CENTRAL BANK OF NIGERIA

MONETARY POLICY REVIEW

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Central Bank of Nigeria

Mandate

▪Ensure monetary and price stability

▪Issue legal tender currency in Nigeria

▪Maintain external reserves to safeguard the international value of the legal tender currency

▪Promote a sound financial system in Nigeria

▪Act as banker and provide economic and financial advice to the Federal Government

Vision

"By 2015: Be the model Central Bank delivering Price and Financial System Stability and promoting Sustainable Economic Development"

Mission Statement

"To be proactive in providing a stable framework for the economic development of Nigeria through effective, efficient and transparent implementation of monetary and exchange rate policy and management of the financial sector"

Core Values

- Meritocracy
- Leadership
- Learning
- Customer - Focus

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STATEMENT BY THE GOVERNOR

Half way into 2013, expectations of speedier recovery of the global economy are less strong than they were at the end of 2012. Growth prospects for major advanced economies – US, UK, Euro area – are lower than observed a year earlier. The slowdown in the emerging market cluster, driven by China, could combine with sluggish growth in the advanced economies to produce a rather uninspiring pace of global recovery in the year. Likewise, the international financial environment continues to be uncertain, posing significant threats to domestic stability. Given the enormous threats from the external environment, the Monetary Policy Committee's considerations in the first half accorded due weight to risks from that sector.

Monetary policy remained generally focused on ensuring price stability in the face of additional domestic pressures, especially on consumer prices and the naira exchange rate. Monetary policy needed to remain relatively tight to rein-in growing pressures on both. The Monetary Policy Committee was persuaded by the need to maintain a tight policy stance for as long as required to bring inflation down to single digit and sustain stability of the exchange rate. Both objectives were reasonably met, with end-period headline inflation at 8.4 per cent and the dollar exchanging on average at around N158.00 in the first half of 2013. The stable naira exchange helped to maintain orderliness in capital flows and the financial markets; although concerns about the end of quantitative easing by the US Federal Reserve have continued to weigh-in heavily on investor sentiment.

As we enter the second half, monetary policy will remain cautious, factoring in real potential risks from within and also from the external environment. Of particular importance will be how the US Fed handles QE3, the slowing growth and other unfolding dynamics in emerging market economies and global output and inflation developments. While not expecting a sudden switch to a contractive monetary policy mode in the advance economies, market reactions to a scale back in monetary easing easy policy may be disproportionate. Flow reversals remain a key risk in frontier economies especially given the high likelihood of increased yields and interest rates in the advanced economies. In the short- to medium-term, monetary policy will continue to support stability of the exchange rate and building of reserve buffers to elicit greater confidence in the economy.

The outlook for the rest of 2013 and first half of 2014 indicates continued moderation in inflation on the back of appropriate monetary policy and developments in the real sector of the economy including the ongoing reform of the power sector and special interventions in support of micro, small and medium enterprises.

Sanusi Lamido Sanusi, CON,
Governor,
Central Bank of Nigeria.

CHAPTER 1
OVERVIEW

Against the background of inflationary pressures observed up to end-December 2012, uncertainties in the international oil market, and sluggish global economic recovery, monetary policy was deployed to balance multiple risks during the review period

The conduct of monetary policy in the first half of 2013 was tailored primarily towards the achievement of price stability. Against the background of inflationary pressures, especially the headline inflation observed up to end-December 2012, the sluggish global economic recovery and the uncertainties in the financial system, monetary policy was designed to balance the risks during the review period. The orientation of monetary policy was also informed by the challenges of sustaining a stable exchange rate of the naira, creating a buffer of external reserves, sustaining stability of the money market rates, narrowing the spread between lending and deposit rates and mitigating the impact of the slow recovery of the global economy on domestic output. In consideration of these multi-dimensional challenges, monetary policy applied a mix of instruments to deliver on price stability and restore confidence in the economy.

…Nigerian Treasury Bill auctions and foreign exchange market interventions were also used for monetary management, while the Bank sustained efforts towards improving communication with market operators and other stakeholders

The Monetary Policy Rate (MPR) remained the major instrument for signalling the direction of interest rates in order to lock-in inflation expectations. Open market operations (OMO) was employed as the principal instrument of liquidity management, which was complemented by repurchase agreements and discount window operations. In addition, reserve requirements and foreign exchange net open position (NOP) limit for deposit money banks were deployed to address the surge in banking system liquidity and pressure on the exchange rate during the review period.

The public auction of Nigerian Treasury Bills and interventions in the foreign exchange market were also used in monetary management to mop up excess liquidity while the Bank strengthened its communication strategy through periodic information to the markets of its determination to maintain exchange rate stability by defending the naira in order to sustain confidence among market operators and other stakeholders.

The decision by the MPC to retain previous policy measures in the first half of 2013 was to allow the effects to work fully through the economy and deliver on stable and low inflation

The Monetary Policy Committee (MPC) held three regular meetings in the review period, during which the MPR was retained at 12.0 per cent with a symmetric corridor of +/- 200 basis points. In keeping with the monetary tightening stance, cash reserve requirements (CRR) was maintained at 12.0 per cent and NOP limit was left at 1.0 per cent. The Liquidity Ratio (LR) was kept at 30.0 per cent while the mid-point of the exchange rate was unchanged at N155/US$ with a band of +/-3.0 per cent. The decision of the MPC to retain previous policy measures in the first half of 2013 was to allow the full effects of past policy actions to work through the economy and deliver on stable and low inflation.

Short-term interest rates were largely within the MPR corridor.

Inflationary pressures continued to moderate mainly in response to the policy measures implemented by the Bank. Year-on-year headline inflation decelerated to 8.4 per cent in June 2013, from 12.0 per cent in December, 2012. Also, core inflation declined significantly to 5.5 per cent from 13.75 per cent over the same period. Similarly, food inflation declined to 9.60 per cent in June 2013, from 10.20 per cent in December 2012.

The non-oil sector continued as the major driver of growth during the period. The share of the oil sector in output suffered a severe setback during the period under review, due largely to the incidents of pipeline vandalisation, illegal oil bunkering and shut down of oil facilities.

Short-term interest rates remained largely within the MPR corridor and movements in the interbank interest rates were less volatile. The average interbank call and open buy back (OBB) rates declined by 29 and 54 basis points to 11.59 and 11.19 per cent in June 2013, from 11.88 and 11.73 per cent in December 2012, respectively. This development in short term interest rates was influenced by liquidity surfeit in the system despite the tight monetary policy stance maintained during the period. In addition, the implementation of administrative measures such as the prohibition of concurrent dealings in wDAS and the Standing Lending Facility Window affected market activities. However, there was an upsurge in the demand for foreign exchange in the latter part of the review period, owing mainly to seasonal dividend repatriation by foreign investors.

The demand for foreign exchange at the wDAS segment, during the first half of 2013, declined by 2.0 per cent when compared with the demand in the first half of 2012. Supply to the market was similarly lower in the review period, relative to the same period in 2012. But relative the second half of 2012, average demand at the wDAS segment rose by 20.51 per cent. In the same vein, average supply of foreign exchange to the bsame market segment increased by 20.62 per cent over the level in the corresponding period of 2012. The Bank's interventions in the foreign exchange market in the first half of 2013 provided strong support for the naira. As a result, the average exchange rate appreciated by 0.03, 0.12 and 0.52 per cent at the wDAS, Interbank and Bureau de Change (BDC) segments of the foreign exchange market, respectively.

Domestic output growth experienced slight decline caused by the challenges in the global economy. Data from the National Bureau of Statistics (NBS) showed that Nigeria's real GDP grew by 6.18 per cent compared with 6.39 per cent in the first half of 2012. Also, relative to the growth of 6.99 per cent in the second half of 2012, growth performance in the review period showed a marginal decline. The non-oil sector, particularly agriculture, wholesale trade and services, remained the major drivers of growth during the review period. The share of the oil sector in total output declined during the period under review, due largely to the incidents of pipeline vandalisation, illegal oil bunkering and shut down of oil facilities.

Key risks to output growth in the near term include the lingering sluggish growth in Europe, rising revenue leakage from oil theft, lingering security challenges as well as delays in the reform of critical infrastructure…

The outlook for inflation in the domestic economy suggests that it would remain within the single digit in the rest of 2013. This is underpinned by expected improvements in output growth arising from favourable and continued stable macroeconomic conditions. Key risks to output growth in the near-term include the lingering sluggish growth in Europe and revenue shortfalls in the oil sector. In addition, the lingering security challenges as well as slow progress in the provision of critical infrastructure could further undermine output growth.

CHAPTER 2
DOMESTIC PRICE DEVELOPMENTS AND THE REAL ECONOMY

In the first half of 2013, inflationary pressures moderated significantly, in response to the sustained tight monetary policy stance, complemented by the relative stability in the exchange rate of the naira. Domestic output growth was modest compared with 2012.

In the first half of 2013, inflationary pressures moderated significantly, partly in response to the sustained tight monetary policy and the base effects of the partial withdrawal of subsidy from the pump price of premium motor spirit (PMS) in the first half of 2012. The moderation was complemented by the relative stability in the exchange rate of the naira. Domestic output growth in the review period was modest compared with the corresponding period of 2012, owing to persistent security challenges in some parts of the country, which affected economic activities, particularly agricultural production and consumer demand in the affected areas.

2.1 Domestic Economic Activity

The contribution of the oil sector to real GDP was lower at 12.90 per cent in the first half of 2013 compared with 13.9 per cent in the corresponding period of 2012, though higher than the 12.59 per cent in the second half of 2012.

Domestic output growth remained resilient on the back of favourable conditions for increased agricultural production despite the security challenges and the slow pace of recovery in the global economy. Growth in both the oil and non-oil real Gross Domestic Product (GDP) was higher in the review period, relative to the corresponding period of 2012. Real GDP stood at 6.36 per cent as in the corresponding period of 2012 but lower than the 6.75 per cent in the second half of 2012. The contribution of the oil sector to real GDP has continued to decline. It was lower at 13.79 per cent in the first half of 2013 compared with 13.86 per cent in the corresponding period of 2012, though higher than the 12.10 per cent recorded in the second half of 2012. The decline resulted from a number of factors including disruptions in oil production due to facility shut downs and pipeline vandalism; incidents of oil theft; increase in international oil market supply due to discovery of shale oil in the US and China (see Box 1) as well as the emergence of new African oil exporters competing for Nigeria's traditional export market.

The major driver of growth in the review period remained the non-oil sector at 7.61 per cent, though down from 7.90 per cent in the second half of 2012, in contrast to the 1.00 per cent

The average manufacturing capacity utilisation rate increased to 58.0 per cent from 57.9 and 56.0 per cent in the second half and the corresponding half of 2012.

contraction in the oil sector. The contribution of agriculture to overall growth was 1.93 per cent which was marginally lower than the 1.96 percentage points experienced in the first half of 2012. Wholesale and retail trade; and services sectors contributed 1.86 and 3.09 percentage points to growth in the review period compared with the 2.00 and 3.26 percentage points in the corresponding periods of 2012. The marginal decline in the contribution of agriculture to output growth was attributed to security challenges, which affected farming activities in some parts of the country. As with agriculture, the security challenges in the country was responsible for the negligible increase in the contribution of the wholesale and retail trade subsector.

The index of industrial production rose to 138.69(1990=100) in the first half of 2013 from 137.59 in the second half of 2012, and 137.25 in the corresponding period of 2012. The index of manufacturing production increased to 110.6 (1990=100) from 106.3 in the second half of 2012 and 106.8 in the corresponding half of 2012. Compared with the two preceding periods, this represented an increase of 3.55 and 4.04 per cent, respectively. Unlike the industrial and manufacturing indexes, the index of mining production at 146.25(1990=100) was 0.48 and 0.31 per cent lower than the 146.9 and 146.7 per cent recorded during the second half and the first half of 2012, respectively. The average manufacturing capacity utilisation rate increased to 58.0 per cent from 57.9 and 56.0 per cent in the second half and the corresponding half of 2012. The noticeable increase in the industrial index was attributed largely to the improved electricity supply, favourable performance of the value-chain initiatives of government (such as rice and cassava), as well as improved business confidence arising from measures to address the security challenges in the country.

Developments in the global economy, particularly the sustained, though weak recovery in major trading partner economies, notably the US, UK and Japan also contributed to the modest domestic output growth in 2013, relative to 2012.

