

Central Bank of Nigeria Communiqué No. 81 of the Monetary Policy Committee Meeting of Monday and Tuesday, January 30 and 31, 2012

The Monetary Policy Committee (MPC) met on January 30 and 31, 2012 with all 12 members in attendance to review the domestic economy in 2011 and the nature of current challenges against the background of developments in the international economic and financial environments.

At the outset, the Committee recalled that in a bid to ensure price and financial stability, the Committee, held six (6) regular meetings and one (1) extra-ordinary meeting in 2011 during which it raised the Monetary Policy Rate (MPR) six (6) times, from 6.25 to 12.0 per cent; raised the Cash Reserve Requirement (CRR) three (3) times from 1.0 to 8.0 per cent; and the liquidity ratio (LR) once from 25.0 to 30.0 per cent. It also reduced the foreign exchange net open position of DMBs from 5.0 to 3.0 per cent, and adjusted the mid-point of the exchange rate band from N150/US\$1 to N155/US\$1. These decisions signalled to the market the Committee's clear and unambiguous commitment to the primacy of price stability as its key mandate.

The Global Economy

Latest projections by the International Monetary Fund (IMF) indicated that global output growth which had slackened from 5.2

per cent in 2010 to 3.8 per cent in 2011 could decelerate further to 3.3 per cent in 2012. Advanced economies are expected to record a lower rate of growth of 1.2 per cent in 2012 compared to the estimated 1.6 per cent in 2011. The US economic growth in the coming quarters would depend a great deal on growth of the Euro area. The Euro area is projected to record a negative growth of 0.5 per cent in 2012 essentially on account of the burden of high public debt and the fragility of the credit and financial markets. Output growth in emerging and developing economies slowed down in 2011. China, India and Brazil all posted lower growth rates in 2011 than in 2010. Sub-Saharan Africa has been a major exception to the global trend: it is estimated to have grown by 4.9 per cent in 2011 and is expected to record a higher growth of 5.5 per cent in 2012.

Inflation rates in most of the advanced economies trended upward in 2011 with the exception of Japan. In the US, UK, and Germany, inflation rose from 1.4, 3.7, and 1.7 per cent in 2010 to 3.0, 4.2, and 2.1 per cent in 2011, respectively. The Euro-zone debt crisis worsened; leading to credit ratings downgrades, change of governments, and implementation of austerity measures, even as a few nations appeared to have entered into a recession.

The Committee felt that in the light of the expected deceleration in the economies of the country's major trading partners, and the

absence of adequate commitment of most advanced economies to effectively address the fiscal imbalances and to reform their financial systems, there would be continued pressure on Nigeria's external sector in 2012. The anticipated slack in external demand would, in the view of the Committee, have to be offset by generating the needed domestic demand. This, however, would require a shift in the economic development strategy that allows greater diversification of the economy without losing sight of the need to pursue sound demand management policies.

Key Domestic Macroeconomic and Financial Developments

Output and Prices

Provisional data from the National Bureau of Statistics (NBS) indicated that real Gross Domestic Product (GDP) grew by 8.68 per cent in the fourth quarter of 2011 up from 6.64, 7.72, and 7.40 per cent in the 1st, 2nd and 3rd quarters, respectively. The overall GDP growth rate in 2011 was estimated by the NBS at 7.69 per cent, marginally lower than the 7.87 per cent recorded in 2010. This projection is based on the estimated Quarter III and Quarter IV growth rate of 7.40 per cent and 8.68 per cent respectively. The 2012 Budget proposal assumed a growth rate of 7.2 per cent. This is in line with the latest World Bank forecast of 7.1 per cent growth for Nigeria in 2012. The Committee noted with satisfaction, the good

performance of non-oil activities including agricultural and services sectors as well as the recovery in crude oil output in 2011, particularly in the fourth quarter. In the Committee's view, the opportunity to build on the robust non-oil growth with further investments in infrastructure and manufacturing and processing activities should be utilized in order to mitigate any negative impacts from the likely external shocks during the year.

The Committee also noted the NBS survey data on the rise in the unemployment rate to 23.9 per cent in 2011 from 21.4 per cent in 2010. The latest unemployment rate is considerably higher than the 12.3 per cent recorded in 2006 by the NBS survey, which suggests that the consistently high output growth during this period had failed to create adequate employment for the growing labour force.

In view of this, the Committee recommends that in addition to the structural reforms being currently pursued, emphasis should be placed on technical and vocational education in order to produce a labour force that is compatible with the current stage of the country's development.

In 2011, the Inflation rate fluctuated within the lower double-digits range during the early part of the year, but moderated thereafter. The year-on-year headline inflation rate, which was 12.1 per cent in

January 2011 rose to 12.8 per cent in March, before moderating to 10.2, 10.3, and 10.3 per cent in June, September, and December, respectively. Similarly, food inflation rose from 10.3 per cent in January 2011 to 12.2 per cent in March and thereafter moderated to 9.2, 9.5, and 11.0 per cent in, June, September, and December, respectively. Core inflation also rose from 12.1 per cent in January to 12.8 per cent in March stabilizing at 11.5, 11.6, and 10.8 per cent in June, September and December, respectively.

The headline inflation rate stood at 10.3 per cent in December 2011, by far the lowest since December 2008 and lower than the average of 12.75 per cent during the period 2001-11. Food inflation, at 11.0 per cent in December 2011, was lower than its level in the preceding three years. Similarly, the year-on-year core inflation declined in 2011. At 10.8 per cent in December 2011, core inflation was marginally lower than the 10.9 per cent in December 2010 and 11.2 per cent in December 2009. The Committee noted that both food and core inflation have remained high exerting immense pressure on the headline inflation rate. The Committee was therefore of the view that while the focus on growth continues to be a key imperative, the containment of inflation equally deserves immediate attention. It noted that the inflation outlook in the short- term will be impacted by the anticipated fiscal injections in relation to the proposed 2012 budget, the recent partial deregulation of pump price of PMS, and

new tariff regimes on certain food imports. The Committee has also noted comments indicating possible plans by the National Assembly to revise the budget benchmark price of oil from \$ 70 per barrel to \$75 or even \$80 per barrel. Such a measure would significantly increase expenditures especially given the already high oil output assumptions. In addition, it would reduce accretion to the Excess Crude Account (ECA) and increase the inflationary pressure already in place on the supply-side. In the event of this happening, the likelihood of further tightening during 2012 increases. The Committee would like to reaffirm its commitment to price and exchange rate stability and its determination not to pursue an accommodative policy stance. The Committee therefore, strongly supports the recommendations of the Executive for a benchmark price of a maximum of \$70 per barrel.

