

**Central Bank of Nigeria Communiqué No. 71 of the Monetary Policy Committee
Meeting, July 5, 2010**

The Monetary Policy Committee (MPC) met on 5th July, 2010 to review domestic economic conditions during the first half of 2010 and the challenges facing the Nigerian economy against the backdrop of developments in the international economic and financial environments in order to reassess the options for monetary policy for the remainder of the year.

On the global scene, the Committee noted that market anxiety over the fiscal positions of several Euro Area countries was posing new challenges for the world economy even as global economic recovery remained fragile. In order to address the weak fiscal position, governments in these countries have started unwinding the fiscal stimuli by cutting government spending. Such cuts in public spending may have serious implications for growth and employment and may lead to a double dip recession with possible contagion effects on the global economy. If this were to happen, there may be an impact on global commodity prices, including prices of oil, with knock-on effects on the government's fiscal position and the foreign sector. However, recovery remained robust in most developing and developed countries, with the exception of high-income European countries where it stagnated. In this regard, the Committee commended the recent commitment of the G-20 Summit in Toronto, Canada, which agreed to safeguard and strengthen the recovery process to lay the foundation for strong, sustainable and balanced growth, as well as strengthen the financial systems against risks. The G-20 leaders of the world's major industrialized and emerging market economies welcomed measures so far taken to sustain global recovery and strengthen the financial systems, while agreeing to work together to curb public deficits, enhance economic growth and job creation as well as global prosperity. The Committee believes that the decision of the G-20 Summit would refocus and galvanize global strategies towards the recovery process.

On the domestic scene, the MPC observed that financial markets, though still fragile, have recovered faster than expected, urging greater efforts in accelerating reforms in the other sectors of the economy. This is critical for economic growth.

The MPC also noted the sustained rebound in commodity prices which is helping to support growth in commodity producing regions, including Nigeria. However, it underscored the need to diversify the economy to protect the country from the vagaries of oil price volatility. The Committee believes that the inflation risk of the rebound in energy prices appears mitigated by the continuing low levels of capacity utilization, weak private demand, good harvest, and well-anchored inflation expectations. In addition, as mentioned above, the European fiscal crisis and the recent slowdown in manufacturing output in China and other Asian countries may moderate the robustness of the markets.

Key Domestic Macroeconomic and Financial Developments

Output and Prices:

The Committee observed that the impressive output growth recorded in 2009 continued in 2010. Provisional data from the National Bureau of Statistics (NBS) indicates that real Gross Domestic Product (GDP) grew by 7.23 per cent in the first quarter of 2010 up from 4.50 per cent recorded in the first quarter of 2009. GDP was projected to grow by 7.68, 7.76 and 8.13 per cent in the second, third and fourth quarters of 2010, respectively. Overall GDP growth for 2010 is projected at 7.74 per cent which is higher than the revised figure of 6.66 per cent recorded in 2009. The non-oil sector is expected to remain the main driver of overall growth, with agriculture, wholesale and retail trade, and services contributing 2.49, 2.03 and 2.11 per cent, respectively.

The Committee believes that the impressive growth forecasts reflected prospects for moderate rainfall in 2010, which is expected to support the production of major crops across the country, coupled with the current peace in the Niger-Delta, which has led to an increase in crude oil and natural gas production. It, however, cautioned that there is a thick cloud hanging over commodity producing countries because of the current crisis facing the Euro Area and emerging slowdown in manufacturing in major Asian countries

and the US as indicated above. In addition, the Committee highlighted the binding constraints on the domestic economy namely; infrastructure inadequacy, lack of access to finance, lack of requisite skills, unfavourable trade policy and a poor investment climate all of which have the potential to constrain economic growth. The MPC, therefore, stressed the need for government to pursue macroeconomic, structural and institutional reforms that appear to have slowed down in the past few years.