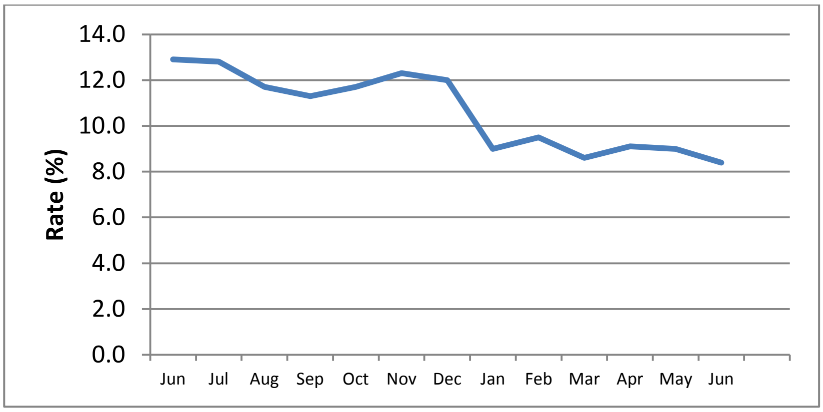
2.2 Trends in Inflation Rates

The Bank sustained its tight monetary policy stance during the review period. The restrictive policy stance, base effects as well as the waning impact of the partial withdrawal of subsidy from the pump price of petrol in January, 2012 largely contributed to the moderation in consumer prices in the first half of 2013. At end-June 2013, headline inflation (year-on-year) moderated to 8.40 per cent from 12.0 and 12.90 per cent at end-December and end-June 2012, respectively (Figure 2.1). Headline inflation in the first half of 2013 was driven mainly by food and non-alcoholic beverages; housing; water; electricity; and transport. Food inflation (year-on-year) continued to moderate as observed since 2011. It was 9.60 per cent at end-June 2013, down from 10.20 per cent at end-2011, respectively. The 4.44 percentage point drop from 4.40 to negative 0.04 per cent in the processed food component contributed to the moderation in food inflation. The decline in processed foods prices was traced to moderation in transportation costs following improved fuel supply as well as declining processing costs due to improvements in electricity supply. Between January and June, 2013, the contribution of processed food to food inflation decreased from 3.20 to -0.04 per cent. Similarly, the contributions of meat and yams, potatoes and other tubers to inflation declined from 1.12 and 1.26 per cent at end-January, 2013 to 0.9 and 1.13 per cent in June 2013, respectively (Table 2.3). In the same period, the contributions of farm produce and fruits to inflation increased from 7.0 and 0.38 to 10.0 and 0.45 per cent, respectively.

Core inflation (year-on-year) decelerated to 5.5 per cent in the first half of 2013 from 13.70 per cent at end-December 2012 and 15.2 per cent at end-June 2012

Core inflation (year-on-year) decelerated to 5.5 per cent in the first half of 2013 from 13.70 per cent at end-December 2012 and 15.2 per cent at end-June 2012. The continued decline in core inflation indicated that the inflationary pressures from the partial removal of subsidy on PMS at the beginning of 2012 had abated considerably, and that the relatively stable exchange rate regime greatly assisted in delivering low inflation during the period.

Figure 2.1
Headline Inflation (June 2012 – June 2013)



Source: NBS

The core and food components of the consumer price index increased from 141.80 and 141.20 at end-December 2012 to 145.50, and 147.50 respectively (Table 2.1). While the index of core inflation increased by 3.7 percentage point that of food rose by 6.3 percentage points. In effect, the food component of inflation exerted greater pressure on headline inflation.

Table 2.1
Inflation Rate (June 2012 – June 2013)

	Headline Inflation			Core Inflation			Food Inflation		
	CPI	Y-on-Y	12 MMA	CPI	Y-on-Y	12 MMA	CPI	Y-on-Y	12 MMA
Jun -12	135.30	12.90	11.30	138.00	15.20	12.70	134.50	12.00	10.60
Jul	135.70	12.80	11.60	138.10	15.00	13.00	135.00	12.10	11.00
Aug	136.60	11.70	11.80	139.00	14.70	13.30	135.90	9.90	11.10
Sep	138.00	11.30	11.90	139.70	13.10	13.50	137.50	10.20	11.10
Oct	139.20	11.70	11.90	140.30	12.40	13.50	138.80	11.10	11.20
Nov	140.00	12.30	12.10	140.90	13.10	13.60	139.80	11.60	11.40
Dec	141.10	12.00	12.20	141.80	13.70	13.90	141.20	10.20	11.30
Jan	141.90	9.00	11.90	143.80	11.30	13.70	142.30	10.10	11.10
Feb	143.00	9.50	11.70	143.80	11.20	13.70	143.30	11.00	11.20
Mar	144.00	8.60	11.40	144.80	7.20	13.00	144.60	9.50	11.00
Apr	144.80	9.10	11.10	144.50	6.90	12.30	145.60	10.00	10.80
May	145.80	9.00	10.80	145.20	6.20	11.50	146.40	9.30	10.50
Jun	146.60	8.40	10.40	145.50	5.50	10.70	147.50	9.60	10.40

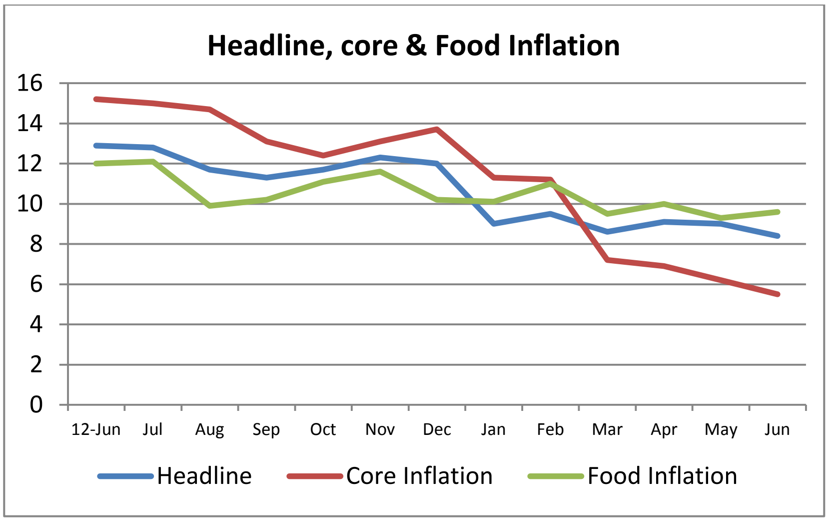
Source: National Bureau of Statistics (NBS)

Table2.2
Quarterly Consumer Price Development
(November 2009=100)

	12 -Sep		12- Dec		13 -Mar		13-Jun	
	Y-on-Y	**12 MMA**	**Y-on-Y**	**12MMA**	**Y-on-Y**	**12MMA**	**Y-on-Y**	**12MMA**
Headline	11.30	11.90	12.00	12.20	8.60	11.40	8.40	10.40
Core	13.10	13.50	13.70	13.90	7.20	13.00	5.50	10.70
Food	10.20	11.10	10.20	11.30	9.48	11.00	9.60	10.40

Source: National Bureau of Statistics (NBS)

Figure 2.2
Y-o-Y Headline, Core and Food Inflation Rates
(June 2012 - June 2013)

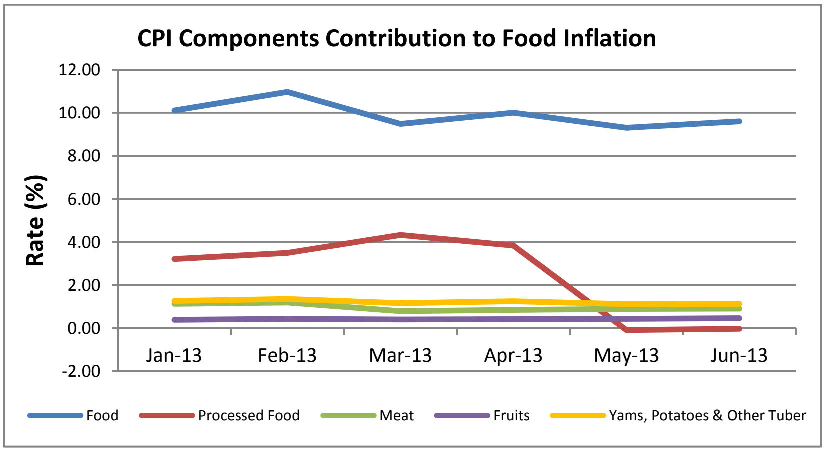


Source: NBS

Table 2.3
Selected CPI Components' Contribution to
Food Inflation (Year-on-Year) Jan – Jun 2013

Date	**Jan-13**	**Feb-13**	**Mar-13**	**Apr-13**	**May-13**	**Jun-13**
Food	10.10	10.97	9.48	10.01	9.30	9.6
Processed Food	3.20	3.49	4.32	3.83	-0.10	-0.04
Farm Produce	7.00	7.48	5.17	6.18	9.40	10
Meat	1.12	1.19	0.78	0.84	0.89	0.9
Fruits	0.38	0.43	0.40	0.41	0.42	0.45
Yams, Potatoes & Other Tubers	1.26	1.35	1.15	1.24	1.11	1.13

Figure 2.3
Selected CPI Components' Contribution to Food Inflation (Year-on- Year) Jan – June 2013



Source: NBS

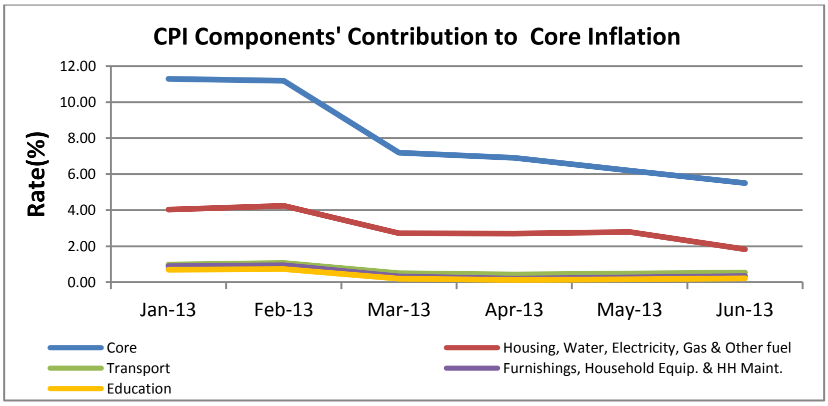
All the major components of core inflation contributed to its decline during the first half of 2013. The contributions of housing, water, electricity, gas and other fuels; transport; furnishings, household equipment & maintenance; and education declined from 4.03, 0.99, 0.90 and 0.70 to 1.83, 0.53, 0.35 and 0.22 per cent between January and June 2013, respectively (Table 2.4).

Table 2.4
Selected CPI Components' Contribution to Core Inflation (Year-on-Year) Jan – Jun 2013

Date	Jan-13	Feb-13	Mar-13	Apr-13	May-13	Jun-13
Core	11.30	11.18	7.20	6.90	6.20	5.50
Housing, Water, Electricity, Gas & Other fuel	4.03	4.25	2.73	2.70	2.79	1.83
Transport	0.99	1.08	0.51	0.43	0.48	0.53
Furnishings, Household Equip. & HH Maint.	0.90	0.95	0.33	0.21	0.28	0.35
Education	0.70	0.74	0.21	0.13	0.17	0.22

Source: NBS

Figure 2.4
Selected CPI Components' Contribution to Core Inflation (Year-on-Year) January – June 2013

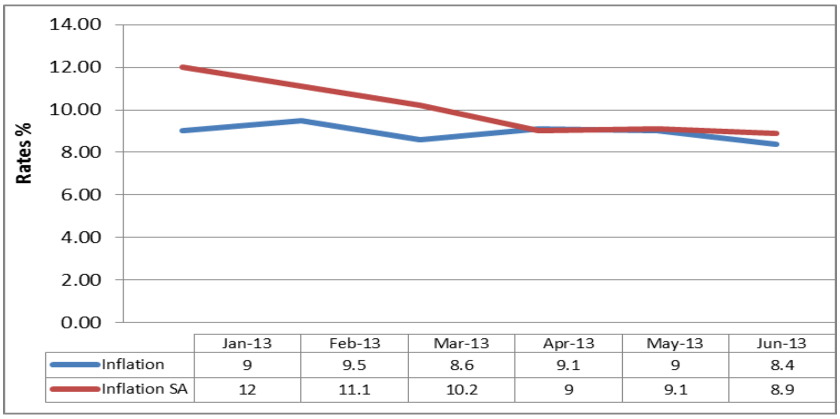


Source: NBS

2.3 Actual and Seasonally Adjusted Headline Inflation

Except in April, seasonally adjusted inflation was higher than the actual inflation rate in the first half of 2013, (Figure 2.5). The development was traced to the spill-over effects of the flood in the third and fourth quarters of 2012, which reduced food availability and exerted upward pressure on domestic food prices. In April, actual inflation was above the seasonally adjusted inflation due to the spike in consumption expenditure associated with the Muslim and Christian festivals which held one after the other during the review period.

Figure 2.5
Actual and Seasonally Adjusted Headline Inflation January 2013 – June 2013



	Jan-13	Feb-13	Mar-13	Apr-13	May-13	Jun-13
Inflation	9	9.5	8.6	9.1	9	8.4
Inflation SA	12	11.1	10.2	9	9.1	8.9

...the Central Bank continued rigorous liquidity mopping up exercises through Open Market Operations (OMO), thereby limiting credit creation opportunities

2.4 Key Factors that Influenced the Domestic Price Developments

The year-on-year headline inflation which stood at 12.0 per cent at end-December, 2012 declined to 9.0, 8.6 and further to 8.4 per cent in January, March and June 2013, respectively. Thus, the inflationary pressure which prevailed in the second half of 2012, moderated in the first half of 2013. The major factors that mitigated the inflationary pressure during the period were demand-pull and cost-push.

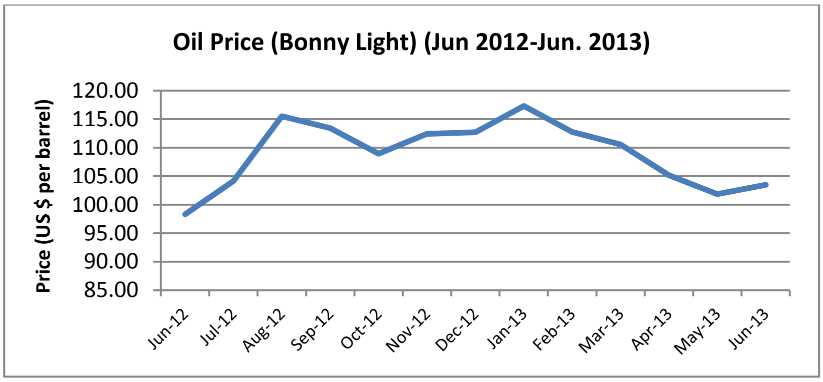
2.4.1 Demand-Pull Factors

The moderation in inflation during the review period was in part the result of the tight monetary policy stance. In particular, the monetary policy rate and CRR were each unchanged at 12.0 per cent. The Bank also retained the foreign exchange net open position (NOP) for DMBs at 1 per cent. To complement the tight monetary policy stance, fiscal policy through a delay in signing the 2013 Federal Government budget into law, curtailed capital budget releases during the period under review, thereby helping the overall monetary policy stance by moderating growth in money supply.