Monetary, Credit and Financial Market Developments

Broad money supply (M2) growth was sluggish up to May, 2011, accelerated thereafter to 5.66, 9.50 and 15.40 per cent in June, September, and December 2011, respectively. When annualised, M2 grew by 11.32, 12.67, and 15.40 per cent in June, September and December, respectively, which hovered around the indicative growth benchmark of 13.75 per cent for 2011. Thus, M2 growth of 15.4 per cent in 2011 was higher than the 6.9 per cent growth in 2010. The significant increase in credit to the private sector as result

of loan to AMCON to finance its activities was a major factor underlying growth in monetary aggregates in 2011.

The Committee noted that money market rates moved upward in 2011. The average OBB rate increased to 15.50 per cent in December from 6.22, per cent in January. Similarly, the average call rate rose to 14.09 per cent in December from 6.42, per cent in January. The rise in money market rates should be viewed in the overall context of monetary tightening stance of the Bank in 2011 through hikes in the monetary policy rate (MPR) as well as the sharp increase in the cash reserve ratio (CRR) from 4 per cent in September to 8 per cent in October. The Committee observed that monetary tightening was also used to restore stability in the foreign exchange market. In January 2012, money market rates have been hovering within a range of 12.85-15.70 per cent. Long term bond yields have tended to move in the range of 14-15 per cent.

Responding positively to the hike in policy rates, both the lending and deposits rates of deposit money banks also moved up in 2011, although substantially less in the case of the latter. The maximum lending rate increased to 23.21 per cent in December from 21.75, 22.02, 22.02 and 22.09 per cent in January, March, June and September, respectively. Also, the prime lending rate rose to 16.75 per cent in December from 15.73, 15.81, 15.76 and 15.87 per cent in

January, March, June and September, respectively. The spread between the maximum lending rate and the average deposit rate which was at 19.22 percentage points in June moved up to 20.12 percentage points in December.

External Sector Developments

Foreign exchange reserves amounted to US\$ 32.64 billion as at end December 2011, more or less flat relative to the US\$32.34 billion as at end December 2010, despite the higher oil price in 2011. Notwithstanding the high prices of Nigeria's reference crude oil (Bonny Light) which averaged US\$106.32 per barrel for the year, the limited accretion to external reserves was due to the high demand for foreign exchange in the market. The Committee noted that pressure on the exchange rate emanating from the high demand reflected the import-dependent nature of the economy, probably compounded by the activities of speculators. The reduction in arbitrage opportunities in the oil marketing sectors combined with stronger controls in foreign exchange practices have already led to a noticeable moderation in foreign exchange net demand.

The official wDAS rate (inclusive of 1 per cent commission) moved up from N151.62 per US\$1 in January 2011 to N154.45/US\$1 in June and further to N158.21/US\$1 in December 2011. The volatility in the official rates, however, was limited with the coefficient of variation being

1.28 per cent for the year as a whole compared to 0.32 per cent in 2010. The Committee commended the CBN for its efforts at establishing stability in the market. It also urged the CBN to strive to eliminate speculative demand for foreign exchange. The Committee also noted that as at January 24, 2012, the exchange rate was N158.57/US\$1, while the foreign exchange reserves amounted to \$34.18 billion on January 27, 2012, which could finance over 6 months of imports of goods and services. The outlook for oil prices in the short-term as well as the forecast demand/supply balance, suggest that the current exchange rate band should be retained while still achieving moderate continuous accretion to reserves

The Committee's Considerations

The Committee is pleased that ahead of most African countries, Nigeria had been proactive by responding to the threats of inflation induced by fiscal spending and global food, fuel and other commodity prices as well as to the challenges of financial stability. The Committee observed that the mandate of the Bank was largely achieved, as inflation was contained within tolerable levels and the exchange rate was generally stable throughout 2011. The resolution of the banking crisis during the year was also commended. Against this background, the Committee welcomed the stated fiscal stance of the Federal Government as part of its programmed movement

towards fiscal consolidation. The increased share of capital expenditure in the proposed total expenditure in 2012 is an important signal of the commitment of the Federal Government to improve the productive capacity of the economy. The Committee finds the current environment to be conducive for improved co-operation and coordination between fiscal and monetary authorities.

The Committee acknowledged that the decision to remove the fuel subsidy was a major development that took place since its last meeting in November 2011. It commended the Federal Government on the partial removal of subsidy on Premium Motor Spirit (PMS), which it noted will have salutary effects on the external reserves and exchange rate as well as on investment in oil and gas downstream sector. It further commended the Federal Government for the commitment towards the passage of the Petroleum Industry Bill (PIB) which, it believes, would further complement the benefits of the fuel subsidy removal. On the other hand, it recognized the possible negative impact of the partial removal of fuel subsidy on the general price level and hence inflation in the short run. In this regard, it underscored the need for the speedy implementation of the palliative measures and entrenchment of social safety nets for the more vulnerable groups. However, the long-term benefits far outweigh the likely short term costs as far as inflation is concerned.

Furthermore, the Committee commended the fiscal authorities for the benchmark crude oil price of \$70 per barrel as proposed in the 2012 budget and advocated for its retention as any upward revision would tend to undermine macroeconomic stability.

The Committee considered the need to sustain the high output growth that the country has seen in recent years partly because of the slowdown in the advanced and other emerging economies and partly because of the need to generate employment in the economy. However, to help generate new jobs, it would be essential for the Federal Government to move quickly with the structural reforms such as (a) power sector reforms, (b) implementing the agricultural sector transformation programmes and the associated value chain, and (c) refocusing attention to the provision of technical and vocational training to bring about skills development that would match the needs of the economy.

The Committee underscored the need for maintaining price stability in a manner conducive to the achievement of employment-generating growth. In this connection, it observed that the announced increase in import duties on some food items by the end of June 2012 would exert further pressure on food prices which would compound the effect of increased transportation costs induced by

the partial removal of the fuel subsidy on the general price level and the associated inflation expectation.