The year-on-year headline inflation declined to 11.0 per cent in May 2010 from 12.5 per cent in April and 11.8 per cent in March. Similarly, core inflation fell to 8.8 per cent in May 2010 from 9.8 per cent in April and 9.5 per cent in March. The downward trend in the domestic price level could be attributed to a number of factors, including the continuing underperformance of monetary aggregates, with the associated constrained demand, adequate food supply, stable exchange rates and improvement in the availability of petroleum products, amongst others. Notwithstanding these developments, the MPC reiterated its earlier position on the threat of inflationary pressure arising from several factors including the announcement effect of salary increase in the civil service and the rising food prices against the backdrop of the famine in neighboring Niger Republic. The Committee restated its commitment to continue to monitor price developments with a view to taking appropriate measures to stem any inflationary threat and ensure that the downside risk of inflation to growth is minimized.

Monetary, Credit and Financial Market Developments:

Provisional data showed that relative to end-December 2009, broad money (M2) declined by 0.2 per cent in May 2010, which, when annualized represented a contraction of 0.48 per cent, compared with the indicative growth target of 29.26 per cent for 2010. Reserve money (RM), which stood at ₦1,668.50 billion at end-December 2009, declined to ₦1,516.55 billion at end-April and ₦1,534.79 billion at end-May 2010. As at June 23, 2010, the RM level of ₦1,618.02 billion was below the provisional 2010 second quarter indicative benchmark of ₦1,872.80 billion by 13.6 per cent.

Available data showed that in May 2010, aggregate domestic credit (net) grew by 12.38 per cent over the December 2009 level, and by 29.72 per cent when annualized, which was still below the 2010 indicative target of 55.54 per cent. Credit to government (net), which grew substantially by 50.87 per cent over end-December 2009 (or 122.1 per cent on annualized basis), was the major contributor. Credit to the private sector declined by 1.88 per cent

(or 4.51 per cent on annualized basis), in contrast to the growth benchmark of 31.54 per cent for 2010. The substantial growth of credit to government (net) against the backdrop of declining private sector credit reflected the risk aversion of the DMBs to lending to non-government borrowers. The Committee believes that in order to provide the private sector with the necessary credit to grow the economy, further efforts are needed to unlock the credit market in order to enhance the flow of credit to the real economy.

The rates at the inter-bank segments of the money market were much higher than what obtained in the preceding period owing to the short-lived tight liquidity conditions in May 2010. Consequently, in May 2010, the average inter-bank call and Open-Buy-Back (OBB) rates rose significantly to 5.97 and 4.92 per cent, respectively, representing increases of 470 and 381 basis points above the 1.27 and 1.11 per cent recorded in the preceding month. In line with the increase in rates at the inter-bank call and OBB segments, the 7- and 30- day NIBOR rates increased by 397 and 311 basis points to 6.43 and 8.24 per cent, respectively, from 2.46 and 5.13 per cent in April. However, with the release of statutory revenue in the last week of May, the banking system became liquid. As a result, the average inter-bank call and OBB rates declined from 7.71 and 7.07 per cent, respectively on May 25, 2010 to 1.17 and 1.10 per cent on June 1, 2010. Thereafter, rates remained stable and low, hovering around an average of 1.20 per cent.

Developments in interest rates structure indicated that the retail lending rates were still relatively high even though they were declining. The average maximum lending rate dropped to 22.56 per cent in May 2010, from 23.45 percent in December, 2009. Also, the average prime lending rate dropped to 18.77 per cent in May 2010, from 19.03 per cent in December 2009.

Similarly, the weighted average savings rate dropped marginally to 2.92 per cent in May 2010 from 3.36 per cent in December 2009. The consolidated deposit rates declined to 3.30 per cent in May 2010 from 6.13 per cent in December 2009. Thus, the spread between the average maximum lending rate and the consolidated deposit rate widened to 19.27 per cent in May 2010 from 17.34 per cent in December, 2009. The Committee noted that the key policy challenges remained the negative growth in money supply and private sector credit as well as the subsisting high lending rates in the face of declining inter-bank rates.