The Fiscal Authorities also suspended regular augmentation of current revenue receipts from the Excess Crude Account. This helped to slowdown public sector spending as well as reduced the availability of funds in the banking system.

The slow recovery in advanced economies, despite monetary easing operations in the United States, the United Kingdom, the Euro area and Japan helped to ensure that global inflation remained subdued. The combination of subdued global inflation and domestic exchange rate stability minimized the effect of imported inflation on the domestic economy.

Figure 2.6
Bonny Light Crude Oil Price
June 2012 – June 2013



Source: Bloomberg

2.4.2. Cost-Push Factors

Improvement in the supply of electricity and petroleum products nation-wide contributed to reduction in production cost in the manufacturing, wholesale and retail, agricultural and service sectors of the economy. A number of federal roads were rehabilitated while new ones were also initiated, which generally reduced transport costs across the country and improved agricultural as well as general goods supply. In the first quarter of 2013, the government intensified security measures including the declaration of a state of emergency in three north eastern States. The demand by labour for public sector wage increases was successfully contained.

The Bank's consumer protection programme resulted in a reduction in bank charges following the release of the new Banking Tariff, while its foreign exchange market interventions kept the exchange rate stable enough for producers to make meaningful medium-to long-term production plans.

By these policy actions, economic costs have been benign, thereby contributing to the overall moderation in inflation during the period.

2.4.3 Moderating Factors

…the government continued the process of transfer of power generation and distribution to the private sector which has elicited confidence in the business outlook.

Major factors that accounted for moderation in inflation were the lowering of transportation and manufacturing processing costs occasioned by improved fuel and electricity supply. From the beginning of the year, the Federal Government continued the process of transfer of power generation and distribution assets to the private sector. The reform in the power sector improved investor confidence and business outlook despite the upward adjustment in tariff during the period. In the same vein, there were improvements in road construction, including reconstruction and rehabilitation of roads and bridges to improve the road network across the country. Access to some regions, cut off by the 2012 flood, was restored in several industrial and agricultural production zones.

Volatility in oil prices moderated during the period and it remained well above the budget benchmark price of US$79 per barrel. However, there were production and export shortfalls due to oil theft and pipeline vandalism which led to occasional sharing of moneys drawn from the Excess Crude Account by the Federal, States and Local Governments to meet fiscal revenue gaps. In addition, the government continued to express commitment to its policy of reducing the fiscal deficit in the 2013 budget. This improved investor confidence and helped to lock-in inflationary expectations.

…credibility of monetary policy during the period triggered a rally in the capital market, allowed for capital inflows and accumulation of foreign exchange reserves…

Given developments in the global and domestic economies during the review period, the Monetary Policy Committee (MPC) held three meetings, which took place in January, March and May 2013, and retained the MPR at 12.0 per cent, CRR at 12.0 per cent and foreign exchange Net Open Position (NOP) at 1.0 per cent. Apart from controlling inflation, these policy measures were aimed at sustaining the stability of the naira exchange rate and building-up external reserves.

The credibility of monetary policy during the review period boosted confidence in the capital market, engendered capital inflows and strengthened foreign exchange reserves buffer against future shocks. In addition, the decision of the MPC to keep monetary policy rate unchanged during the review period, not only helped all the measures work through the system, but also ensured macroeconomic stability. Consequently, the domestic financial market remained generally stable in the first half of 2013.

Box 1
Impact of Global Shale Oil Production on Nigeria

The US for a long time was the major importer of Nigerian crude oil, accounting for 40 per cent of the country's exports. However this has changed as the Energy Intelligence Agency (EIA) of the United States reported significant declines in oil imports from Nigeria. From January 2011 to January 2012, US crude oil imports from Nigeria fell by 54 per cent from 968,000 to 449,000 barrels per day. Apart from the overt policy of reducing energy dependency, the US has increased domestic oil output through new drilling techniques including hydraulic fracturing, which have produced oil and gas from shale and tar sand. Total US oil output is expected to reach 7.75 million barrels a day by the end of 2013 and 8.09 million in 2014. This development has made the US the world's largest exporter of refined fuels including gasoline and diesel. In March 2013, according to the EIA, the US met 89 per cent of its own energy needs from domestic sources.

Importantly, shale oil has been found in Russia, China and the Middle East. Increasing oil supply from shale and an uncertain global growth outlook will likely keep oil prices trading in a relatively narrow range. The boom in shale oil has cut global dependence on OPEC oil even as global demand is increasing.

For Nigeria, there is the additional concern of new oil finds in Africa; in Ghana, Uganda and Chad, which will compete with Nigeria as source but without the political upheaval and violence associated with the Niger Delta where Nigeria's oil is produced. As oil export is the dominant source of public sector revenue and the country's foreign exchange, the emergence of shale oil and gas is a threat to the macroeconomic stability of Nigeria. Experts say that according to current knowledge, only if crude oil price falls below US$80/bbl will shale oil production become uneconomic. That price is only $5.00 above the 2013 budget benchmark of oil price.

In summary, production of oil from shale by developed countries and new crude oil producing countries, constitute downside threat to inflation, foreign exchange stability, accretion to foreign reserves and fiscal sustainability. Drastic decline in foreign exchange inflow will reduce monetary growth and threaten banking system stability. What is required to mitigate these challenges is to increase fiscal discipline, diversify the economic and export base with policies that facilitate growth in industries like agriculture, mining, tourism and manufacturing and increase internally generated revenue by raising the tax base. It also calls for early disengagement of oil revenue from direct public sector finance through a large scale operationalisation of credible Sovereign Wealth Fund mechanism as is the case of the Netherlands, Norway and Kuwait, for example.

CHAPTER 3
MONETARY POLICY

...Monetary Policy Committee (MPC) continued with the tight monetary policy stance to rein in liquidity in the domestic money market and stabilize the exchange rate of the naira.

Globally, the monetary policy environment in the first half of 2013 was easy, reflecting benign inflationary pressures linked to slow growth and financial market weaknesses in the advanced economies as well as lower-than-expected growth in the large emerging and developing economies. Nonetheless, the Monetary Policy Committee (MPC) continued with the tight monetary policy stance that commenced in October 2011 to rein in liquidity in the domestic money market and stabilise the exchange rate of the naira.

3.1 The Monetary Policy Environment in the Review Period

3.1.1 International

The global economy remained subdued characterised by uncertainty and contraction in the Euro zone and Japan, including lower than expected growth in the large emerging and developing economies. Although the partial resolution of the Fiscal Cliff in the US offered some hope for gradual economic recovery by staving off of automatic tax increases and expenditure cuts on 1st January, 2013, the robust prospects for energy independence of the US and the likely downside risk for global oil prices in the medium- to long-term might threaten fiscal sustainability in many oil-dependent economies around the world.

3.1.2 Domestic

Developments in the domestic economy reflected some new threats notably, the significant decline in the demand for oil, leading to a fall in oil prices and government revenues, pressure on the exchange rate and decline in external reserves level. There were additional threats concerning the low level of credit growth to the private sector and the risk to the inflation objective from the oil price benchmark for the 2013 budget, which was increased from US$75 to US$79.

3.2. Highlights of Monetary Policy Measures

The monetary policy stance of the Bank remained restrictive during the first half of 2013 with the MPR retained at 12.0 per cent. The CRR which was raised at the MPC meeting of July 2012, from 8.0 to 12.0 per cent was maintained at that rate throughout the review period. Similarly, the foreign exchange NOP, which was reduced to 1.0 per cent from 3.0 per cent at the same July 2012 MPC meeting, was retained. In addition, the mid-point of the exchange rate remained at N155.00/US$1.00 with the band of +/- 3.0 per cent in order to sustain the stability of the domestic currency, attract foreign investments, and build-up external reserves.

The sustained tight monetary policy stance was informed by the need to stabilise the exchange rate; mitigate inflationary risks from increased sub-national government spending (through borrowing from DMBs and the capital market) and high recurrent expenditure in the 2013 Federal Government budget.

3.3 Decisions of the Monetary Policy Committee

Uncertainties in the international and domestic economic environment shaped the MPC decisions in the first half of 2013. The key challenges were the continued international financial market fragility and threats of fiscal weakness, sluggish global economic recovery, less than expected domestic growth performance, inflation expectation, high unemployment and possible speculative attack on the naira.

3.3.1 January 2013 MPC Meeting

The MPC at its January 2013 meeting faced three policy choices. The first was an increase in the MPR to tame the inflationary pressure observed up to December 2012 as well as neutralise the effect of higher crude oil price benchmark for fiscal 2013. Given the double digit rate of headline inflation that averaged 12.24 per cent in 2012, the MPR of 12.0 per cent was judged to be about right. The second was a reduction in MPR in view of the declining GDP growth trajectory and the upward trend in headline inflation. The third policy option was to retain the current monetary policy stance to address conflicting price signals, global uncertainties and preserve the stability of the financial system. Other uncertainties were increased sub-national government spending, the expected high Federal Government expenditure in 2013 and the looming

US debt ceiling crisis with possible impact on commodity prices.

Given these uncertainties, the Committee decided that it was prudent to maintain the prevailing stance and monitor developments until the March 2013 MPC meeting. It therefore retained the MPR at 12 per cent with symmetric corridor of +/- 200 basis points. The CRR was raised to 12.0 per cent from 8 per cent and the MOP was reduced to 1.0 per cent from 3 per cent, to contain excess liquidity conditions in the banking system, and address speculative attacks on the Naira.

…the Committee was encouraged by signs of macroeconomic stability from both external and domestic environment.

3.3.2 March 2013 MPC Meeting

At the March 2013 meeting, the Committee was encouraged by signs of macroeconomic stability from both the external and domestic environments. However, the Committee took note of risks related to the mixed price signals reflecting base effect of the first and second round impacts of the partial fuel subsidy removal in January 2012, as well as the declining yield on FGN bonds partly traced to the quantitative easing measures in the US and the EU. The MPC again considered three policy options. First, it examined the option of an increase in rates in response to the uptick in headline and food inflation as well as pressure on the exchange rate, but rejected the option because there were no major inflationary concerns at the time. The second option of reducing the rates in the light of declining core inflation and GDP growth was also dropped to avoid sending wrong signals of a premature termination of the tightening cycle. The Committee, therefore, decided in favour of retaining the existing tight monetary policy stance to sustain the gains already achieved. Accordingly, the decisions were to retain the MPR at 12.0 per cent with a corridor of +/- 200 basis points; retain the CRR at 12.0 per cent and the liquidity ratio at 30.0 per cent with the Net Open Position at 1.0 per cent.

…moderation in all measures of inflation on month-on-month basis, stable banking system and exchange rate and robust external reserves.

3.3.3 May 2013 MPC Meeting

At the May 2013 meeting, the Committee observed the main areas of concern to include the threat in the oil-sector notably the uncertain oil market environment, high output leakages, the low level of credit to the private sector and declining yields

Considering that the potential output gain from monetary easing may not be sufficient to overturn the long term implications of sending a wrong signal....

on FGN bonds. The Committee, however, noted with satisfaction the emerging and prevailing macroeconomic stability — moderation in all measures of inflation on month-on-month basis, stable banking system and exchange rate and robust external reserves. In these circumstances, the Committee emphasised the importance of sustaining the declining core inflation, stable exchange rate and relative accretion to reserves. The option of reducing the MPR, considering the potential risk factors associated with increasing fiscal expenditure in the short- to medium-term, was rejected by the Committee because it that could possibly result in a resurgence of inflationary pressures. Consequently, the prevailing monetary policy stance was retained to sustain the macroeconomic gains of tight monetary policy and to continue to rein in inflationary expectations. Accordingly, the Committee voted to retain the MPR at 12 per cent with a corridor of +/- 200 basis points; retained the CRR at 12 per cent and the Liquidity Ratio at 30 per cent with the Net Open Position at 1.0 per cent (Table 3.1).

Table 3.1
MPC Decisions, January – May, 2013

Items	**January**	**March**	**May**
MPR	Retain the MPR at 12%	Retain the MPR at 12%	Retain the MPR at 12%
MPR Corridor	Maintain +/- 200 basis points	Maintain +/- 200 basis points	Maintain +/- 200 basis points
SDF Rate	Maintain at 10%	Maintain at 10%	Maintain at 10%
SLF Rate	Maintain at 14%	Maintain at 14%	Maintain at 14%
CRR	Raise to 12% from 8%	Retain at 12%	Retain at 12%
LR	Retain at 30%	Retain at 30%	Retain at 30%
NOP	Reduce to 1% from 3%	Retain at 1%	Retain at 1%
FX Rate Mid–Point	Retain at N155/US$1	Retain at N155/US$1	Retain at N155/US$1
FX Band	Maintain +/-3 per cent band	Maintain +/-3 per cent band	Maintain +/-3 per cent band

Increase in OMO sales was attributed to the impact of monetization of AMCON bonds

3.4 Monetary Policy Instruments

In furtherance of the price stability objective and the need to create an environment conducive to local and international investment, the MPC deployed the MPR complemented by CRR and employed Open Market Operations (OMO) and Discount Window Operations in the review period. The choice was guided by the need to rein in excess liquidity, sustain the goal of price stability and the generally favourable domestic macroeconomic environment.