The Committee noted that historically, upward adjustments in the price of PMS have tended to have a short-term impact on the rate of inflation. A review of previous instances of adjustment in fuel prices shows that without exception, each instance is accompanied by an increase in the rate of inflation followed almost immediately by a moderation in the short - to - medium term. Staff estimates indicate that inflation in the first two quarters of 2012 would range between 11.0 per cent and 14.5 per cent, and then moderate steadily towards the single digit zone by late 2013. Real interest rates are therefore likely to remain positive on a trend basis, even if the rate of inflation were to rise briefly above the MPR in the second quarter.

Finally, the Committee recognized the current security challenges and Government's efforts to find a lasting solution through dialogue, economic measures and enhanced intelligence. It expressed confidence on the ability of Government to resolve the problem.

Decisions

In the light of the above, and considering the clear impact of previous tightening on the rate of inflation and exchange rates up to December 2011, the Committee unanimously decided as follows:

1. Retain MPR at 12.0 per cent with interest rate corridor of +/- 200 basis points;
2. Retain CRR at 8.0 per cent;
3. Retain minimum liquidity Ratio of 30.0 per cent; and
4. Retain the Mid-point of exchange rate at N155/US\$1 with a band of +/-3.0 per cent.

The Committee also resolved to watch closely developments with respect to the fiscal stance and to respond appropriately if, and when, the need arises.

Sanusi Lamido Sanusi, CON
Governor
Central Bank of Nigeria

January 31, 2012

PERSONAL STATEMENTS BY MPC MEMBERS:

1.0 ALADE, SARAH

This Committee meeting is the first for the year 2012, and is coming on the back of a partial fuel subsidy removal and nation-wide labor strike that affected economic activities for a week in the country. Although economic prospects for the country remain optimistic, it has many challenges. Headline inflation moderated to 10.3 in December 2011; however, staff projection for 2012 suggests a temporary spike before trending downwards in 2013. Money market rates indicate tight liquidity conditions in the market as interbank rates and other interest rates have trended upwards, posing constraint to private sector growth and job creation. These developments, coupled with uncertain global economic environment, calls for a stay of action on policy rate to help address the growth needs in the economy.

Removal of Oil subsidy will have inflationary impact, albeit temporary. Although full subsidy removal was not achieved, the partially compromised removal of 50 percent price increase reached between labor and government will have an inflationary impact on the economy. This increase in petroleum prices will impact transportation, energy and food prices, leading to temporary inflationary pressure. However, as consumers result to expenditure switching, rather than spend more income, the inflationary impact should be short-lived. Additionally, the staggered nature of the subsidy removal and introduction of palliative measures such as public transport system by government is expected to cushion the impact of the higher fuel prices on the poor and help moderate the inflationary impact. Inflation, which ended 2011 at 10.3 percent, is expected to increase temporarily in the first few months of the year. Staff estimate suggest that it will then moderate to single digit by 2013. This is because, since there are no additional increase in salaries/wages, consumers will only switch spending towards fuel related expenditure, away from other extra expenditure items. Although inflation is projected to rise, the preemptive

tightening stance adopted by the Bank in 2011 calls for a pause for now, to allow for the full effect of the policy.

Fiscal consolidation is enshrined in the 2012 budget and the fiscal authority has placed greater emphasis on transparency and prudent spending. The 2012 budget proposal of N4,749 trillion, presented to a joint session of the National Assembly on December 13, 2011 reduced budget deficit to 2.77 percent of GDP in 2012 down from 3.0 percent recorded in 2011 budget. This is within the threshold of 3 percent of GDP stipulated in the Fiscal Responsibility Act of 2007. Crude oil production is expected to reach the budget target of 2.48 bpd, and price is expected to remain high in international market on the back of disrupted supply in the Middle East and renewed recovery in the US that saw 2011 fourth quarter GDP grew by 2.8 percent, the highest quarterly growth rate recorded in more than two years. If the budget is implemented as proposed, the inflationary pressure coming from fiscal injection will be contained.

Developments in the domestic money market indicate tight monetary conditions. Money market rates increased in the fourth quarter of 2011, with maximum lending rate reaching 23 percent by December 2011 from 22.02 percent in June. Similarly, average OBB rate increased from 9.6 percent in June to 15.5 percent in December 2011. This is as a result of monetary tightening implemented by CBN in 2011 and further tightening could increase lending cost to private sector and further constrain economic activities.

Global growth prospect remain fragile and weak. Developments in the global economy are still of concern as most advanced economies are projected to show a lower rate of growth in 2012. The latest IMF estimates project growth in advanced economies to decelerate to 1.2 percent in 2012 from 1.6 percent recorded in 2011. The Euro-area would be the hardest hit on the back of high

public debt and fragile financial market. The Federal Reserve Bank has indicated that it will keep key interest rate very low till late 2014, in an effort to give the growth prospects in the US an extra push and also in an attempt to shield the US economy from a potentially more severe recession in Europe. The Euro-zone debt crisis has worsened, leading to crediting rate downgrade in some countries and recession in others. In such an uncertain global outlook, tightening will not be a good option.

Based on the above, I will recommend a “no change” in monetary policy rate and Cash Reserve Requirement (CRR). The combination of weak global economic environment and domestic challenges calls for prudent monetary policy stance to help maneuver the uncertain environment.

2.0 BARAU, SULEIMAN

A. Developments Since the last MPC

- A.1 GDP is forecast to grow from 7.40% in Q3 to 8.68% in Q4. The non-oil sector remained the main driver of GDP growth. Agriculture, Wholesale and Retail Trade, and Services are expected to contribute 2.28, 2.39 and 2.23 percent, respectively. Overall, GDP growth is forecast at 7.69 percent in 2011.
- A.2 Year-on-Year (YOY) Headline Inflation remained stable at 10.3%, though the Month-on-Month (MoM) measure showed an increase of 1.02%. Year-on-Year (YoY) Core Rate also increased to 10.8%. However, Month-on-Month Inflation rates also increased by 1.9% and 0.4% for Food and Core measures, respectively.

