Central Bank of Nigeria Communiqué No. 73 of the Monetary Policy Committee Meeting, November 22-23, 2010

The Monetary Policy Committee (MPC) met on 22nd and 23rd November, 2010 to review domestic and international economic and financial conditions in order to reassess the options for monetary policy for the rest of the year and beyond.

On the global scene, the Committee noted with concern the continued slowdown in global economic recovery, especially in the US against the backdrop of the huge US trade deficit, requiring both domestic and external rebalancing of demand.

On the domestic front, the MPC noted the high economic growth rate and the progress made towards restoring stability in the banking sector. It, however, observed with concern the continued high inflation rate and reiterated the urgent need for fiscal consolidation and the continuation of comprehensive economic and structural reforms to remove supply-side bottlenecks.

Key Domestic Macroeconomic and Financial Developments

Output and Prices:

The Committee observed the sustained impressive output growth recorded thus far in 2010. Provisional data from the National Bureau of Statistics (NBS) indicates that real Gross Domestic Product (GDP) is estimated to grow by 8.29 per cent in the fourth quarter of 2010, up from 7.86 per cent recorded in the third quarter. Overall GDP growth for 2010 is projected at 7.85 per cent compared with 6.96 per cent recorded in 2009. The non-oil sector remained the main driver of overall growth.

The Committee, however, cautioned that the recent slowdown in economic activity in some major advanced economies could have adverse effects on commodity-producing economies like Nigeria, notwithstanding the expected high crude oil prices in the international markets. While urging greater efforts at diversifying the economy, the Committee stressed the need for policy reforms to address the binding growth constraints on the domestic economy, especially, infrastructural inadequacy. The Committee noted with satisfaction the progress made thus far on the power sector front, but stressed the need for renewed focus on the petroleum and agricultural policy sectors. The continued dependence of the country on imported food and energy, which is totally avoidable, is one of the main sources of erosion of our foreign reserves.

The year-on-year headline inflation (rebased) stood at 13.4 per cent in October 2010 relative to 13.6 per cent in September 2010. Food inflation was 14.1 per cent in October, down from 14.6 per cent in September. However, core inflation rose to 13.2 per cent in October from 12.8 per cent in September. The persistence of high inflation remains a major challenge, when viewed against the relatively good harvests, improved supply of petroleum products and weak expansion of credit to the private sector. This reality further underscored the need for addressing supply-side constraints in the medium to long term, and the urgent need to restrain debt-financed government spending in the short term.

The MPC reiterated its earlier position on the threat of inflationary pressure arising from high inflation expectations, calling for stronger fiscal prudence to support the monetary policy stance. This is particularly critical for improving the dynamics of policy coordination. Nevertheless, the Committee would continue to monitor price developments with a view to taking appropriate policy measures to stem any inflation threat and ensure that the upside risk to growth is minimized.

Monetary, Credit and Financial Market Developments:

Provisional data showed that relative to end-December 2009, broad money (M2) grew by 4.25 per cent in October 2010, which, when annualized represented a growth of 5.10 per cent. Reserve money (RM), which stood at N1,653.86 billion at end-December 2009, fluctuated downward and by November 15, 2010, stood at N1,4449.95 billion.

Available data showed that in October 2010, aggregate domestic credit (net) grew by 19.69 per cent over the December 2009 level, and by 23.63 per cent when annualized. Credit to government (net), which grew substantially by 53.35 per cent over end-December 2009 (or 64.02 per cent on annualized basis), was the major source of expansion in aggregate credit. Credit to the private sector, grew marginally by 3.22 per cent (or 3.86 per cent on an annualized basis). In general, the growth in monetary and credit aggregates remained below the long term trends.

The interest rates at the interbank segment of the money market responded to the increase in the Monetary Policy Rate (MPR) effected at the last meeting of the MPC in September in line with policy expectation. Consequently, in October

2010, the average inter-bank call and open-buy-back (OBB) rates rose significantly to 8.45 and 7.53 per cent, respectively, representing increases of 526 and 461 basis points from the 3.19 and 2.92 per cent recorded in the preceding month.

Developments in market interest rates indicated that the retail lending rates were still relatively high. The average maximum lending rate moderated slightly to 21.85 per cent in October from 22.20 per cent in September while the average prime lending rate stabilized at 16.66 per cent.

The weighted average savings deposit rate remained relatively stable while the consolidated deposit rates increased to 2.31 per cent in October from 2.07 per cent in September. Thus, the spread between the maximum lending rate and the consolidated deposit rate narrowed marginally to 19.54 per cent in October from 20.14 per cent in September.

The domestic capital market continued to show some signs of recovery. The All-Share Index (ASI) increased from 23,050.59 at end-September to 25,301.34 as at 15th November, 2010, or by 9.8 per cent. Market capitalization (MC) - equities only, increased by 43.1 per cent from N5.65 trillion to N8.08 trillion over the same period. The number of deals increased by 21.6 per cent, while the volume and value of shares traded decreased by 38.5 and 62.7 per cent, respectively. The increase in ASI and MC was principally due to the share price increases in the Banking, Food & Beverage, insurance and Oil/Gas sectors, and new and supplementary listings of shares on the exchange. The Committee believes that the effective take-off of the Asset Management Corporation (AMCON) and progress made on resolution of the banking system crisis have been major contributions to this improvement in sentiment.