3.4.1 Monetary Policy Rate (MPR)

The MPR, the Bank's benchmark policy rate, remained the major signalling instrument for monetary policy complemented by interest rate corridor (standing lending/deposit facility rates). The Committee kept the MPR unchanged at 12.0 per cent with a symmetric band of +/- 200 basis points during the three regular meetings held in the first half of 2013.

3.4.2 Open Market Operations (OMO)

Open Market Operations (OMO) remained the major tool of liquidity management in the review period. CBN Bills were the main securities for OMO transactions during the period, with total amount of N10,020.00 billion offered, while subscription was N11,532.75 billion. Actual sales, however, amounted to N7, 099.54 billion in the first half of 2013, compared with N2,795.58 billion in the second half of 2012 and N1,717.35 billion in the corresponding period of 2012. This represented an increase of 313.40 and 153.95 per cent, respectively (Table 3.2). The increase in OMO sales was attributed to the impact of monetisation of AMCON bonds, attractive long-dated bills. Public subscription and sales in the review period were remarkably higher than the corresponding period of the preceding year due to high liquidity and attractive yields.

3.4.3 Reserve Requirements

The Bank retained the use of reserve requirements (Cash Reserve and liquidity ratios) in the review period to complement OMO and other instruments of liquidity management. The Cash Reserve Ratio was retained at 12.0 per cent, and the Liquidity Ratio was unchanged at 30.0 per cent in the first half of 2013. The retention of the CRR was against the background of the relative liquidity surfeit in the banking system.

Table 3.2
OMO Bills Auction (₦ million) January 2009 – December 2012

Date	2009	2010	2011	2012	2013	% Change over the Previous Period
Jan	115.47	149.83	205.59	246.64	1,756.66	
Feb	80.11	100.22	216.92	297.70	1,351.59	
Mar	80.00	65.00	284.06	491.59	1,265.25	
Apr	101.36	160.49	215.07	304.18	1,516.69	
May	120.22	100.22	204.60	363.13	1,27.40	
Jun	120.00	158.70	340.24	14.12	81.95	
1st Half	**617.16**	**734.46**	**1,466.48**	**1,717.35**	**7,099.54**	**313.40**
Jul	125.36	250.91	209.74	0.05		
Aug	105.22	141.16	218.92	4.50		
Sep	91.76	206.57	280.57	318.42		
Oct	170.26	167.01	309.95	882.80		
Nov	120.22	205.93	242.93	939.54		
Dec	162.56	297.91	319.91	650.27		
2nd Half	**775.38**	**1,269.49**	**1,582.02**	**2795.58**		**153.95**
Cumulative Figure	**1,392.54**	**2,003.95**	**3,048.50**	**4,518.18**		

Requests for SLF amounted to N5,248.70 billion compared with N7,733.53 billion in the second half of 2012 and N10,721.44 billion in the corresponding period of 2012

3.5 Standing Facilities

In the first half of 2013, the DMBs and Discount Houses (DH) actively accessed the standing facilities (lending/ deposit) to meet their daily liquidity requirements. However, there was a reduction in the cumulative volume of transactions at the CBN standing lending facility (SLF) window. Requests for SLF amounted to N5,248.70 billion compared with N7,733.53 billion in the second half of 2012. The volume of SLF at end-June 2013 represented a decrease of 51.04 and 32.13 per cent compared with the levels in the first half and the second half of 2012, respectively (Table 3.3). The significant decrease in the volume of SLF transactions in the first half of 2013 was attributed to improvement in liquidity conditions in the banking system largely driven by AMCON injections, and repayments of matured FGN bonds and CBN securities.

Table 3.3
CBN Standing Lending Facility (N'billion)
(January 2009- June 2013)

Date	2009	2010	2011	2012	2013	% change over the preceding/corresponding period
Jan	846.18	135.5	565.51	939.16	669.75	-28.69
Feb	3,457.57	-	1,369.60	1,060.90	1,115.64	5.16
Mar	4,592.69	-	3,425.47	2,053.62	993.47	-51.62
Apr	3,875.48	-	3,328.35	1,875.31	778.7	-58.48
May	2,581.43	270.97	3,722.41	1,472.21	796.89	-45.87
Jun	3,691.75	21.70	5,217.30	3,320.24	894.25	-73.07
1st Half	**19,045.10**	**428.17**	**17,628.64**	**10,721.44**	**5,248.70**	**-51.04**
Jul	4,675.02	55.76	3,334.91	3,322.49		
Aug	3,733.78	0.00	2,714.70	2,235.59		
Sep	2,287.90	73.10	7,698.83	979.61		
Oct	1,231.61	983.44	6,675.79	319.72		
Nov	537.58	1374.8	2592.94	355.79		
Dec	1,022.60	853.50	2,057.10	520.33		
2nd Half	**13,488.49**	**3,340.60**	**25,074.27**	**7,733.53**		
Total	**32,533.60**	**3,768.77**	**42,702.91**	**18,454.97**		

There was, however, a significant increase in the cumulative volume of transactions at the CBN Standing Deposit Facility (SDF) window in the review period. The cumulative volume of SDF stood at N17, 484.789 billion in the first half of 2013, compared with N9, 885.25 billion in the second half of 2012 and N3,727.96 billion in the corresponding period of 2012. The level of SDF as at end-June 2013 represented 369.02 and 165.17 per cent increases over the levels in the corresponding period of 2012 and the second half of 2012, respectively (Table 3.4). The observed increase in the use of the SDF window was a reflection of increased system wide liquidity in the review period, compared with the corresponding period of 2012. Another factor was the remuneration of part of the facility after October 2011, when the reserve averaging scheme was suspended in favour of daily maintenance of CRR.

Table 3.4
CBN Standing Deposit Facility (₦ billion)
(January 2009- June 2013)

Date	2009	2010	2011	2012	2013	% change over the preceding /corresponding period
Jan	-	5,622.63	1,864.84	868.1	2,132.70	24.93
Feb	-	6,101.90	721.62	788.26	3,047.91	42.91
Mar	-	9,413.45	325.75	352.85	6,101.42	100.18
Apr	-	6,853.06	49.65	201	2,817.00	(53.83)
May	-	1,735.45	73	1,242.50	1,718.53	(38.99)
Jun	-	5,563.64	97.18	275.25	1,667.22	(2.99)
1st Half	-	**35,290.13**	**3,132.04**	**3,727.96**	**17,484.78**	**369.02**
Jul	162	4,055.52	-	294.95		
Aug	1,453.38	6,849.71	-	980.55		
Sep	1,058.75	4,224.80	-	2,130.35		
Oct	3,106.30	1,117.30	422.5	2,408.70		
Nov	1,050.59	443.78	436.47	2,363.53		
Dec	1,797.92	1,191.78	576.85	1,707.17		
2nd Half	**8,628.94**	**17,882.89**	**1,435.82**	**9,885.25**		
Total	**8,628.94**	**53,173.02**	**4,567.86**	**13,613.21**		

Decline in demand reflected more stringent documentation and close monitoring of the foreign exchange market

3.6 Foreign Exchange Intervention

Intervention in the foreign exchange market remained a major policy tool employed by the Bank in sustaining the stability of the Naira. In the first half of 2013, the total supply of foreign exchange by the Bank was US$12,974.65 million compared with US$10,756.78 million and US$14,184.24 million in the second half and the corresponding period of 2012, respectively (Table 3.5). There was an increase in total supply compared with the level in the preceding half-year, but a decrease relative to the corresponding period of 2012. The decline in supply reflected more stringent documentation and close monitoring of the foreign exchange market by the Bank in the review period. These measures were complemented by increased autonomous foreign exchange inflows (Box 2) due to favourable crude oil price as well as increased private capital inflow attracted by the relatively high rate of returns on the domestic, vis-à-vis, the global financial markets.

Table 3.5
Foreign Exchange Supply by the CBN US$ million

Year	2011			2012			2013		
	Total wDAS sales	Sales to BDC	Total Supply (wDAS + BDC)	Sales to wDAS	Sales to BDC	Total Supply (wDAS + BDC)	Sales to wDAS	Sales to BDC	Total Supply (wDAS + BDC)
Jan	2,000.0	135.5	2,135.5	1,640.7	365.7	2,110.89	833.5	303.5	1,137.0
Feb	1,794.9	300.0	2,094.9	1,942.2	720.6	2,684.63	1,152.8	299.3	1,452.1
Mar	3,274.4	330.5	3,604.9	1,452.8	698.2	2,226.24	1,901.5	365.0	2,266.5
Apr	2,385.6	322.3	2,707.8	891.5	492.8	1,451.22	2,154.6	381.0	2,535.6
May	2,825.2	392.0	3,217.2	1,487.0	625.5	2,121.44	2,018.7	487.6	2,506.3
Jun	2,895.0	347.3	3,242.3	3,000.0	544.8	3,589.81	2,650.0	427.2	3,077.2
1st Half	**15,175.0**	**1,827.7**	**17,002.7**	**10,414.1**	**3,447.6**	**14,184.24**	**10,711.1**	**2,263.6**	**12,974.65**
Jul	2,895.5	398.2	3,293.7	1,961.7	419.5	2,381.2	-	-	-
Aug	3,172.7	504.3	3,677.0	1,842.9	361.8	2,204.7	-	-	-
Sep	4,161.9	995.7	5,157.6	1,539.4	371.2	1,910.6	-	-	-
Oct	3,406.0	716.8	4,122.8	1,051.0	389.8	1,440.8	-	-	-
Nov	3,260.9	795.4	4,056.3	1,278.7	311.7	1,590.3	-	-	-
Dec	2,475.8	675.7	3,151.5	990.3	239.9	1,230.2	-	-	-
2nd Half	**19,372.8**	**4,085.9**	**23,458.7**	**8,664.0**	**2,093.7**	**10,756.78**	**-**	**-**	**-**
Total	**34,547.8**	**5,913.6**	**40,461.4**	**19,078.1**	**5,541.3**	**24,941.02**	**10,711.1**	**2,263.6**	**12,974.8**

Box 2
MANAGING CAPITAL FLOWS IN NIGERIA

Capital flows across borders either as foreign direct or portfolio investments. Financial globalisation provided impetus for increased capital flows around the world basically in search of higher returns and safe investments. Capital flows are desired for a number of reasons including bridging investment resource gaps, especially in capital constrained economies; providing opportunities for returns in high interest-yielding countries and the search for safe tax heavens for capital in flight, among others. However, massive capital inflow can also create problems for recipient countries by creating liquidity surge that come from excessive bank lending, excessive investments, speculative activities that create asset bubbles, induced inflation spirals and macroeconomic instability in the case of sudden reversals. In response, many countries adopt countercyclical policies such as capital controls, sterilisation, fiscal consolidation, growth balancing and other macroeconomic policies to hedge against the negative effects of massive inflows and the risk associated with a sudden reversal.

In Nigeria, after the global financial crisis, capital flows have resumed on a phenomenal scale. The World Bank estimates that net capital inflow into sub-Saharan Africa as a whole could double from $43.4 billion in 2008 to $86.1 billion in 2015. Nigeria recorded $9.1 billion aggregate capital inflow including foreign direct and portfolio investment in the fourth quarter of 2012, indicating an increase of 6.53 per cent and 116.84 per cent from the levels recorded in the third quarter of 2012 and the last quarter of 2011, respectively. In the first quarter of 2013, capital inflows into Nigeria amounted to $1.29 billion as against $6.82 billion in the corresponding period of 2012. A number of factors explain the huge capital flows into Nigeria. They include relatively high return on portfolio investment, stable macroeconomic environment, robust outlook for oil prices and output, enlistment in the JP Morgan Bond Index and a healthy foreign reserve buffer that continue to buoy confidence of global investors on the ability of the economy to withstand domestic and external shocks.

In order to ensure that current capital inflow build up does not undermine macroeconomic stability, Nigeria introduced a number of strategies. The first is sterilisation of capital inflows with the potential to negatively impact on domestic liquidity by the Central Bank of Nigeria. The second approach is to control the quantum of off-shore credit lines open to DMBs and lastly a stand-by arrangement to invoke capital controls if the need arises. However, an attempt was made in the past to introduce capital controls such as the introduction of a time cap on divestment and profit repatriation but was dropped because of the mixed signal the policy sent to international investors. More importantly, the monetary authorities keep vigil over the growth and relative size of capital inflows (hot money) as a percentage of total foreign reserves. This approach is intended to alert monetary policy authorities when to introduce proactive counter cyclical monetary policy measures to mitigate the negative impact of imminent sudden capital outflow on the economy.

3.7 Performance of the Monetary Aggregates

The sluggish growth in monetary aggregates continued in the first half of 2013 owing partly to the maintenance of tight monetary policy by the Bank and the preference of DMBs to lend to the public sector by buying treasury instruments rather than extend credit to the private sector.

Broad money stock (M2) grew by 0.71 per cent to N15,593.26 billion as at end-June 2013 from N15,483.85 billion at end-December 2012 (Table 3.6). This translated to an annualised growth rate of 1.42 per cent, compared with 2.7 per cent in the corresponding period of 2012 and the benchmark of 15.20 per cent for end-December 2013. On year-on-year basis, M2 rose by 15.65 per cent at end-June 2013, compared with 8.10 per cent in the corresponding period of 2012.