A.3 Money market rates were largely volatile dictated as usual by Governments' fiscal operations particularly delays associated with the activities of FAAC recently.

B. Comments/Context Setting

B.1 Current inflation numbers do support my earlier view that the rather very proactive policy measures that we have taken in the recent past have contained the inflation risk that we face, as reflected particularly, by the Year-on-Year indicators. However, the Month-on-Month measures indicate upside risk to inflation. Inflation upside risk is further compounded by the recent upward adjustment in the prices of petroleum products which has indeed translated into similar, and often, more radical adjustment of the prices of general goods and services.

However, the very comprehensive staff presentation on inflation outlook using models that trended inflation after successive past adjustments in the prices of petroleum products, suggests observed initial spike in inflation rates, and which is usually followed by declines.

The inflation numbers just released did not show significant build in inflation expectations, except mildly, as indicated by the Month-on-Month measures. The explanation for this is perhaps the fact that the adjustment was sudden, with the adjustment actually expected to be effected in April, 2012.

Having reviewed the above, it is my firm belief that in the context of effectiveness of the policy measures taken in the recent past, it does appear compelling to hold and watch trends in the next few weeks in order to decide whether to actually recommend measures to contain the upside risk to inflation.

- B.2 It is also significant to hold any new policy measure pending the outcome of the review of the Appropriation Bill currently before the National Assembly. The provisions in the Bill appear realistic under the circumstance, with particular reference to the benchmark price for crude oil sales. Given the structure of our expenditures, with a larger recurrent component, any attempt by the National Assembly to increase the benchmark would increase the expansionary nature of the budget, the proportionate deficit and ultimately increase the associated inflation risk. This is a risk I recognize but would caution that we watch developments in this regard. Therefore, in the context of my earlier comment on the petroleum price adjustment related risk, we should come up with complementary response package to these combined risks in due course.
- B.3 It is commendable that we now have unemployment numbers from the National Bureau of Statistics. With unemployment rate at 29% and with a whopping 16 million Nigerians being unemployed, we do not need to go far to explain the negative commentaries on our state of governance, the strike in response to petroleum price adjustment by a segment of the society and the general security challenges that we currently face as a country.

The unemployment numbers, in my view, conveyed two important messages. The first is that contrary to general uninformed commentary that is now perverse, the economy has been creating new jobs, though dismal, in the last three years. This, therefore, gives me hope. Secondly, whereas the economy has grown at an average of over 6% since 2006, trending unemployment growth over the same period showed flat growth. The hope that I had just referred to, must be supported by an aggressive incentive plan and structure to make our youth to gravitate towards vocational and job creating education rather than white collar

type. We can borrow a leaf from the current programme in South Korea and other countries. This should complement CBN's current efforts and those of related organizations in providing access to finance for Micro, Small and Medium Enterprises, and the provision of vocational education. Government through relevant Ministries must elicit necessary policies and more aggressively put the infrastructure for generating employment.

In other words we are currently challenged as a country to translate economic growth into job creating and poverty reducing economic development.

B.4 In light of the foregoing and in the context of my arguments for hold position during the last MPC, I'm compelled to also ask for maintenance of status quo today.

C. Recommendation for Policy

- Maintain the tightening stance;
- Keep MPR at 12%;
- Keep CRR at 8%; and
- Maintain the existing corridor.

3.0 GARBA, ABDUL GANIYU

Decision

I vote for:

- I. Holding the MPR at 12%
- II. Maintaining the subsisting Corridor for SLF and SDF
- III. Holding CRR at 8%

Observations

Since the last MPC Meeting on November 21st, 2011

- a. The National Bureau of Statistics (NBS) released inflation figures for November and December which show that Headline inflation was 10.3% in December and 10.5% in November compared to 10.5% in October 2011. Indeed, the NBS data from January 2010 indicates that headline inflation has been trending downwards. While Food Inflation exhibited its characteristic seasonal trend (rising in December by 1.4% year on year relative to November), its effects were moderated by a 0.7% decline in core inflation in December. The downward trend of headline and core inflation in 2010-2011 supported **Staff forecasts** that year on year Headline inflation would fall below 10% by February 2012.
- b. The gap between the operating targets (OBB and Call rate) narrowed from a peak of 5.4% (December 1, 2011) to an average of 0.65% from December 28th to January 24th 2012. In addition, both rates have declined from peak levels in early December 2012 to average 14.0% (call rate) and 13.4% (OBB) in the last month. The averages of call rate and OBB are within expected target rates (MPR + 2%). The moderation in rates correlates with expansion in M1 (12.6%) and M2 (10.8%) in late December 2011.
- c. The short term interest rates - Prime Lending Rate and Maximum Lending Rates - averaged 16.8% and 23.3% respectively. The averages for 2011 were respectively 22.4% and 16%. The interest rate spread of 6.5% indicates high risks of lending to small and medium scale businesses and the high rates correlate with declines in Deposit Money Banks' Loans and Advances to the private sector.

The rate in December was -4% which was significantly higher than the 2011 average of - 0.17%.

- d. On the first day of 2012, the economy experienced a strong supply and demand shock in the form of a sharp increase in the price of Premium Motor Spirit (PMS) from N65 per liter to N141 per liter on January 1 2012. Following the crisis that followed, the government reduced the price to N97 per liter. The shock shifts the Aggregate Supply to the left. In addition, it shifts the aggregate demand leftwards, alters relative prices and the general price level thus, reducing the demand for many commodities. The change in real incomes and relative prices has distributive consequences that can significantly deepen and widen poverty and, limit the poverty reducing elasticity of growth. This is particularly serious given that a range of 90 – 150 million Nigerians are estimated to be living below \$2 a day.
- e. The supply shock has inevitably altered the path of inflation in 2012 and 2013 as Staff estimates projections have shown that inflation levels will rise above earlier projections and elongate the period for attaining target inflation rate of under 10% from February 2012 to late 2013.
- f. The international economic outlook for Euro zone remains very bleak as the political system grapples with the challenges of sovereign debt and the dangers of contagion. The signs of recovery in the United States' economy are good and investors have responded positively to the decision of the Federal Reserve to maintain a policy of low interest rates to the end of 2014. The EU ban on imports of Iranian crude and, the ongoing crisis in Syria and

the good signs of US recovery all suggest a good outlook for Nigerian crude prices at least in the near term. High crude prices offer Nigeria with good opportunities to build reserves and to generate additional revenue to finance infrastructural development. However, the benefits are conditional on a transformation of the fiscal system (1) to bring into compliance with provisions of Fiscal Responsibility Act 2007; (2) to significantly cut the waste in recurrent and capital budget; (3) to significantly raise the share of investments in infrastructures and (4) to shifts to performance budgeting from the current line item budget.

