CENTRAL BANK OF NIGERIA

COMMUNIQUÉ

NO. 47

OF THE MONETARY POLICY COMMITTEE MEETING, AUGUST 9, 2006

PRESS RELEASE

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OF THE MONETARY POLICY COMMITTEE, AUGUST 9, 2006

The Monetary Policy Committee of the CBN met today and decided to maintain the Minimum Rediscount Rate (MRR) at 14.0 per cent.

(1) The Monetary Policy Committee (MPC) met on 9th August, 2006. The MPC reviewed the major macroeconomic developments and the implementation of fiscal, monetary and exchange rate policies in the first seven months of 2006, as well as the challenges for the rest of the year. The meeting, the third in the year, lasted four hours. The MPC noted with satisfaction the improvement in the overall macroeconomic environment during the review period, and restated its commitment to ensuring monetary and price stability in the rest of the year.

KEY MACROECONOMIC DEVELOPMENTS

(2) **Inflation**

The MPC noted that at end-June both the headline and core inflation rates had decreased to 8.5 and 13.6 per cent from 12.0 and 16.3 per cent at end-March, 2006 respectively. It, however, noted that core inflation at 13.6 per cent was still unacceptably high. Furthermore, the MPC observed that the overall downward trend in inflationary pressure reflected the effects of monetary policy tightening to address the excess liquidity in the second quarter as well as the appreciation of the exchange rate. In addition, the early harvest of some agricultural food products, sustained stable prices of petroleum products in the domestic market and the narrowing of the BDC market premium all helped to dampen inflationary pressure in the review period. Nevertheless, some threats to the sustenance of low inflation still exist; they include the planned supplementary budgetary expenditure of the Government, and rising private (autonomous) inflows, both of which are likely to shore up liquidity in the system.

(3) **Economic activity**

Gross domestic output (GDP) was low reflecting the decline in oil production and the seasonal slowdown in agricultural production. Economic activity, however, is projected to pick up in the months ahead, during which the harvesting of crops (the major agricultural sector growth driver) would commence in earnest.

The MPC noted with satisfaction the sustained stability of the naira following the Bank's liberalization of the forex market since March 27, 2006. The naira exchange rate in the BDCs has continued to appreciate. From US $1/N151.00 in March, the naira appreciated to US $1/N130.00 at end-June 2006, and further to $1/N128.60 in July. Against the DAS exchange rate, which has stabilized at about US $1/N128.00, the BDC market premium has dropped to below 2.0 per cent. The MPC restated its c x ommitment to sustain the BDC exchange rate premium within the 3.0 per cent margin.

Following the US $4.6 billion exit payment to the Paris Club in April, the stock of external reserves stood at US $32 billion at end-April, and rose to US $38 billion at end-July 2006.

Broad money (M2) grew by 34.69% as at end-July 2006 over the December 2005, which represented an annualized growth rate of 59.46 per cent compared with the target of 15.0 – 17.0 per cent for 2006. The rise in money stock was due to a combination of factors which included: the credit to government which increased by about 16.0 per cent in June, as against -0.4 per cent programmed target, reflecting sustained expansionary fiscal operations; The net foreign assets also continued to increase.

Growth in aggregate domestic credit (net) was 15.2 per cent in the first six months. This increased to 16.9 per cent at end-July 2006 and 28.96 per cent on annualized basis. The credit development was driven largely by DMBs credit to government through investments in treasury securities. Credit to the private sector, however, fell short of the target for the year

At end-June 2006, reserve money was N794.00 billion, which was lower than the target of N800.00 billion for the second quarter 2006. The level of RM was also within the target in July.

The MPC noted the general decline in banks' deposit and lending rates following the excess liquidity in the system. Consequently, the spread between the average savings deposit and maximum lending rates fell from

16.2 percentage points in December 2005 to 15.2 percentage points at the end of June 2006, and slightly further down to 15.1 per cent by end-July.

CURRENT CHALLENGES/RIS[illegible]

(10) Some risks to low inflation and monetary management still exist. They include: increasing cost of liquidity management; rapid growth in M2; planned extra-budgetary spending by the government; increasing autonomous (private) inflows. The expansionary fiscal operations remain a major source of risk to monetary policy.

DECISIONS

The Committee thus dec[illegible]

(a) maintain the MRR at 14% with a proviso to review it should the threat to monetary policy continue.

(b) approve a new framework for monetary policy implementation. The IT and other logistics requirements are to be sorted out between now and October, 2006. Pilot implementation is expected to commence on or before November 1st, 2006

(c) sustain the CBN's zero tolerance to lending to government

(d) reaffirm that there is no control on interest rate or pegging of lending rate to the MRR.

(e) approve operational guidelines on the CBN Discount Window

(f) approve guidelines for discount window operations in FGN bonds and

(g) sustain the on-going liberalization of the forex market.

Thank you for your kind attention.

Prof C. Soludo
Governor
Central Bank of Nigeria,
Abuja.

August 2006