External Sector Developments:

The foreign exchange market remained relatively stable. The total foreign exchange inflow in October was US$2.38 billion, representing a decrease of US$0.32 billion or 11.85 per cent below the US$2.70 billion recorded in the preceding month. Total outflows or payments in October amounted to US$3.46 billion, a decrease of US$1.62 billion or 31.89 per cent compared with US$5.08 billion recorded in the preceding month. Consequently, the net outflow during this period was US$1.09 billion.

Inflows from autonomous sources in October were US$10.43 billion compared with US$7.55 billion in September. Cumulatively from January-October 2010, total foreign exchange inflows to the market amounted to US$ 88.32 billion comprising funds from the CBN (US$21.15 billion) and from autonomous sources such as oil companies, international institutions and home remittances (US$67.17 billion). The Committee noted with satisfaction the complementary role of autonomous inflows in moderating demand pressure in the foreign exchange market.

In October, the WDAS average closing rate was N151.25/US$ compared with N151.07/US$ recorded in September, representing a depreciation of 18 Kobo (0.12 per cent). On November 15, 2010, the WDAS exchange rate was N150.29/US$ compared with N151.25/US$ for October, representing an appreciation of 96 kobo (0.64 per cent)

At the interbank segment, the average buying and selling rates for October, were N151.68/US$ and N151.78/US$, compared with N152.51/US$ and N152.61/US$ respectively recorded in September, representing an appreciation of 83 kobo (or 0.54 percent). On November 15, 2010 the corresponding rates were N150.65/US$ and N150.75/US$ as against N151.68/US$ and N151.78/US$, in October, registering an appreciation of 103 kobo (or 0.68 per cent)

At the BDC segment, the average buying and selling rates in October were N151.98/US$ and N153.98/US$ respectively, compared with N152.30/US$ and N153.80/US$ in September. The buying rate represented an appreciation of 32 kobo (0.21per cent) while selling rate represented a depreciation of 18 kobo (or 0.12 percent). The buying and selling rates on November 15 were N151.50/ US $ and N153.50/ US$ compared with N151.98/US$ and N153.98/US$ for October, represented an appreciation of 48 kobo (or 0.31 per cent). Thus, the stability of the naira exchange rate since the first half of 2009 continued into 2010. The MPC believes that the relative stability in the foreign exchange market is likely to be sustained in the near term. The Committee would continue to monitor developments in the market to ensure that measures are taken to eliminate speculative demand and exchange rate volatility.

The gross external reserves stood at US$34.27 billion on 15th November, 2010 compared with US$33.597 billion as at end-October and US$34.59 billion as at end-September.
The committee noted the elevated demand for foreign exchange at the WDAS which led to an increase in reserve utilization to defend the currency. It also noted recent moderation of demand pressure following Central Bank's interventions to curtail speculative demand. It, however, stressed that the solution to reserve accretion have to be in implementation of appropriate reforms to industrial and trade policy aimed at reducing import-dependence, and these are beyond the scope of monetary policy.

The Committee's Considerations

The key concerns noted by the Committee were:

1. The elevated inflation levels;
2. Rising government expenditure and borrowings with the possible crowding out effects on the private sector; and
3. Demand pressure in the foreign exchange market, leading to reduction in external reserves.

The view of the Committee is that the solution requires both fiscal and monetary measures, and reiterated the need to eliminate unnecessary subsidies that add to government expenditure and debt. There is need also for continuing reforms in the economy particularly in the energy and agricultural sectors to curb high import bills through appropriate fiscal policies. The Committee remains conscious of its core mandate and reaffirms its commitment to price stability to engender sustainable economic growth.

The MPC remained committed to exchange rate stability in order to attract foreign direct investment and anchor expectations. The MPC emphasized greater communications with stakeholders to remove speculative demand in the foreign exchange market. It also held that, in view of the low price elasticity of demand for imported necessities, depreciation of the currency would not in itself address the structural problem of import-dependence.
The Committee continued to urge greater fiscal responsibility and commitment to reforms that will enhance the effectiveness of monetary policy.

Overall, members agreed that there is need for tightening, but the discussions centered on the form and the timing of the tightening. After due consideration of the pros and cons of various policy options, the Committee agreed on a majority decision of 6 to 4 members to retain the current policy rate, given the need to retain flexibility and allow the effect of the previous rate increase to work through the system, against the argument for immediate increase in view of the elevated inflation risk. Also, the Committee agreed by a majority of 9 to 1 members to narrow the corridor around the MPR by reintroducing the symmetry of +/- 200 basis points.

Decisions

The MPC's decisions were therefore:

1. To Retain the Monetary policy Rate (MPR) at 6.25 per cent.

2. To adjust the corridor to +/- 200 basis points, implying Standing Lending Facility (SLF) rate of 8.25 per cent, and Standing Deposit Facility (SDF) rate of 4.25 per cent.

3. Maintain the policy stance of a stable exchange rate.

4. Continue to monitor inflationary trends with a view to taking appropriate steps as and when necessary.

5. On the stance of monetary policy in the year ahead, the Committee reaffirmed that monetary policy would seek to exert pressure on aggregate demand, thereby helping to lower inflation expectations.

   In addition, monetary policy would stand ready to provide adequate and timely liquidity to support credit dynamics that would sustain fiscal mechanisms to bolster growth.

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November 23, 2010