Key Concerns

- a. The growing levels of unemployment from 12.3% in 2006 to 23.9% in 2011 is serious especially since the most active population group (16-44) are the most affected. The coincidence of rising unemployment and real GDP growth is inconsistent with Okun's Law given that an average growth of 6.8% in the period is not creating jobs. It is expected that as the economy grows beyond a threshold (3% in the US), unemployment falls. The NBS claims that agriculture, services and wholesale and retail trade are the growth drivers. Typically, the formal employment elasticity is not high enough to provide decent jobs for a growing labor force.
- b. Despite the much vaunted emphasis on FDI and Portfolio investments, the inflows are very small compared to outflows of investment income and service payments. For instance, available data for the first three quarters of 2011 shows that whereas, the net outflows from investment incomes and services averaged N1.6 Trillion per quarter, the net inflows from FDI and Portfolio investments

averaged N408 billion per quarter. Thus, the economy has to maintain a surplus trade balance of an average of N1.38 Trillion and supplemented by remittances from its top quality labor force drained to Eurozone, North America and other countries to offset the hemorrhage of investible resources. The challenge for policy makers is how to alter incentives through new institutions and competitive infrastructures and policy environment to alter (1) composition of output and (2) composition of exports to align (1) Nigeria's aggregate demand and aggregate supply and (2) increase the job elasticity of economic growth. Clearly, such structural issues fall within the domain of fiscal authorities.

- c. The size of the fiscal deficit and public debt and its crowding-out effects on credit to real sectors of the economy and implications for monetary aggregates has been a major concern since the global financial crisis impacted on Nigeria in 2008. In addition, the monthly "FAAC effect" has tended to unsettle the money market causing the interbank rate to exhibit FAAC related volatilities. It is necessary for the fiscal authorities to better manage the allocation of the Accruals to the Federation Account in Fiscal Year 2012 in ways that do not unsettle the money market.
- d. The performance of the capital market is also a key concern. In 2011 it lost about N2.2 Trillion of its value with Banking Stocks the worse hit. In 2012 it is important that the vulnerabilities of the market are addressed. A more supportive fiscal regime will minimize the need to mop up liquidity and raise MPR which seems to have the expected theoretical effects on stock prices, market index and market capitalizations.

Deciding Issues

1. The supply shock is already inflationary and its dynamic and general equilibrium effects are still unfolding. An expansionary monetary policy at this time is inappropriate: it will amplify the inflationary impacts of the supply shock without delivering a positive output response or a reduction in unemployment. It may also, undermine the commitment to a stable exchange rate, which is key to achieving inflation targets. For it is obvious that (1) stable prices of PMS depend strongly on the stability of the stable exchange rate and (2) the price of PMS has significant effects on headline inflation.
2. Holding
 - a. allows the menu of tightening policies of 2011 to work through the economic system;
 - b. provide investors **policy stability** as they plan their investment strategies for 2012 and beyond; and
 - c. Incentivizes the fiscal authorities to undertake the fiscal and associated fundamental reforms required to change the incentive system, begin to build the infrastructural system that will make the economy competitive in oil and gas, solid minerals, industry and agriculture so as to create the jobs needed to reverse the trend of unemployment.

4.0 KIFASI, DANLADI

Key domestic macroeconomic indicators were largely favourable in 2011. Overall, GDP grew by 7.69% for 2011, marginally lower than the 7.78% recorded

in 2010. However, unemployment increased from 21.4% in 2010 to 23.9% in 2011. The rising rate of unemployment, which is of great concern, is being addressed by government through making employment generation one of the cardinal objectives of the Transformation Agenda.

2. The year-on-year headline inflation rate which was 11.8% in December, 2010 moderated to 10.3% in December, 2011. The inflationary pressures moderated towards the end of the year following series of monetary policy tightening measures adopted by the Central Bank of Nigeria, as well as the restraint on government expenditure which culminated in a lower deficit than planned.

3. The MPC adjusted the mid-point of the exchange rate band from ₦150.00/US\$1.00 to ₦155.00/US\$1.00 in November, 2011 to stabilize the foreign exchange market. It is hoped that the deregulation policy of the Government would further assist in moderating the pressure on foreign exchange demand and thus boost the external reserve position.

4. Output growth projection for 2012 remained robust. The prospect for robust GDP growth was anchored on the expectations of increased crude oil production; stable naira exchange rate; and increased credit delivery by banks due to the operations of AMCON, amongst others.

5. Forecasts for inflation for 2012 based on ₦97 per litre of petrol indicate that the year-on-year headline inflation will remain above 10.0% but not likely to exceed 13%. This is premised on the maintenance of the prevailing monetary policy stance and interest rate regime as well as government's initiative to control expenditure and minimize budget deficit.

5. In view of the above, I recommend that the MPR should be retained at the current level of 12% for the next two months when another review will be due for consideration.

5.0 LEMO, TUNDE

The Global economic outlook remains unstable and growth projection has been revised downwards by IMF to 3.3% in 2012 well below the unimpressive growth of 3.8% in 2011. Euro area remains a major concern as it is almost certain to shrink in 2012 largely as a result of unresolved debt crises in a few member countries. US economic growth forecast in 2012 may be affected by the recession in Euro area. Japan recorded trade deficit, the first in 30 years – no thanks to the appreciation of the yen. The global economy's growth is therefore largely expected to come from the BRIC countries and Sub-Sahara Africa.

On the domestic front, output projection is fairly robust in spite of the current security challenges. GDP growth estimate in 2011 was 7.69%, slightly lower than 7.87% recorded in 2010. The 2012 growth estimate of 7.2% will largely be on the back of the agricultural sector which is expected to benefit from additional bank credit, now made possible by the CBN led NIRSAL programme. The stable crude oil price outlook will also help to anchor this expectation.

