prices even at the present time would cause serious problems for financial system stability.

The above unfortunate scenario is however the consequence of the rentier structure of the Nigerian state which inherently encourages fiscal indiscipline on the part of government. Until this structural problem is addressed, inflationary pressures will continue to be a real threat to the growth of the real sector. Unfortunately, trying to control inflation in such an economy also distorts the credit market for real sector players.

Despite the above complex and difficult circumstances, I am of the view that there is still some room for regulatory maneuver in order to ameliorate the credit environment for the real sector. One obvious problem that should be addressed is the increasing margin between the deposit rates and lending rates offered by Nigerian banks. As I stated in my last MPC decision statement, it is troubling that rising interest rates have only led to increased margins between deposit and lending rates. This is no doubt the classic scenario in an oligopolistic market where collusion thrives. A margin of almost 20 percent between savings and borrowing rates is clearly not supportive to financial system savings and the general health of the financial sector. It also adversely impacts on the health of the real sector. Clearly, this is unacceptable in any economy. We therefore need to consider putting in place some kind of controls on the intermediation margins of Nigerian banks. The two possible outcomes from the above policy choice: reduction in lending rates or increase in savings rates would be of great benefit to our economy.

In the light of the above analysis and in the interest of avoiding regular policy summersaults, I am willing on this occasion to vote for the maintenance of the status quo. I therefore vote as follows: (1) to retain MPR at 12 percent with interest rate corridor of +/- 200 basis points; (2) to retain CRR at 12 percent; and (3) to retain Liquidity Ratio at 30 percent.

If current oil prices continue to be favourable, I am hopeful that by the next MPC meeting, the conditions would be right for a gradual reduction in MPR. This will no doubt help promote real sector development which incidentally is a necessary condition for Nigeria to break out of its current vicious cycle of overdependence on oil rents and the attendant consequences.

10.0 SANUSI, LAMIDO SANUSI

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

A key feature of the decision making of the MPC in the last 2 to 3 years remains our ability to anticipate developments and courage to act in advance of crystallization of anticipated risks. The last MPC meeting was held in a global environment characterized by slow growth (and even recession in some cases) in the United States, Europe, and major Emerging Market economies like China, India and Brazil.

The currency markets were in turmoil and the Naira was under pressure leading to a breach of our target band and posing a risk to reserves. The economy at this time needs to build up reserve buffers in order to withstand the spillover effects of the slowdown in commodity prices and portfolio flows.

The MPC therefore decided to act and send a clear signal of its commitment to price and exchange rate stability and the protection of this stability partly through minimizing attrition of foreign reserves. We expressed concern at the slow pace of structural reforms, particularly in the power sector, as well as fiscal leakages including illegal bunkering of crude oil in the Niger Delta and suspicious subsidy payments to oil marketers which were constituting a drain on reserves. The decision to increase CRR to 12% was a first step towards moving to structurally tight monetary condition conducive to long-term price stability. This was complemented by administrative changes aimed at reducing foreign exchange balances held for speculative purposes (reduction in the Open Position Limit and the holding period of purchased funds), as well as bringing to an end the tendency to finance interbank placements and foreign exchange bids from funds borrowed at the CBN window. We effectively reversed the remaining measures introduced during the banking crisis as part of our accommodative stance of 2008 – 2010.

Although the global environment, in my view, has not significantly improved, it is a fact that it has also not significantly deteriorated. Furthermore, Central Banks on both sides of the Atlantic have taken a decisively more accommodative stance. The United States Federal Reserve has moved beyond “Operation Twist” on to QE3.

Chairman Bernanke clearly believes that QE has contributed significantly to United States growth and employment, although the transmission channel does not seem to have been clearly identified. It is also an open question if the “bounce” in stock and real estate is really an indicator of sustainable GDP growth or a short-term palliative that marks the beginning of a new boom-bust cycle. In Europe, Governor Draghi has announced a new package for increasing ECB purchases of Sovereign Bonds of distressed countries to moderate yields, subject to firm commitment to a fiscal compact.

The actions of the Fed and ECB have brought to fore once more the debate on the limits of monetary policy and if central bankers in Europe and United States are not providing short-term relief instead of allowing Governments to implement the difficult fiscal and structural policies required for sustainable growth and employment. Irrespective of the merits of the arguments on both sides, it is evident that these policies will lead to increased capital flows to frontier and emerging markets. In the short-term, there is good news for the exchange rate and borrowing costs, as well as inflation, but it comes with the risk of volatility, and the flows must thus be strictly monitored.

My reading is that we achieved all the limited objectives we set for ourselves at the last meeting. The exchange rate has stabilized

(even strengthened), the reserve position has improved and inflation came down first to 12.8% in July and then 11.7% in August.

While welcoming the decline in inflation rate it is important to note the following:

1. Core inflation remains stubbornly high at 14.7%.
2. Decline in inflation in food and non-alcoholic beverages accounted for 51.8% of the decline in headline inflation in August.
3. Food inflation declined very steeply from 12.09% in July to 9.91% in August. This may have been due to a combination of a base effect, budget-line import of new tariffs and subsidy-removal, and tight monetary conditions.
4. Imported food inflation declined by 231 basis points from 18.01% in July to 15.7% in August. This is counter-intuitive given global trends and increased tariffs, especially as sharp declines in the index for rice and wheat (where new tariffs kicked-in in July) contributed to the result.

After reviewing the unchanged global environment, the balanced risks posted by QE3 and monetary easing by the ECB, the tentative recovery of the capital market and the mixed signals contained in the inflation numbers my vote is to hold our current position and

watch developments in output, prices and the global economy as we approach year end.

I therefore vote for retaining:

1. MPR at 12% +/- 2%
2. CRR at 12% and
3. NOP at 1%