Narrow money (M1) declined by 6.49 per cent to N6,939.63 billion at end-June 2013 from N7,420.95 billion at end-December 2012. On annualised basis, M1 dropped by 12.98 per cent at end-June 2013, compared with a decline of 5.08 per cent in the corresponding period of 2012 and the benchmark growth of 17.44 per cent for end-December 2013.

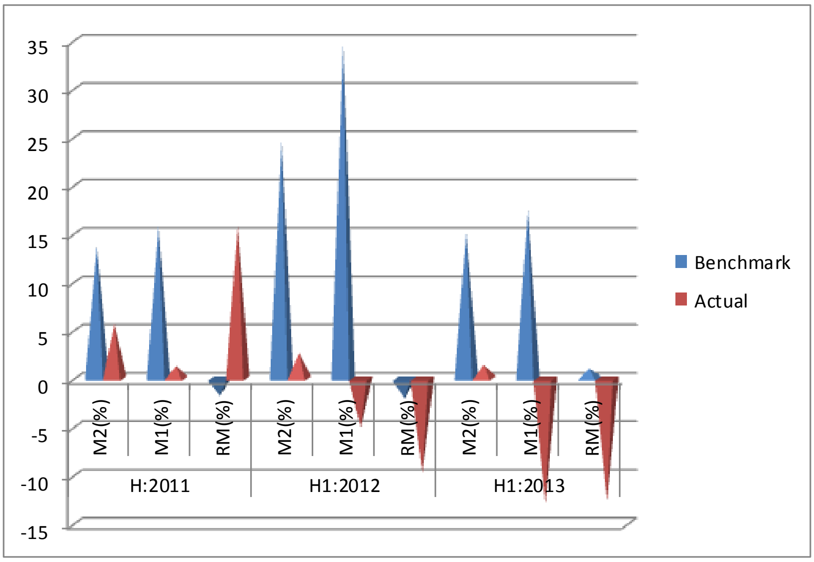
Reserve Money (RM) declined by 12.64 per cent to N3,236.15 billion at end-June 2013 from N3,704.48 billion at end-December 2012. The end-June 2013 RM level was 13.56 per cent (N507.82 billion) less than the benchmark of N3,743.97 billion for the second quarter of 2013

Table 3.6
Performance of Monetary Aggregates (H1: 2012 and 2013)

Monetary Aggregate	2012			2013			Change over Preceding December	
	Bench-mark	Actual end-June (H1: 2012)	Deviation (Actual – Benchmark)	Bench--mark	Actual end- June (H1: 2013))	Deviation (Actual – Benchmark)	H1: 2012	H1: 2013
M2 (N'b)	16577.53	13,483.06	-3,094.47	17,232.01	15,593.26	-1,638.75	179.57	109.41
M2 (%)	24.64	2.7	-21.94	15.20	1.42	-13.78	01.35	0.71
M1(N'b)	9,117.64	6,599.70	-2,517.94	8,097.56	6,939.63	-1,157.93	-172.19	-481.31
M1 (%)	34.71	-5.08	-39.79	17.44	-12.98	-30.42	-2.54	-6.49
RM (N'b)	2,726.14	2,511.98	-214.16	3,743.97	3,236.16	-507.81	-272.09	-468.32
RM (%)	-2.08	-9.77	-7.86	1.07	-12.64	-13.56	-9.77	-12.64
NDC (N'b)	18,873.49	13,567.43	-5,306.06	17,032.01	13,294.51	-3,737.50	-119.30	596.30
NDC (%)	52.17	-1.74	-53.91	22.68	9.40	-13.28	-0.87	4.70
Cg (N'b)	-204.66	-1,133.63	-928.97		-2,397.52	-1,642.71	-636.77	56.03
Cg (%)	61.47	-256.32	-317.79	44.22	4.56	-39.66	-128.16	-2.28
Cp (N'b)	19,078.15	14,701.06	-4,377.09	17,786.82	15,692.03	-2,094.79	517.47	540.27
Cp (%)	47.50	7.3	-40.2	17.52	7.14	-10.38	3.65	3.57
NFA (N'b)	7,654.56	7,522.26	-132.3	10,561.41	9,016.99	-1,544.42	383.59	-26.69
NFA (%)	6.60	10.74	4.14	16.78	-0.6	-17.38	5.37	-0.30

Figure 3.1
The Performance of M2, M1 and RM (H1: 2011 - 2013)

The FGN continued to be a net creditor to the banking system



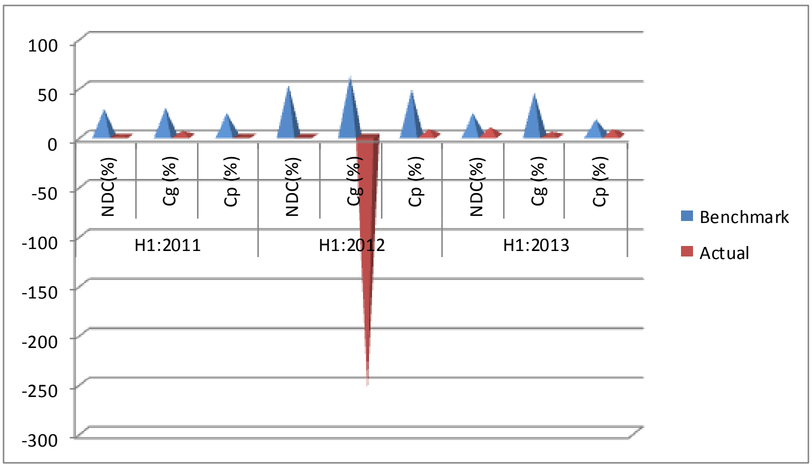
Aggregate net domestic credit (NDC) grew by 4.7 per cent to N13,294.51 billion at end-June 2013 from N12,698.21 billion at end-December 2012. When annualised, NDC grew by 9.4 per

The year-on-year growth in Aggregate Domestic Credit was 1.98 per cent, which was far below the benchmark of 52.17 per cent…..

cent at end-June 2013, compared with 1.74 per cent decline in the corresponding period of 2012 and the benchmark of 23.58 per cent for end-December 2013. The low performance was partly due to FGN's reliance on public financing through issuance of bonds.

Net Credit to Government (C_g) declined by 2.28 per cent to stand at N2,397.52 billion at end-June 2013 from N2,453.56 billion at end-December 2012. When annualised, C_g dropped by 4.56 per cent, compared with the decline of 256.52 per cent in the corresponding period of 2012 and the indicative benchmark of 44.22 per cent for end-December 2013. Thus, the FGN continued to be a net creditor to the banking system during the review period.

Figure 3.2
The Performance of NDC, Cg and Cp (H1: 2011 – 2013)



Credit to the private sector (C_p) rose by 3.57 per cent to N15,692.03 billion at end-June 2013 from N15,151.76 billion at end-December 2012. On annualised basis, C_p grew by 7.14 per cent at end –June 2013, compared with 7.30 per cent growth in the corresponding period of 2012 and the benchmark of 17.52 per cent for end December, 2013.

Net foreign assets (NFA) declined by 0.30 per cent to N9,016.99 billion at end-June 2013 from N9,043.68 billion at end-December 2012. When annualised, NFA dropped by 0.6 per cent at end-June 2013, as against 10.74 per cent growth in the corresponding period of 2012 and the benchmark of 16.78 per cent growth for end-December 2013.

CHAPTER 4
DOMESTIC FINANCIAL MARKETS

4.1 Money Market

Administrative measures like prohibition of concurrent dealings in wDAS and the Bank's standing lending facility

The money market remained robust in the first half of 2013 with government securities and CBN OMO bills being actively traded. Money market activities were influenced largely by liquidity conditions and the implementation of administrative measures such as the prohibition of concurrent dealings in wDAS and the Bank's standing lending facility. Interbank interest rates remained largely locked-in within the corridor of +/- 200 basis points around the MPR of 12 per cent. However, occasional spikes were observed, particularly during periods of temporary liquidity shortfalls.

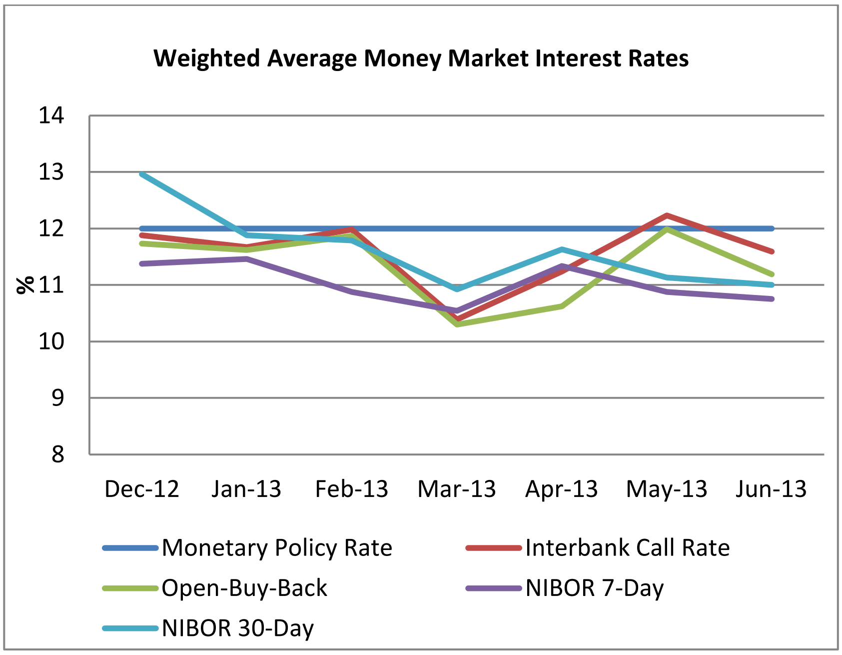
4.1.1 Developments in Short-Term Interest Rates

Stabilising short-term interest rates around the policy rate remained a challenge for monetary management. This was because the monthly distribution of federally-collected revenue among the three tiers of government created system-wide liquidity swings in short-term interest rates (Figure 4.1). The average interbank call rate ranged from 10.39 to 12.23 per cent, while the open buy back (OBB) rate ranged between 10.30 and 11.99 per cent in the first half of 2013.

Table 4.1
Weighted Average Money Market Interest Rates (%)
(December 2012 – June 2013)

Month	Monetary Policy Rate	Overnight Interest Rates		Tenored
		Interbank Call Rate	Open-Buy-Back	NIBOR 30-Day
Dec-12	12.00	11.88	11.73	12.96
Jan-13	12.00	11.67	11.62	11.88
Feb-13	12.00	11.98	11.87	11.79
Mar-13	12.00	10.39	10.30	10.92
Apr-13	12.00	11.24	10.62	11.63
May-13	12.00	12.23	11.99	11.13
Jun-13	12.00	11.59	11.19	11.00

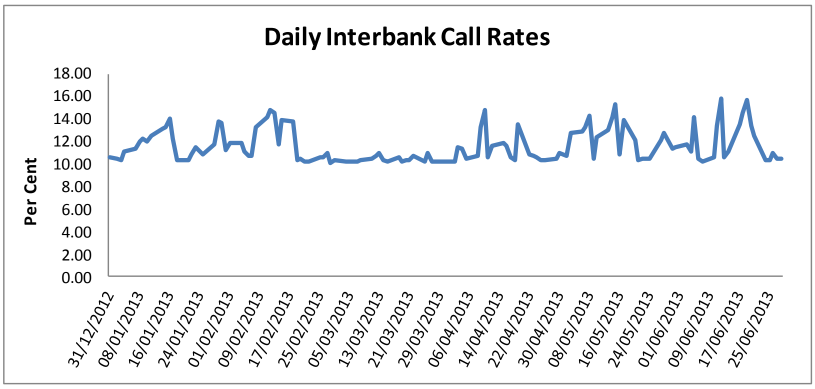
Figure 4.1
Weighted Average Money Market Interest Rates (%)
(December 2012 – June 2013)



(i) Interbank Call Interest Rate

The average (weighted) interbank call rate declined from 11.88 per cent in December 2012 to 11.59 per cent in June 2013. During the intervening months, the rate however, rose to 11.98 and 12.23 per cent, respectively in February and May, 2013. Over the entire first half of 2013, interbank rate declined by approximately 29 basis points compared to a decrease of 304 basis points between June and December 2012. On year-on-year basis, the weighted average interbank (call) rate declined by approximately 333 basis points (Figure 4.2).

Figure 4.2
Daily Interbank Call Rates (%)
(December 2012 – June 2013)

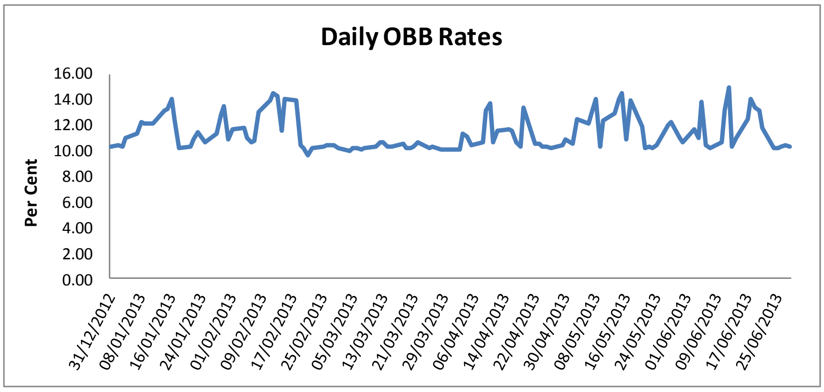


(ii) Open Buy-Back Rate

The average (weighted) open buy back (OBB) rate declined from 11.73 per cent in December 2012 to 10.30 per cent in March 2013, and further declined to 11.19 per cent in June 2013. Over the first half of 2013, the OBB rate declined by approximately 40 basis points compared with a decline of 314 points between June and December 2012. On year-on-year basis the average OBB rate declined by approximately 300 basis points (Figure 4.3).