Inflation outlook presents an upside risk as a result of the pass through effect of the partial deregulation of petroleum product prices, extension of the 2011 budget implementation to the first quarter of 2012, continued implementation of the national minimum wage as well as the expected increase in the tariff on importation of rice and wheat during the year. This can be further heightened by any increase of the benchmark price beyond USD70 per barrel by the National Assembly. This is clearly not recommended.

In my view, the recent partial deregulation is painful but necessary to ensure the country's long term fiscal sustainability and therefore commendable. The near-term inflation outlook however confirms that the inflation pressure will be short-

lived and it is projected to moderate after the second quarter of 2012 with complementary tight fiscal stance.

The foreign exchange market is relatively stable with mild accretion to reserve in spite of the high demand of foreign exchange in the second half of the year. The outlook is stable as international crude oil price is expected to be strong, given the on-going EU sanction on Iran and the inability of Libya to resume crude oil export.

Given the stable forex outlook, the present level of liquidity in the system and the indication of moderation of inflation after the second quarter, as well as the relatively high money market rates of up to 15.7%, maximum and marginally positive real interest rates, further tightening may be in expedient now and may therefore constrain growth.

I therefore vote as follows:

- (a) Retention of the MPR at 12% as well as the symmetric corridor of +/- 200 basis points
- (b) 8% of CRR to remain unchanged
- (c) Minimum liquidity Ratio of commercial banks to remain 30%

6.0 MOGHALU, KINGSLEY CHIEDU

As the Monetary Policy Committee considers its position on the Monetary Policy Rate and other indices of monetary policy at its first meeting in 2012, I believe the MPC should hold the MPR at 12% and adopt a wait-and-see posture until its next review meeting in March 2012. The Committee should also hold the Cash

Reserve Ratio at 8% and maintain the present corridor of plus/minus 2% for the Standing Lending Facility and the Standing Deposit Facility.

The most important development since our last meeting in November 2011 was the partial deregulation of the price of Premium Motor Spirit (PMS) at the beginning of 2012, which has introduced a price shock in the economy. Despite this development, which the MPC anticipated and factored into its decisions on the MPR in the second half of 2011, there is no overwhelming argument to raise the MPR at this time. There are several reasons to hold steady, some of which I briefly outline below.

Firstly, it is essential to pause and give adequate time for the pass-through effects of previous rate hikes – the last of which, from 9.25% to 12% in October 2011, was a steep increase – to filter through the economy. A rate hike at this time could introduce serious disequilibrium into the economy when added to the initial price shock of the partial fuel subsidy removal.

Secondly, staff estimates indicate that headline inflation will go up to 14.5% at the end of the second quarter of 2012, and that Core and Food Price Inflation are projected at 16.1% and 14.5% respectively. While these projects are significant, they do not argue for a rate hike at the present time because a detailed study of 17 previous fuel price hikes over the past nine years since 2003 have established that in the medium to long term such fuel price increases have not had a direct causative relationship with inflation. The implication, then, is that if all things are equal, the price shocks we have witnessed in January 2012 as a result of fuel subsidy removal may not be sustainable. Staff projections point to an ultimately downward trend in inflation back towards a single digit by the end of 2013.

Thirdly, raising rates when, as now, it is not absolutely necessary will stifle the growth of credit to the private sector, in particular the real sector.

Fourth, at a time when the global economic looks bleak and the threat of a recession looms in several industrialized economies especially the Eurozone countries, it is wise to be cautious. While there is no reason to adopt an accommodative monetary policy stance in 2012, and in fact the possibility of further monetary tightening remains if circumstances warrant, it appears more appropriate to hold for now.

Finally, it should be stressed that the monetary policy stance of the MPC for the remainder of 2012 will depend largely on the fiscal authorities' continuation of measures to improve fiscal discipline. Should fiscal expansion resume, the MPC will have no choice but to resume monetary tightening in order to maintain price stability. This is quite apart from the important issue of the need to maintain positive interest rates depending on how much, in fact, inflation increases in 2012. This is why it would be a matter of concern if the legislature were to change the benchmark crude oil price of \$70 in the 2012 budget to a higher figure of \$75 or \$80. Such an action would do more harm than good to price stability.

Overall, on the balance the MPC should maintain the MPR, CRR, Liquidity Ratio and the exchange rate at their present levels, in order to avoid running too far ahead of possible inflation, and in order to foster an environment that supports real sector growth. This is especially important in an environment of a high unemployment rate of 23%.

7.0 OLOFIN, SAM

The long awaited removal of "fuel subsidy" (for want of any other more appropriate name) as a necessary major fiscal policy step in the much needed fiscal consolidation process has at long last been taken. It would appear that it

had become sufficiently obvious to the fiscal authorities that this so-called subsidy, with all its attendant rent seeking leakages that was increasingly being funded from government borrowing was no longer sustainable. There are also strong indications that the fiscal authorities in the aftermath of the partial removal of the subsidy, and in reaction to its fall-out effects, are beginning to see the need for strong commitment to fiscal prudence. This is a very much welcome development, if the major domestic and external challenges confronting a fragile single commodity dependent economy like ours are to be effectively tackled. This is particularly more so, if the uncertainty surrounding the weak and sluggish recovery of the country's major trading partners are taken into consideration. From the monetary policy perspective of ensuring stable prices, the tight monetary policy stance of the last several meetings should, all things being equal, ameliorate the inflationary impact of this measure. An initial predictable upward adjustment in other prices in response to the shock is to be expected; but there is no reason to believe that this would translate into a sustained inflationary pressure in the medium term, if the experiences with earlier hikes in petroleum prices are anything to go by.

Other developments in the economy show that the overall GDP growth rate is likely to be sustained around 8 percent in 2012, without significant impact on the level of unemployment. The NBS recently released figures show that the unemployment rate remains high and was estimated to have increased from 21.4 percent in 2010 to 23.9 percent in 2011. Headline inflation rate remained at a two digit level, hovering around 10-12 percent prior to the partial removal of the petroleum subsidy. There is strong evidence that measures taken to curb the speculative attack on the Naira at the October 2011 extraordinary meeting are continuing to succeed in stabilizing the exchange rate, despite the observed slight depreciation of about 5 percent in the value of the Naira.