The Nigerian capital market is still showing some signs of recovery. The All-Share Index (ASI) increased from 20,827.17 at end-December 2009 to 25,554.35 as at 23rd June, 2010, or by 20.70 per cent. Market capitalization (MC)—equities only, increased by 24.9 per cent from ₦4.98 trillion to ₦6.28 trillion over the same period. The number of deals, volume and value of shares traded increased by 16.34, 19.23 and 100.00 per cent, respectively. The increase in ASI and MC was principally due to share price increases in the Banking, Food & Beverage and Oil/Gas sectors. The Committee welcomed the continuing improvement in the stock market, and noted the potentials for further recovery given the passage of the harmonized Asset Management Corporation (AMCON) Bill by both chambers of the National Assembly.

External Sector Developments:

The foreign exchange market remained relatively stable in the first half the year. During the period- January 01 - June 16, 2010, total sales at 45 bi-weekly WDAS auctions amounted to US\$11,155.10 million, equivalent to an average of US\$247.89 million per auction. In the corresponding period of 2009, the sum of US\$12,995.48 million was sold at 70 daily and bi-weekly RDAS auctions, equivalent to an average of US\$185.65 million per auction.

In May 2010, the average foreign exchange demand of US\$459.26 million per auction was recorded against the average sales of US\$394.45 million, representing sales as a

percentage of demand of 85.89. As at June 23, 2010 average demand for the month dropped to US\$315.73 million and, correspondingly, the average sales also declined, to US\$297.69 million, representing sales as a percentage of demand of 94.29

In June 2010, the WDAS rate opened at ₦150.27/US\$1 (inclusive of 1% commission) and closed at ₦150.09/US\$1, at an average exchange rate of ₦150.24/US\$1 for the month. This represented an appreciation of 6 kobo (0.04 per cent) compared with the average closing rate of ₦150.30/US\$1 recorded in May 2010. The BDC segment of the market recorded average selling rates of ₦153.26/US\$1 and ₦153.86/US\$1 in the months of May and June 2010 respectively, representing a depreciation of 0.4 per cent.

At the inter-bank market, the average selling rates for May and June 2010 were ₦151.48/US\$ and ₦151.35 respectively, representing a 0.09 per cent appreciation. The WDAS and interbank segments of the foreign exchange market witnessed mild naira exchange rate appreciation while the BDC segment experienced mild depreciation. Thus, the stability of the naira exchange rate attained in the foreign exchange market since the first half of 2009 continued in the first half of 2010. The Committee observed that the naira exchange rate has remained stable in all segments of the market during the review period, reflecting increased confidence in the Naira and the efficacy of the current exchange rate policy stance. It believes that the relative stability in the foreign exchange market is likely to be sustained in the near term. The Committee will, however, continue to monitor developments in the market to ensure that measures are taken to eliminate speculative demand and volatility in the market.

The Gross external reserves stood at US\$37.63 billion on 23rd June, 2010 representing a decrease of US\$1.19 billion or 3.06 per cent when compared with the level of US\$38.82 billion as at 31st May 2010. The Committee, however, noted that the current external reserves level is still adequate as it would finance 16 months of import, compared to the internationally recommended benchmark of 3 months of import cover for a country's external reserves.

The Committee's Considerations

Against the backdrop of the foregoing, the MPC noted with satisfaction the continued macroeconomic stability. It, however, stressed the need to grow the real sector on a sustainable basis. It also reiterated the possible inflation risks highlighted at the last MPC meeting, in the light of the anticipated budget deficit and the operationalisation of the proposed Asset Management Corporation. However, monetary aggregates are still under-performing and the Asset Management Corporation is yet to take-off. On balance, therefore, the inflation threat remained subdued in the short to medium term. In addition, some of the approved quantitative easing measures are yet to be completely implemented. The Committee, therefore, considered it appropriate to continue to monitor developments with a view to intervening as the need arises.

Decisions

In the light of the above, the Committee decided that :

1. No changes are made to the current policy stance viz: the MPR should remain unchanged at 6.0 per cent; and
2. The asymmetric corridor of 200 basis points above and 500 basis points below the MPR, respectively, are to be retained.

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