Figure 4.3
Daily Open Buy Back (OBB) Rates (%)
(December 2012 – June 2013)

The general decline in short-term rates in the period under review was primarily due to easing liquidity conditions partly engendered by OMO bills maturities and fiscal operations of government



(iii) Nigeria Interbank Offered Rate (NIBOR)

NIBOR, the traditional reference rate for tenured transactions, remained relatively stable in the review period. The average weighted 30-day NIBOR, which was 16.04 per cent in June 2012 moderated to 12.96 per cent in December 2012, and further to 11.0 per cent at the end of the first half of 2013 (Figure 4.1).

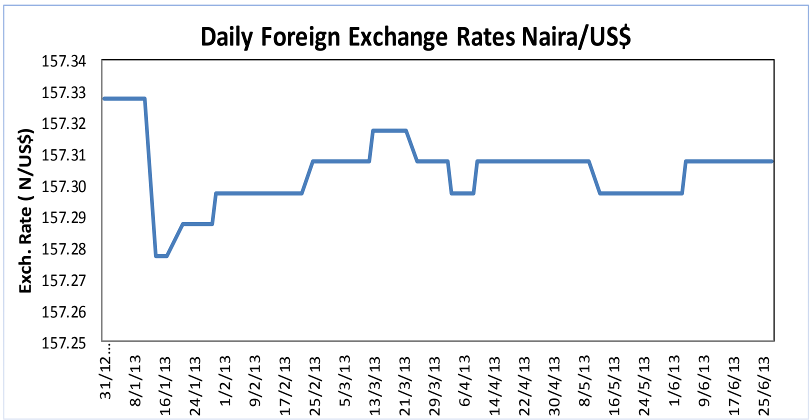
The general decline in short-term rates in the period under review was primarily due to liquidity easing conditions partly engendered by OMO bills maturities and injections through government fiscal operations.

4.2 The Foreign Exchange Market

The Bank's interventions in the market was aimed at stabilizing the exchange rate around N155/US$ with a band of +/- 3 per cent

The thrust of foreign exchange policy remained the maintenance of a stable exchange rate of the naira. In the period under review, the Bank's interventions in the market was aimed at stabilising the exchange rate around N155/US$ with a band of +/- 3 per cent. The period witnessed increased demand pressure which peaked in June, attributed to seasonal factors and slowdown in capital inflow, following hints of possible moderation of the US Fed's third round of Quantitative Easing. This pushed the exchange rate slightly higher than was observed early in the period.

Figure 4.4
Daily Exchange Rate (December 2012 – June 2013)



…appreciation in rates across all the segments of the foreign exchange market was attributed to increased supply…

4.2.1 Average Exchange Rate

The wDAS spot rate appreciated mildly to an average of ₦157.30/US$ in the first half of 2013 from ₦157.35/US$ in the second half of 2012 and ₦157.65/US$ in the corresponding period of 2012. This represented appreciation of 0.03 and 0.22 per cent respectively.

At the interbank foreign exchange market (IFEM), the naira exchange rate averaged ₦158.18/US$ in the first half of 2013 compared with N158.37/US$ in the second half of 2012, representing an appreciation of 0.12 per cent. Similarly, relative to ₦159.31/US$ in the first half of 2012, the exchange rate at the interbank market appreciated by 0.7 per cent. The rate at the BDC segment averaged ₦159.66/US$ in the first half of 2013 compared with ₦160.49/US$ in the preceeding period and ₦161.23/US$ in the first half of 2012. This represented appreciations of 0.5 and 0.9 per cent, respectively.

The appreciation in rates across all segments of the foreign exchange market was attributed to increased supply, more effective official interventions and administrative measures aimed at curtailing speculative demand (Table 4.2).

4.2.2 End-Period Exchange Rate

The naira appreciated in all segments of the foreign exchange market at end-June 2013. At the wDAS, the naira appreciated by 0.012 per cent to ₦157.31/US$ from ₦157.33/US$ at end-December 2012. On year-on-year basis, the naira appreciated by approximately the same magnitude (0.012 per cent) at end-June 2013 (Table 4.3).

At the interbank segment, the naira exchange rate rose to N162.60/US$ from N157.25/US$ at end-December 2012, representing a depreciation of 3.2 per cent. However, relative to the end-June 2012 level of N162.85/US$, the naira appreciated marginally by about N0.25k. At the BDC segment, the naira depreciated by approximately 1.9 per cent to ₦162.00/US$ at end-June 2013, from ₦159.00/US$ at end-December 2012. Relative to the end-June 2012 level of ₦164.00/US$, the exchange rate of the naira at the BDC segment, however, appreciated by 1.2 per cent (Figure 4.5).

Table 4.2
Average Monthly Spot Exchange Rates (N/US$):
January 2012 – June 2013

	CBN	IFEM	BDC
Jan 2012	158.39	161.31	164.62
Feb 2012	157.87	158.59	160.85
Mar 2012	157.59	157.72	159.41
Apr 2012	157.33	157.44	159.37
May 2012	157.28	158.46	159.67
Jun 2012	157.44	162.33	163.43
2012: H1 Average	**157.65**	**159.31**	**161.23**
Jul 2012	157.43	161.33	163.32
Aug 2012	157.38	158.97	162.24
Sep 2012	157.34	157.78	159.8
Oct 2012	157.32	157.24	159.00
Nov 2012	157.31	157.58	159.32
Dec 2012	157.32	157.33	159.26
2012: H2 Average	**157.35**	**158.37**	**160.49**
2012 Average	**157.5**	**158.84**	**160.86**
Jan 2013	157.30	156.95	159.13
Feb 2013	157.30	157.50	158.68
Mar 2013	157.31	158.37	159.80
Apr 2013	157.31	158.20	159.81
May 2013	157.30	158.02	159.57
Jun 2013	157.31	160.02	160.98
2013: H1 Average	**157.30**	**158.18**	**159.66**

Figure 4.5
End-Month Exchange Rate (January 2012 – June 2013)

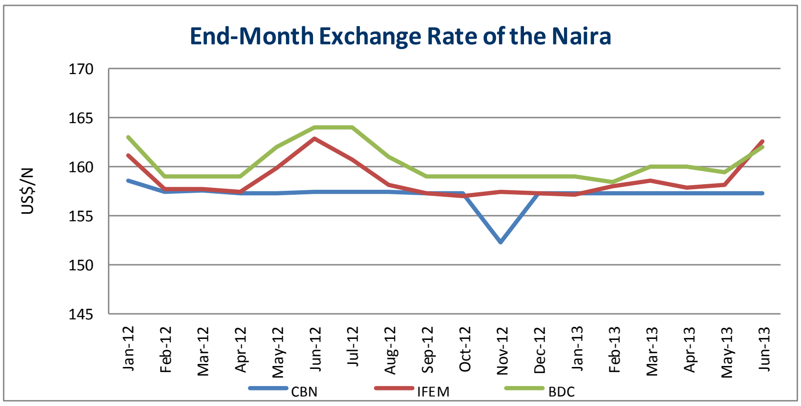


Table 4.3
End-Month Exchange Rates Movements, January 2012 – June 2013 (N/US$)

	CBN	IFEM	BDC
Jan 2012	158.62	161.16	163.00
Feb 2012	157.46	157.75	159.00
Mar 2012	157.57	157.72	159.00
Apr 2012	157.26	157.40	159.00
May 2012	157.31	159.85	162.00
Jun 2012	157.50	162.85	164.00
Jul 2012	157.40	160.75	164.00
Aug 2012	157.36	158.17	161.00
Sep 2012	157.34	157.24	159.00
Oct 2012	157.27	157.06	159.00
Nov 2012	152.32	157.40	159.00
Dec 2012	157.33	157.25	159.00
Jan 2013	157.30	157.20	159.00
Feb 2013	157.31	158.05	158.50
Mar 2013	157.31	158.63	160.00
Apr 2013	157.31	157.90	160.00
May 2013	157.30	158.10	159.50
Jun 2013	157.31	162.60	162.00

4.2.3 Nominal and Real Effective Exchange Rate

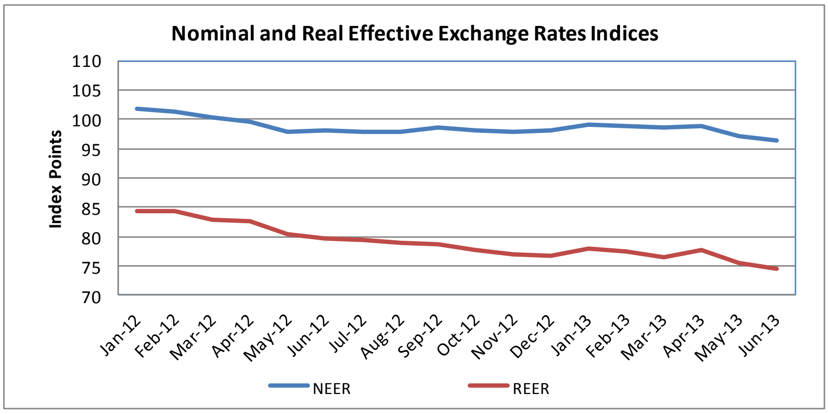
The Nominal Effective Exchange Rate (NEER) index appreciated by 1.7 per cent to 96.41at end-June 2013 from 98.04 at end-December 2012. Relative to the end-June 2012 level of 98 per cent, the NEER appreciated by 1.6 per cent. The Real Effective Exchange Rate (REER) index appreciated by 2.8 and 6.5 per cent to 74.49 at end-June 2013 from 76.65 at end-December 2012, and 79.67 at end-June 2012, respectively (Table 4.4 and Figure 4.6).

On the average, both the NEER and REER increased at end-June 2013, when compared with the level at end-December 2012, reflecting a real exchange rate appreciation relative to the currencies of Nigeria's major trading partners.

Table 4.4
Nominal and Real Effective Exchange Rates Indices
(January 2012 – June 2013)

	NEER	REER
Jan 2012	101.69	84.38
Feb 2012	101.41	84.40
Mar 2012	100.29	82.84
Apr 2012	99.66	82.66
May 2012	97.78	80.53
Jun 2012	98.00	79.67
2012: H1 Average	**99.81**	**82.41**
Jul 2012	97.96	79.35
Aug 2012	97.90	78.89
Sep 2012	98.60	78.75
Oct 2012	98.16	77.80
Nov 2012	97.79	77.01
Dec 2012	98.04	76.65
2012: H2 Average	**98.08**	**78.08**
2012: Average	**98.94**	**80.24**
Jan 2013	98.99	77.88
Feb 2013	98.84	77.54
Mar 2013	98.62	76.56
Apr 2013	98.81	77.65
May 2013	97.23	75.53
Jun 2013	96.41	74.49
2013: H1 Average	**98.15**	**76.60**

Figure 4.6
Nominal and Real Effective Exchange Rates Indices
(January 2012 – June 2013)



4.2.4 Demand and Supply of Foreign Exchange

Total demand for foreign exchange at the wDAS in the review period increased by 23.4 per cent to US$10,748.71 million from US$8,705.60 million recorded in the second half of 2012. The demand for foreign exchange, however, moderated marginally by 2.0 per cent, when compared with the US$10,963.16 million demanded in the first half of 2012. The total supply of foreign exchange at the wDAS in the first half of 2013 increased by 16.8 per cent to US$10,711.03 million compared with US$9,170.00 million recorded in the second half of 2012. It, nonetheless, moderated slightly relative to the level at end-June 2012 (Table 4.5 and Figure 4.7).

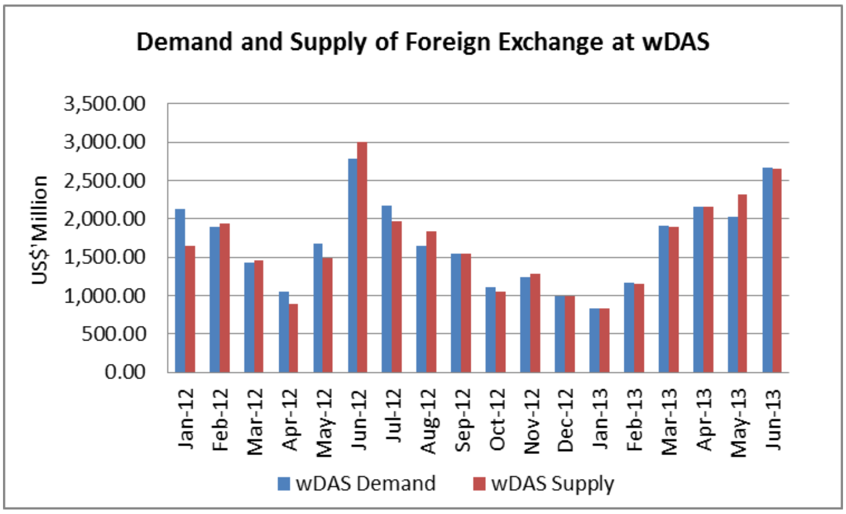
The stability in the exchange rate during the review period reflected the effectiveness of policy measures (low Net Open Position limit; increased Cash Reserve Requirements; restriction on authorised dealers from accessing the CBN Standing Lending Facility and wDAS concurrently); level of CBN market interventions and autonomous inflows in the market.