The short to medium term outlook for the economy and the corresponding policy challenges suggest that there may be no need for substantial revision of the monetary policy measures put in place at the October and November 2011 meetings. As much as there may be justifiable fear of inflationary pressure resulting from the PMS subsidy removal, this is not likely to be significant enough to warrant additional tightening measures at this time. The challenges of sustaining the stability in the foreign exchange market and that of improving the rate of accretion to external reserves as a buffer against any likely external shocks also remain. While real interest rates remain at levels that are less than competitive for attracting net direct foreign investment compared with countries like Ghana and South Africa, the more pressing need for achieving greater competitiveness lies with ensuring a safer business environment devoid of social unrest and insecurity.

In the light of the foregoing there may be no need for any further major tinkering with the MPR, the CRR and LR at this meeting. Rather, more time should be allowed for the full impact of the various policy measures introduced at the last two to three meetings to take effect before any further reappraisal. One would therefore vote for leaving the MPR and other related measures at their current levels, while we monitor any significant domestic and/or external developments that may warrant further major policy interventions in the near future.

8.0 OSHILAJA, JOHN

The Monetary Policy Committee unanimously decided today to maintain its Policy and associated interest rates at levels initiated at our extraordinary meeting of October 2011. The new FX trading bands first announced in November also remain unchanged. With inflation just beginning to recede last year, this was also a unanimous decision to withhold further preemptive moves

in order to allow market supply and demand adjustments to naturally settle first-order effects of recent sharp increases in domestic petrol prices.

The Public should be aware that in price indices monitored by the Committee, there are other quantitatively weightier components besides PMS to consider (imported foodstuffs, to name just one). This in no way diminishes due recognition of the hardships and pains expressed by the Public in the immediate aftermath of the Federal Government's abrupt action on its PMS subsidy. Our decision was supported by an objective review of behavioral effects of prior price-hikes, and econometric projections suggesting that the deflationary trend, which first began surfacing in the closing stages of 2011, is likely to resume in earnest; possibly before the end of next year.

The key ingredient to successfully realizing MPC expectations for 2012-13 nonetheless remains the fiscal stance of Government. All bets (and maybe even gloves) come off, however, if Government continues executing poorly on initial, meaningful, steps towards boosting domestic productive capacities and employment. Better execution entails, among other factors, attacking blatantly wasteful recurrent expenditures with conviction, and concentrating the savings achieved on high-impact investments – i.e. in public, productivity-enhancing, goods and services – and social safety initiatives.

The type of revisions that pass in a reconstituted 2012 Federal Budget should offer further clues on prospects for our current poise on inflation management this year.

I agree with the maintenance of our current non-accommodative monetary stance, and foresee interesting opportunities arising for further refinements in implementation. These should be aimed at curbing local financial market inefficiencies (another source of Public Subsidization, albeit of the implied variety). Such refinements could make available Policy tools less blunt and

more responsive. However, should the consolidations proposed by the Fiscal Authorities turn out to be ineffectual for the purposes officially stated then, in ultimate fulfillment of our Price Stability mandate, the MPC may have little choice but to recourse to blunter, more aggressive measures than were initiated last October.

9.0 SALAMI, ADEDOYIN

Despite the increase in the Pump Price of Petroleum Motor Spirit (PMS), my vote to support the option of leaving Monetary Policy instruments unchanged was not a difficult one. Simply stated, monetary policy should not react to the kind of structural change, represented by higher fuel prices, even though it will adversely affect prices.

If the economy in Nigeria is to grow at the kind of pace which its potentials suggest and the challenge posed by unemployment requires, reform to ease structural bottlenecks and reduce incentive for resource misuse becomes cannot be understated. This, in my judgment, is the light in which the partially successful attempt to introduce a regime of fully market determined prices in the 'downstream' oil sector should be seen. Notwithstanding the inability of Nigeria's government to remove itself from determination of prices, the reduction in subsidy achieved will doubtless raise inflation.

Indeed Central Bank Staff estimates suggest that in the absence of other shocks, Headline Inflation will peak at 14.5 percent at the end of the 2nd quarter of this year. Similarly, Core and Food Price Inflation are expected to be 16.1 percent and 14.5 percent respectively. These estimates are sharply higher than forecasts

made ahead of the increase in fuel prices. It is noteworthy that Bank Staff expect that inflation will return to single digit at the end of the 2013.

It is however pertinent to draw attention to potential 'flies in the ointment' which may leave colleagues and I on the Monetary Policy Committee no choice but to deal with second round effects – perhaps aggressively. Noises from the National Assembly suggesting that the Budget Benchmark Price of crude oil will be raised are a source of concern. If, as proposed, the budget benchmark price rises to US\$75 per barrel, the resulting increase in government sector – Federal Government and States – holds the potential to exert a destabilizing influence – especially on Foreign exchange.

The imperative of tightly managing fiscal conditions cannot be overemphasized. The US Federal Reserve Bank's announcement that it will keep interest rates at current levels until 2014 may serve to keep crude oil prices firm as 'cheap dollars' provide funding for speculative demand for crude oil thereby negating the adverse effect of slower growth in global output on the demand for oil. I remain concerned that firmer oil prices will inspire fiscal looseness in Nigeria. Bearing in mind that the 32 percent growth in Credit to the Private Sector recorded last year, indicated by provisional CBN data, overstates the true position, as it doesn't discount for the influence of AMCON bonds, loose fiscal policy will ensure that the environment remains unfriendly to growth in credit.

10.0 UCHE, CHIBUIKE

For the Nigerian economy, 2012 started on a very shaky note. The withdrawal of 'subsidy' on Petroleum Motor Spirit (PMS) by the federal government led to a nationwide strike which culminated in a compromise PMS pump price of 97 Naira per litre. While this fifty percent increase in the pump price of PMS is

expected to have inflationary consequences for the Nigerian economy, I strongly believe that raising the MPR at this stage will be inappropriate. This is so because the current MPR of 12 percent is unlikely to be eroded into negative territory by the inflationary consequences of this increase in the pump price of PMS in the short run. It has for instance been projected that this policy action will lead to an increase in the headline inflation from 10.3 percent (December 2011) to 11 percent (March 2012). Although inflation may further increase in subsequent quarters of 2012, the expectation is that it will gradually trend towards single digit in 2013.

