CENTRAL BANK OF NIGERIA'S COMMUNIQUE No 56 OF THE MONETARY POLICY COMMITTEE, JUNE 2, 2008

The Monetary Policy Committee (MPC) met today, June 2, 2008. The Committee reviewed the international economic and financial developments alongside the domestic macroeconomic conditions in the first five months of 2008 as well as the outlook for the near term. It also considered the implications of the current macroeconomic situation in Nigeria and the uncertainties in the global economy, especially the rising global prices.

The MPC noted that the domestic macroeconomic environment has been so far relatively stable. However, the path ahead is strewn with many uncertainties, among which the major ones are the upward oil and food price movements, the fiscal expansion, and the international financial market conditions. These uncertainties posed severe challenges to the Committee in its deliberations on the formulation of optimal monetary policy.

At the outset, the Committee observed that the current rate of inflation is a matter of serious concern since inflation affects adversely the economic well being of the country. It however expressed satisfaction over the stability of the foreign exchange market and the accretion to foreign exchange reserves. It restated its commitment to fostering monetary and price stability in order to support continued economic growth.

Key Macroeconomic Developments

Inflation: The Committee noted that at 8.2 per cent, inflationary pressures as measured by the movements in the year-on-year (y-o-y) Consumer Price Index, intensified in April 2008 from a lower 7.8 per cent in March 2008 and 6.6 per cent in December 2007. The elevated inflation rate could be attributed mainly to the increase of 13.1 per cent in food prices which have a large weight of 63.76 per cent in the overall index. The downside risks to inflation would arise if demand pressure is exerted by large fiscal injections and private expenditures beyond what the supply can accommodate.

Growth: The growth in real gross domestic product (GDP) is projected at 6.4 per cent for the first quarter, and 6.6 per cent for the second quarter of 2008, driven principally by the growth in non-oil GDP.

Money and Credit: Provisional data indicate that M2 grew by 34.8 per cent in the first three months of 2008. On a year-on-year basis, M2 has gone up by 62.2 per cent by end March 2008. The growth in M2 was driven by increases in net foreign assets of the banking system as well as credit to the private sector. The Committee envisions that liquidity surge would continue to be intense in the months ahead, requiring the need to take appropriate actions to align the demand for and supply of reserves.

The Committee noted that credit to the private sector maintained an upward trend during the first quarter of 2008. Credit to the private sector grew substantially by 96 per cent in fiscal 2007 and by 12.4 per cent in the first three months of 2008 which on a year-on-year basis would amount to 96.5 per cent. The Federal Government, however, has continued to be a net creditor to the banking system. In the view of the Committee, the prospects of accelerated economic growth would further improve the demand for credit even as the abilities of the regulators as well as the banks to ensure that the quality of lending is secured by appropriate risk management mechanisms are tested.

Exchange Rate: The MPC noted that the external value of the Naira is currently at N 117.83 per US $1. The exchange rate has been relatively stable in the first five months of 2008. Net sales of foreign exchange by the CBN through auctions, to banks and their BDCs amounted to US $ 5248 million since the last MPC meeting on April 01, 2008. The staff's assessment is that there would be continued stability in the foreign exchange market in the months ahead.

External Reserves: The Committee noted with satisfaction that the gross official reserves amounted to US $.59.16.billion as at May 28, 2008. It would support 27 months of current foreign exchange disbursements. The accretion to reserves is expected to be sustained during the remainder of the year.

Interest Rates: The MPC observed that the inter-bank call rates rose in April in response to policy and market conditions. The rates continued to be relatively stable in May at the elevated level of April. The spread between the average term deposit and the maximum lending rates narrowed by 0.08 percentage point to 7.44 per cent at the end of April 2008 from 7.52 per cent in March. With the inflation rate at 8.2 per cent in April 2008, all the interest rates excepting the saving deposit rate were positive in real terms.

Fiscal Stance: The Committee noted that the federal government budget as approved, and the distribution of part of excess crude oil proceeds, would lead to high liquidity injection in the next two quarters of the year. It also noted that the actual and potential impact on liquidity of recent fiscal disbursements from the excess crude oil account and other disbursements scheduled for June 2008 would be considerable.

The Outlook and Policy Considerations

The MPC observed that monetary policy has to be forward looking. The policy therefore has to ensure that concerns about price stability and real activity levels are recognized and actions taken to address them. In view of the sharp growth of credit to the private sector by 96 per cent and of M2 by 62 per cent on a year-on-year basis by March 2008, and as fiscal expansion is all time high, threats of resurgence of inflation are very high. In addition, there is the threat of imported inflation owing to global rise in prices.

Decisions

In the light of the foregoing, the Committee decided to:

1. continue and even strengthen the use of instruments such as open market operations (OMO) and special sale of foreign exchange;
2. signal the tightening of the stance of monetary policy by:
    a) raising the MPR by 25 basis points from 10.0 per cent to 10.25 per cent, and
    b) increasing the CRR by 100 basis points from 3.0 per cent to 4.0 per cent with effect from June 09, 2008; and
3. set up a technical committee to work out other intervention securities that the CBN would issue to further strengthen the effectiveness of liquidity management.

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