Table 4.5
Foreign Exchange Demand and Supply (US Dollar Million)

	wDAS Demand	wDAS Supply
Jan 2012	2,134.00	1,640.65
Feb 2012	1,891.96	1,942.18
Mar 2012	1,426.45	1,452.75
Apr 2012	1,052.88	891.52
May 2012	1,681.26	1,487.00
Jun 2012	2,777.62	3,000.00
2012: H1 Total	**10,964.17**	**10,414.10**
Jul 2012	2,166.32	1,961.69
Aug 2012	1,645.41	1,842.91
Sep 2012	1,549.18	1,539.42
Oct 2012	1,112.89	1,051.00
Nov 2012	1,236.98	1,278.68
Dec 2012	993.81	990.34
2012: H2 Total	**8,704.59**	**8,664.04**
2012: Total	**19,668.76**	**19,078.14**
Jan 2013	836.39	833.50
Feb 2013	1,164.28	1,152.82
Mar 2013	1,911.29	1,901.54
Apr 2013	2,156.22	2,154.57
May 2013	2,019.20	2,318.70
Jun 2013	2,661.33	2,650.00
2013: H1 Total	**10,748.71**	**10,711.13**

Figure 4.7
Demand and Supply of Foreign Exchange at wDAS
(January 2012 – June 2013)

…foreign exchange flows through the CBN resulted in a net inflow of US$933.77 million…



4.2.5 Foreign Exchange Flows

4.2.5.1 Foreign Exchange Flows through the CBN

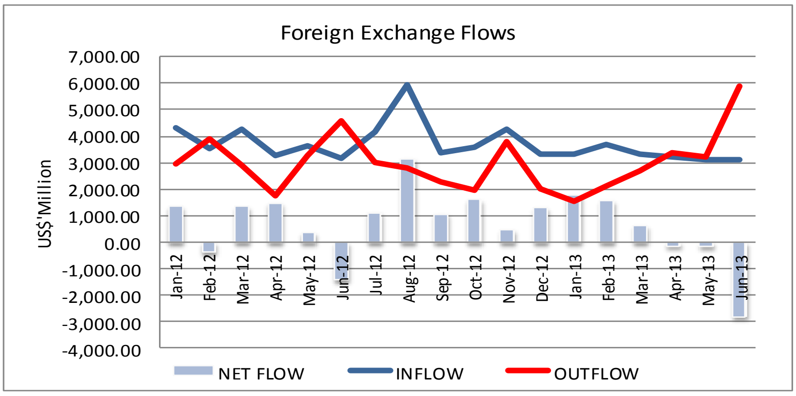
Gross foreign exchange inflow through the CBN declined by 9.7 per cent, to US$19,747.38 million in the first half of 2013, from US$24,611.59 million in the second half of 2012. Relative to the corresponding period of 2012, gross foreign exchange inflow declined by 10.9 per cent from US$22,170.75 million. Foreign exchange outflow rose by 18.8 per cent to US$18,813.70 million in the first half of 2013 from US$15,835.23 million in the second half of 2012. It, however, declined relative to the level of US$19,355.44 million in the corresponding period of 2012 by 2.7 per cent.

During the period under review, foreign exchange flows through the CBN resulted in a net inflow of US$933.77 million compared with US$8,776.36 million and US$2,815.31million in the second half and corresponding period of 2012, respectively (Table 4.6).

Table 4.6
CBN Monthly Foreign Exchange Flows (US$ million)
(January 2012 – June 2013)

	INFLOW	OUTFLOW	NET FLOW
Jan 2012	4,307.02	2,945.79	1,361.23
Feb 2012	3,546.16	3,902.26	-356.10
Mar 2012	4,266.63	2,912.41	1,354.22
Apr 2012	3,242.89	1,754.87	1,488.02
May 2012	3,627.10	3,256.98	370.12
Jun 2012	3,180.95	4,583.13	-1,402.18
2012: H1	**22,170.75**	**19,355.44**	**2,815.31**
Jul 2012	4,132.09	3,006.72	1,125.37
Aug 2012	5,953.41	2,796.59	3,156.82
Sep 2012	3,358.57	2,277.44	1,081.13
Oct 2012	3,576.35	1,960.37	1,615.98
Nov 2012	4,272.42	3,794.48	477.94
Dec 2012	3,318.75	1,999.63	1,319.12
2012: H2	**24,611.59**	**15,835.23**	**8,776.36**
2012 Total	**46,782.34**	**35,190.67**	**11,591.67**
Jan 2013	3,320.75	1,538.09	1,782.66
Feb 2013	3,681.07	2,103.40	1,577.67
Mar 2013	3,302.64	2,671.54	631.10
Apr 2013	3,238.83	3,369.37	-130.55
May 2013	3,095.50	3,233.67	-138.17
Jun 2013	3,108.60	5,897.63	-2,789.04
2013: H1	**19,747.38**	**18,813.70**	**933.77**

Figure 4.8
Foreign Exchange Flows Through the CBN (January 2012 – June 2013)



4.2.5.2 Foreign Exchange Flows through the Economy

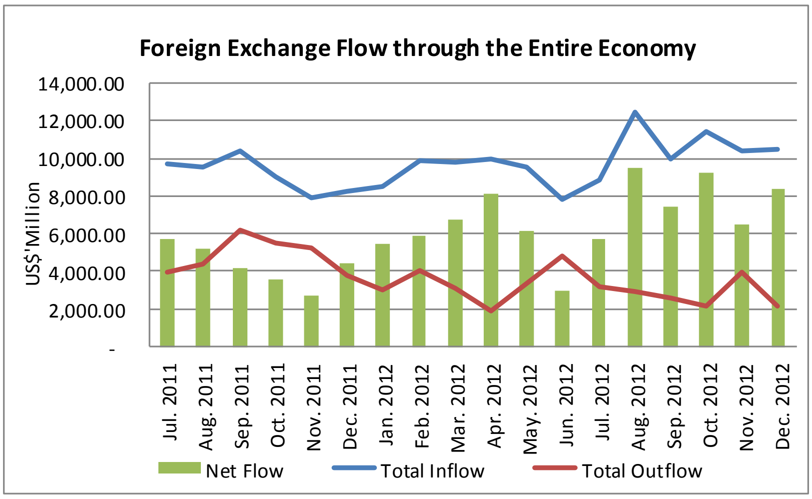
Gross foreign exchange inflow into the economy rose to US$72,277.13 million in the first half of 2013 from US$63,466.93 million in the second half of 2012, and US$55,548.08 million in the first half of 2012 representing an increase of 13.8 and 30.1 per cent, respectively. Gross foreign exchange outflow rose by 13.03 per cent to US$ 19,014.82 million from US$ 16,822.06 million in the second half of 2012 but declined by 5.89 per cent when compared to US$ 20,204.63 million in the corresponding period of 2012.

During the first half of 2013, foreign exchange flows resulted in a net inflow of US$53,262.31million compared to US$46,644.90 million in the second half of 2012 and US$35,343.45 million in the first half of 2012 (Table 4.7).

Table 4.7
Monthly Foreign Exchange Flows through the Economy
(US$ million) (January 2012 – June 2013)

Descriptor	Total Inflow	Inflow (CBN)	Inflow (Autonomous)	Total Outflow	Outflow (CBN)	Outflow (Autonomous)	Net Flow	Net Flow (CBN)	Net Flow (Autonomous)
Jan. 2012	8,518.24	4,307.02	4,211.22	3,027.16	2,945.80	81.36	5,491.08	1,361.22	4,129.86
Feb. 2012	9,859.56	3,546.16	6,313.40	3,998.38	3,902.27	96.11	5,861.18	(356.11)	6,217.29
Mar. 2012	9,812.73	4,266.63	5,546.10	3,060.67	2,912.43	148.24	6,752.06	1,354.20	5,397.86
Apr. 2012	9,973.15	3,242.89	6,730.26	1,895.22	1,754.89	140.33	8,077.93	1,488.00	6,589.93
May. 2012	9,550.02	3,627.10	5,922.92	3,392.09	3,256.97	135.12	6,157.93	370.13	5,787.80
Jun. 2012	7,834.38	3,180.94	4,653.44	4,831.11	4,583.13	247.98	3,003.27	(1,402.19)	4,405.46
Total H1 2012	55,548.08	22,170.74	33,377.34	20,204.63	19,355.49	849.14	35,343.45	2,815.25	32,528.20
Jul. 2012	8,865.39	4,132.10	4,733.29	3,187.15	3,006.74	180.41	5,678.25	1,125.37	4,552.88
Aug. 2012	12,416.40	5,953.41	6,462.99	2,938.76	2,796.56	142.20	9,477.64	3,156.85	6,320.79
Sep. 2012	9,945.14	3,358.57	6,586.57	2,542.85	2,277.44	265.41	7,402.29	1,081.13	6,321.16
Oct. 2012	11,395.17	3,576.34	7,818.83	2,118.23	1,960.36	157.87	9,276.95	1,615.99	7,660.96
Nov. 2012	10,370.22	4,272.42	6,097.80	3,925.45	3,794.48	130.96	6,444.78	477.94	5,966.84
Dec. 2012	10,474.61	3,318.75	7,154.99	2,109.62	1,999.63	47.29	8,364.99	1,319.12	7,107.70
Total H2 2012	63,466.93	24,611.59	38,854.47	16,822.06	15,835.21	924.14	46,644.90	8,776.40	37,930.33
Total 2012	119,015.01	46,783.20	72,231.81	37,026.69	35,253.41	1,773.28	81,988.35	11,529.82	70,458.53
Jan. 2013	12154.31	3320.75	8833.56	1,561.22	1,538.09	23.13	10,593.09	1,782.66	8810.43
Feb. 2013	10972.73	3,681.07	7291.66	2,130.08	2,103.40	26.68	8,842.65	1,577.67	7264.98
Mar. 2013	11141.76	3,302.64	7839.12	2,712.82	2,671.54	41.28	8,428.94	631.10	7797.84
Apr. 2013	12149.85	3,238.83	8911.02	3,430.09	3,369.37	60.72	8,719.76	-130.55	8850.3
May. 2013	13264.85	3,095.50	10169.35	3,252.13	3,233.67	18.46	10,012.72	-138.17	10150.89
Jun. 2013	12593.63	3,108.60	9485.03	5,928.48	5,897.63	30.85	6,665.15	-2,789.04	9454.18
Total H1 2013	72277.13	19747.39	52529.74	19014.82	18813.7	201.12	53262.31	933.67	52328.62

Figure 4.9
Foreign Exchange Flows through the Economy
(January 2012 – June 2013)



4.3 Capital Market

The capital market witnessed improved performance in the first half of 2013, compared with the second half of 2012 and the corresponding period of 2012. This development was due largely to improved earnings and increase in foreign portfolio investments attracted by improved investor confidence in the economy.

4.3.1 Equities Market

The All-Share Index (ASI) increased by 28.8 per cent to 36,164.31 at end-June 2013, from 28,078.81 at end-December 2012, and by 67.4 per cent, when compared with the level at end-June 2012. Market Capitalisation (MC) for equities also increased by 27.4 per cent to N11.43 trillion at end-June 2013 from N8.97 trillion at end-December 2012, and by 65.7 per cent when compared with the N6.90 trillion recorded at end-June 2012 (Table 4.8 and Figure 4.10).

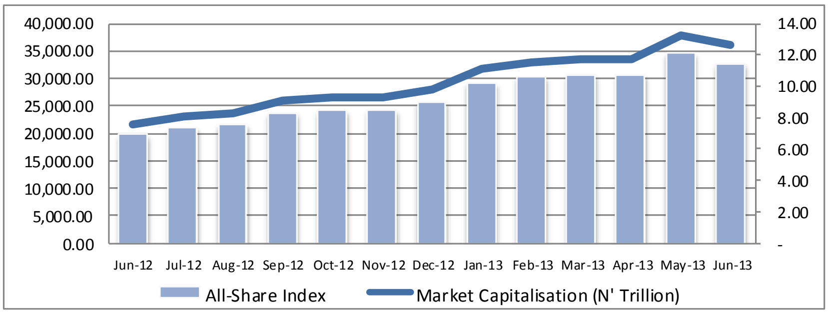
The ASI's 67.43 per cent year-to-date increase was driven mainly by strong performance in the banking and insurance sectors. The Bloomberg NSE Banking Index grew by 32.28 per cent and the Bloomberg NSE Insurance Index increased by 17.21 per cent over their end-June 2012 levels. The indices of two other sectors - the Bloomberg NSE Consumer Goods and the Bloomberg Oil and Gas indices, however moderated the favourable performance with declines of 41.97 and 0.82 per cent, respectively, over their levels at end-June 2012.