In opting for the maintenance of the status quo, I am also mindful of the fact that borrowing rates are already too high. The negative impact of high interest rates on the growth of the real sector is well known and documented. Given the entwinement of banking sector health and stability and real sector growth, raising the MPR at this stage will also not be beneficial to the health of our banking sector which is still recovering from a major crisis.

Despite its inflationary impact, the increase in the pump price of PMS and the ensuing national crisis that followed has had some positive consequences for fiscal management in the country. Government has for instance now committed to prudent financial management. The issue of widespread corruption in government has also, thankfully, now been brought to the fore. Government fiscal indiscipline which has sometimes been fuelled by corruption has, in my view, been both a major cause of inflation and an impediment to the formulation of effective monetary policy in the past. I am therefore cautiously optimistic that current national developments could mark a turning point for monetary policy formulation in Nigeria.

11.0 YAHAYA, SHEHU

I vote to retain the MPR at the current level of 12%, along with the CRR and the corridor. My position is based on the following:

- The partial removal of the subsidy on PMS has already impacted on petrol prices and, thereby, on price levels of food, transport and others. While some of the secondary effects are still unfolding, the main price effects have already hit the economy
- Headline inflation is projected to peak in the second quarter of the year and, thereafter, begin to moderate
- The Naira exchange rate is expected to remain stable at least at the short term, partly due to the stable outlook on oil prices (the decline in demand due to slow down of the economies in Europe and US may be counterbalanced by uncertainties surrounding Iran, Libya) and the gradual building up of reserves.
- It is hoped that fiscal injections in the economy would be moderate within the first months of the first quarter of 2012
- The effects of monetary policy tightening from 2011 are still being played out
- In the near term, there are plans to take important steps to develop agricultural production and agriculture value chains and it is important to have a supportive monetary stance

Given the circumstances described above, we propose to maintain the current level of the MPR and to carefully watch developments in the economy in the next two months to determine subsequent courses of action.

12.0 SANUSI, LAMIDO SANUSI

Governor of the Central Bank of Nigeria and Chairman of the Monetary Policy Committee

We are holding our first meeting of 2012 at a time that is possibly a turning point in the economic history of the country. The dark clouds in the global horizon remain present. Forecasts are for slower growth rates in the developed world and emerging markets. The violence and tragic bombings in northern Nigeria continue to pose a source of concern for investors, and efforts are underway to find a lasting solution. The recent demonstrations by citizens and opposition parties against fuel subsidy removal have also raised temperatures in the political space.

In spite of all the above, there are many positives to take from recent experience. First, the Federal Government has significantly reduced the fiscal burden of unsustainable subsidies and the partial reduction in subsidies was the first in over five years. Secondly, the protests have brought to the fore a number of important concerns that have been central to us - opacity in the subsidy regime, poor execution of capital projects, high levels of recurrent expenditure and overheads and general questions about governance and transparency.

As a result, by implementing this most difficult of reforms and managing the fallout successfully, the government has laid a marker for its commitment to other reforms including electricity tariffs and deregulation of the oil industry. On the other hand, the issues raised by civil society, if kept in focus and in the public space, should move us towards an era of better fiscal management, tighter controls on spending, improvement in foreign exchange savings and thus a more stable environment.

The principal factors underpinning inflation outlook in the short-term appear to be supply side factors- mainly the cost-push effects of higher fuel and transportation costs compounded by the impact of anticipated higher tariffs on imported food like rice, aimed at protecting domestic growers and processors. In such a situation, a monetary response is not, to my mind, the appropriate one. These structural factors will be addressed by improving refining capacity, reducing dependence on imported fuel and investing in agricultural productivity (irrigation, storage, seeds, fertilizer, training, market access, finance etc.) in a manner that makes local output cheaper and more competitive vis-à-vis imports.

The position is further supported by recent experience. December headline inflation at 10.3 percent per annum is in line with our implicit high single digit target and, without subsidy removal, was forecast to decelerate further down to around eight percent per annum by middle of the year. However, sequel to the fuel subsidy removal, the forecasts have changed and staff estimate inflation to range between 11% and 14.5% over the first six months of the year and begin a deceleration in the third quarter, heading back close to single digit at the end of 2013, *ceteris paribus*. With yields in the fixed income market generally in a range above the inflation rate, we expect real returns to remain positive and competitive and indeed we have seen no reversal of capital flows in the face of strong signals that we will not tighten at this MPC. The exchange rate has remained fairly stable, albeit pushing the upper region of our band and records of every increase in fuel prices going bank to 1998 show that the initial spike in inflation is followed almost immediately by a deceleration, thus weakening the correlation between the level of fuel prices and the rate of inflation. The principal concern therefore, is not so much inflation, which is our mandate, but the impact on the budget line and welfare effects on the most vulnerable

segments of society, particularly given the rise in food prices and the weight of food in the consumption basket. This is a matter for the fiscal authorities, and the need for designing and giving effect to safety-nets cannot be overemphasized. For us, as a monetary authority, the main concern comes from the signals that the legislature plans to change the benchmark oil price in the 2012 budget from US\$70/bbl. to US\$75/bbl. or even US\$80/bbl. This is an indication of a lack of total commitment to fiscal discipline and consolidation.

At US\$70/bbl., we believe the fiscal stance would be compatible with price stability and the current interest and exchange rate stance, without placing foreign assets at risk. An overly ambitious expansion may constitute a big risk to price stability, leading to a rise in already high interest rates, or a reversal of the positive trend in reserve accumulation. These will have an impact on the real economy and its ability to cope with external shocks. We can however wait until the next MPC meeting for clarity on the fiscal stance and see if it warrants a change in monetary policy.

For the above reasons, I vote for maintenance of the status quo for now, in MPR, CRR, LR and exchange rates.

I am satisfied that tightening at this point will be too pro-cyclical and unlikely to reverse any inflationary consequence of supply-side shocks.

I vote for:

1. Maintaining MPR at $12\% \pm 2\%$
2. Maintaining CRR at 8%
3. Maintaining LR at 30% and
4. Maintaining exchange rate at $N155/\$1 \pm 3\%$