Central Bank of Nigeria Communiqué No. 65 of the Monetary Policy Committee Meeting, September 01, 2009

The Monetary Policy Committee (MPC) met today to address the challenges faced by the Nigerian economy against the backdrop of recent domestic and international economic and financial developments.

External Environment

The Committee noted at the outset that recessionary conditions in many developed economies seem to be abating. However, there still exists considerable uncertainty as to when economic recovery would set in on a sustained basis. In recent weeks, there has been some improvement in the price of crude oil in international markets. While this development augurs well for Nigeria's fiscal and external sector positions, its sustainability would, however, depend on how quickly the global economy would bottom out of the current recession. Inflation rates have so far been very low in developed countries, making it possible for central banks to maintain record low levels of interest rates. However, unemployment rates continue to be high and the financial system is still not adequately capitalized. Other emerging countries too have recorded economic slowdown and relatively low inflation. They are, however, recovering at an improved rate and their financial and foreign exchange markets have been functioning well.

Key Domestic Developments

Output

The latest estimates of the National Bureau of Statistics (NBS) for 2008 and 2009 show a moderation in the rates of real GDP growth. The revised growth rate for 2008 is put at 5.99 per cent as against an earlier estimate of 6.41 per cent. For 2009, the NBS has projected growth at 5.33 per cent compared with an earlier projection of 5.75 per cent. In the first quarter of 2009, growth was in the order of 4.50 per cent compared with 4.64 per cent in the first quarter of 2008. In the second quarter of 2009, however, output growth is estimated at a higher level of 6.73 per cent compared with 5.65 per cent in the second quarter of 2008. This was largely due to the contributions of agriculture, wholesale and retail trade and a growth in the relative contribution of crude petroleum and natural gas production from -1.72 to 0.57 percentage point. Against this background, the Committee noted the increased agricultural output and the expected improvement in the output of crude petroleum and natural gas will augur well for dampening inflation expectations.

Inflation

The Committee noted that the headline (year-on-year) inflation has been stable at a little over 11 per cent as at July 2009. The average rates of headline inflation and food inflation in the first seven months of 2009 were respectively 13.11 per cent (11.53 per cent in 2008) and 15.94 per cent (15.98 per cent in 2008). Given the outlook on output and limited aggregate demand, the staff assessment is that at the end of the year, the headline inflation would moderate further. However, should there be any reversal in the movement of inflation, appropriate policies would be adopted at the next MPC meeting. The main risk to inflation comes from core inflation with higher oil prices and possible removal of subsidies combining with the usual growth of spending around the Christmas festive season.

Monetary Developments

Provisional data for broad money (M2) for July 2009 showed a growth of 10.2 per cent on a year-on-year basis, the lowest for any month since February 2006. This largely reflected the decline in net foreign assets (NFA) and sharp deceleration in the growth of credit to private sector. The Committee noted that recent improvements in oil output and prices would help to improve the gross foreign exchange reserves of the economy. However, it underscored the importance of continuing with the efforts at improving the macroeconomic climate for attracting foreign capital inflows and spurring growth of private credit for productive purposes.

Interest Rates and Financial Markets

With the reduction of the Monetary Policy Rate and the introduction of the interest rate corridor as well as Central Bank's guarantees of unsecured inter-bank market transactions which were firmly set, effective July 20, there has been considerable improvement in the risk perceptions of market participants. The spread between the unsecured call rate and the secured open buy-back (OBB) rate has since then come down significantly and averaged 430 basis points compared with the average spread of 1384 basis points between July 1 and July 17 and the average spread of 1115 basis points in June 2009. The coupon rates on dated government securities in the primary market have tended to move downwards.

The overnight inter bank rate was 4.11 per cent as at 28th August, 2009. In general, this implied a massive reduction in the interbank rates since the last MPC meeting. However, the translation of this reduction into rates on purchased funds and lending rates seems to be delayed. Both rates are being monitored on an on-going basis.

Exchange Rates and Foreign Exchange Reserves

The foreign exchange market has in general been relatively stable with the re-introduction of the wholesale Dutch auction system and the measures taken to further liberalize the inter-bank market since the last meeting of the MPC. There has also been reduction in exchange rate volatility. The spread between the rates at which the auctions had been settled and the rates quoted by BDCs has narrowed from about 12 per cent to 4.4 per cent. In the view of this, the spread would narrow further once the confidence in the international foreign exchange markets is fully restored with the bottoming out of the current global recession, and more BDCs are being brought into the market.

Foreign exchange reserves as at August 28, 2009 stood at US $41.597 billion. The Committee believes that the recent improvement in the output of oil and the price of crude oil in international markets should help improve the external reserves position towards the end of the year.

Perspectives and the Stance of Policy

Against the backdrop of signs of gradual improvement in the external economic environment and the positive outlook for the domestic economy, the Committee felt that policy initiatives are needed to further improve growth without jeopardising price and financial stability. It will, therefore, continue to manage liquidity actively to ensure that credit requirements are taken care of at reasonable interest rates while monitoring the trends in prices. The Committee will also pursue an interest rate policy that is consistent with price and financial stability and supportive of enhancing the levels of economic activity on a higher trajectory.

On foreign exchange, the policy stance remains that exchange rate should be principally market driven, but interventions will be made to mitigate tendencies towards volatility and to counteract speculative attacks on the national currency.

Decisions

In the light of the above, the Monetary Policy Committee decided to:

a) keep the MPR unchanged at 6 per cent per annum;
b) maintain the interest rate corridor at +/- 2 per cent around the MPR; and
c) Approve in principle the establishment of an "Asset Purchase Facility Fund".

The Central Bank of Nigeria and Federal Ministry of Finance to jointly consider the modalities for setting up the APF Fund for effective liquidity injection and credit easing targeted at specific areas of the economy.

Sanusi Lamido Sanusi
Governor,
Central Bank of Nigeria
Abuja
September 1, 2009