Table 4.8
NSE All-Share Index (ASI) and Market Capitalisation (MC)
(June 2012 – June 2013)

Date	ASI	MC (Equities) (N' Trillion)
Jun-12	21,599.56	6.90
Jul-12	23,061.38	7.34
Aug-12	23,750.81	7.56
Sep-12	26,011.63	8.28
Oct-12	26,430.92	8.42
Nov-12	26,494.44	8.47
Dec-12	28,078.81	8.97
Jan-13	31,853.19	10.19
Feb-13	33,075.14	10.58
Mar-13	33,536.25	10.73
Apr-13	33,440.57	10.69
May-13	37,794.75	12.08
Jun-13	36,164.31	11.43

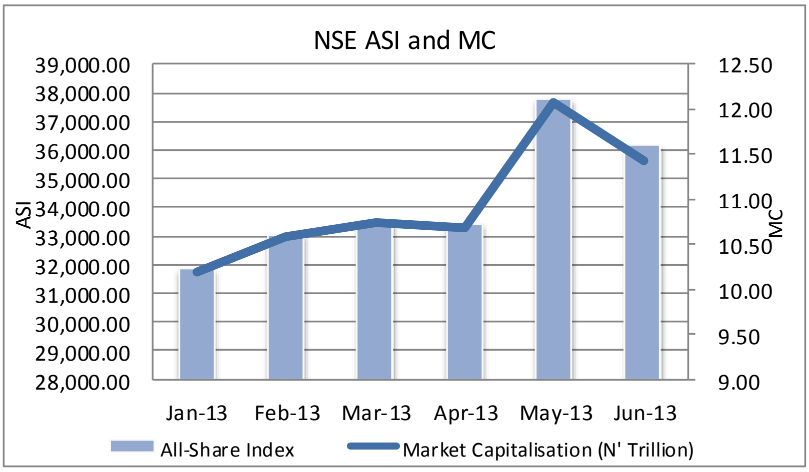
Source: NSE

Figure 4.10
NSE ASI and MC (June 2012 – June 2013)



Source: NSE

Figure 4.11
NSE ASI and MC (January – June 2013)



Source: NSE

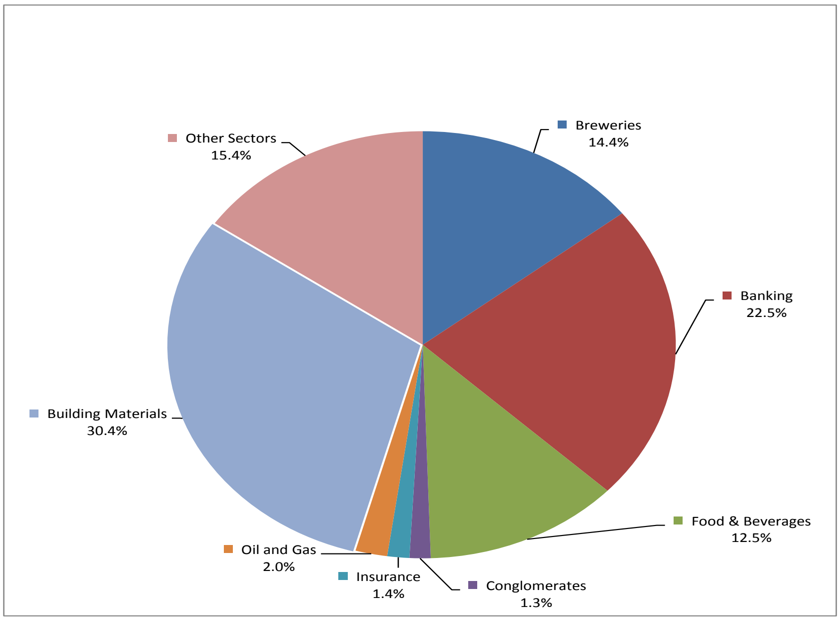
4.3.1.1 Market Turnover

Aggregate stock market turnover, in the first half of 2013, increased by 35.58 per cent. 58.34 billion shares, valued at N591.56 billion, were traded in 763,974 deals, which compared with 43.03 billion shares valued at N340.76 billion, in 528,468 deals in the second half of 2012. Relative to the first half of 2012, market turnover increased by 10.60 per cent with 52.75 billion shares valued at N789.34 billion, in 427,848 deals.

4.3.1.2 Sectoral Contribution to Equities Market Capitalisation

The building materials subsector was the most capitalised sector. Its share in overall market capitalisation rose to 30.4 per cent at the end of the first half of 2013 from 27.0 per cent at end-December 2012. Other leading subsectors were banking; breweries; and food, beverages and tobacco with respective market shares of 22.5, 14.4 and 12.5 per cent, at end-June 2013 (Figure 4.12).

Figure 4.12:
NSE Market Capitalisation by Sector as at End-June 2013



Source: NSE

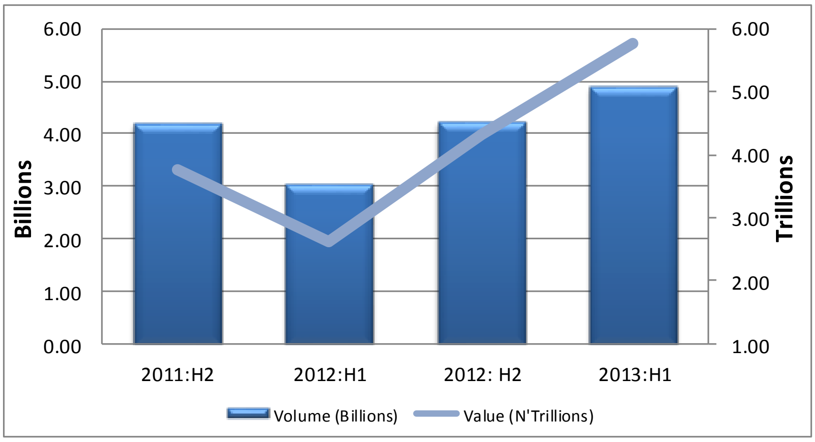
4.3.2 Bonds Market

The bonds market in Nigeria consists of FGN bonds, State Government bonds and corporate bonds. It is dominated by FGN bonds and needs to be further developed and deepened [see Box 3]

4.3.2.1 Federal Government (FGN) Bonds

The total transactions in FGN Bonds in the over-the-counter (OTC) market in the first half of 2013 was 4.89 billion units valued at N5.77 trillion in 28,840 deals, compared with 4.22 billion units valued at N4.32 trillion in 24,082 deals in the second half of 2012 and 3.04 billion units worth N2.62 trillion in 20,357 deals recorded in the first half of 2012 (Figure 4.13). The value of the outstanding FGN Bonds was N3.5 trillion as at June 2013. Increase in activities in the FGN Bonds market was as a result of the continued improvement in investors' confidence following various reforms in the capital market, ample liquidity in the global financial environment following the implementation of unconventional monetary policy in various jurisdictions as well as the high yields of FGN Bonds compared to the yields of other sovereign debt, especially, in the advanced economies.

Figure 4.13
Volume and Value of FGN Bonds Traded in the OTC Market (H2:2011 – H1:2013)

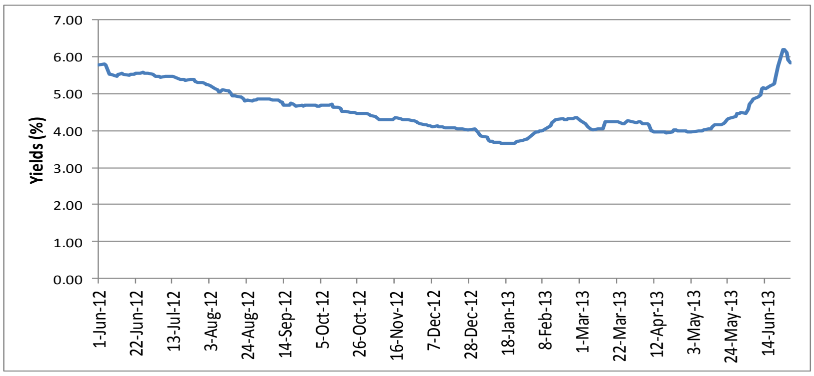


Source: NSE

4.3.2.2 FGN Eurobond

The Federal Government of Nigeria's Eurobond continued to be traded on the London Stock Exchange (LSE) in the first half of 2013. During the period, the US Federal Reserve's comments on the possibility of moderating its quantitative easing 3 programme led the markets to anticipate an earlier-than-expected end to the monetary stimulus, thereby prompting asset re-pricing in financial markets. Consequently, interest rates and yields on dollar-denominated assets rose with the yield on the FGN Eurobond increasing to 5.83 per cent at end-June 2013 from 4.04 and 4.02 per cent at end-December and end-June 2012, respectively (Figure 4.14).

Figure 4.14
Yields on Nigeria's 10-Year U.S. Dollar-denominated Bond
(June 1, 2012 – June 28, 2013)

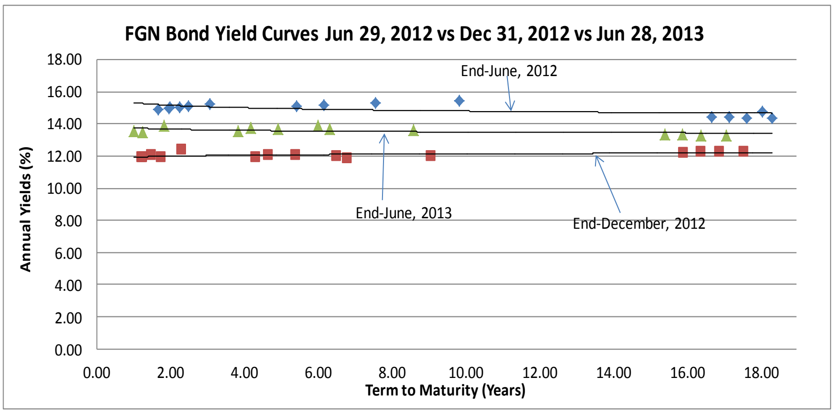


Source: Bloomberg

4.3.2.3 Yields on Federal Government Bonds

The yield curve of FGN bonds at end-June 2013 shifted upwards by 135 basis points compared with the position at end-December 2012, but shifted downward by 149 basis points when compared with the level at end-June 2012 (Figure 4.15). The development reflected improvements in inflation expectations arising from the sustained tight monetary policy stance of the CBN and the stable macroeconomic environment.

Figure 4.15
FGN Bonds Yield Curves:
End-June 2012 vs. End-December 2012 vs. End-June 2013



4.3.2.4 State/Local Government Bonds

The total value of state/local government bonds issued in the first half of 2013 was N406.94 billion compared with N341.0 billion in the second half of 2012.

4.3.2.5 Corporate Bonds

In the first half of 2013, the value of outstanding corporate bonds was N1.40 trillion, same as recorded in the second half of 2012.

Box 3
Deepening the Bonds Market: Policy Issues

Capital Markets the world over has been dominated in terms of value by the Bonds Market leaving the more exciting Equities Market to become second. Although, these two broad categories of the Capital Market have grown in importance, the direct significance of the bonds market to the developmental needs of an emerging market economy like Nigeria cannot be over-emphasised. Thus, the growing need for cheaper long-term financing necessitates the existence of a bonds' market that is deep enough to cater for corporates, sub-national and the federal governments alike.

Bond markets provide greater investment opportunities for both retail investors and financial institutions and help to deepen financial markets. This is particularly the case if international investors are attracted. From a macroeconomic policy perspective, the lack of a bond market places constraint on the financing of fiscal deficits, while performance of the market provide useful signals of macroeconomic policy. Domestic debt is also needed for monetary policy purposes, including for sterilising inflows of foreign exchange. Bond markets also help to influence interest rates across the various maturity spectra and promote a more efficient pricing of risk. By providing an alternative source of financing, bonds reduce concentration of inter-mediation in banks. Credit transactions of banks can be hedged in the bond market, giving banks the ability to lend for longer terms.

Various and continuing attempts have been made to develop and deepen the Nigerian Bond Market. In 1946, the Local Loan Ordinance was promulgated under which the government floated the first three hundred thousand (₦300,000.00) naira, 3 per cent Government stock 1956/61 Stock to finance the 1946-1956 10-year development plan. Later, the government issued the first N2 million Federation of Nigeria Development loan stock in May 1959. The enactment of the Lagos Stock Exchange Act of 1960 enabled the incorporation of the Lagos Stock Exchange on September 15, 1960 as a private limited liability company limited by Guarantee. In 1962, and ad-hoc consultative and advisory body, the Capital Issues Committee, was established and located in the Central Bank of Nigeria (CBN). Its function was to consider applications to raise capital from the capital market and recommend the timing of approved issues to avoid overstretching the market's capacity. In 1977, the Lagos Stock Exchange became the Nigerian Stock Exchange under the Indigenisation

Decree. The first sub-national government to issue a bond was Bendel State in 1978; it issued a ₦20 million 7%, revenue bond to finance the state housing development programme. Many more States have issued bonds in recent times. The Federal Government discontinued bond issuance in 1987 but resumed in 2003 through the Debt Management Office (DMO) which was established in year 2000. By issuing short-term maturity notes, the government has created an Over-the-Counter (OTC) bond market.

Nevertheless, the market remains underdeveloped and shallow, offering mostly short term instruments. In addition, bond market capitalisation remains low, while corporate bonds market is very thin. It is therefore imperative to simultaneously develop the market width, market depth and market infrastructure, in order to attract investors through competition among market participants and openness to both domestic and foreign players. Such conditions ensure that market prices for risk are properly reflected and provide fair returns.

Some of the initiatives to deepen the bond market include the creation of Primary Dealers/Market Makers (PDMMs) by the Debt Management Office in 2006. Its goal is to increase liquidity in FGN Bonds over a two-way quote system. In August 2006, a Primary Dealership/Market Maker (PDMM) network was established. There are currently 19 PDMMs. PDMMs play an active role in the issuance, sale and marketing of all government bonds. Also in 2006, the Bond Market Steering Committee (BMSC), comprising major public and private sector stakeholders was established to make for regular interaction among key stakeholders. The BMSC is mandated to ensure speedy development of the market by coordinating all necessary activities.

The Central Bank of Nigeria (CBN) took the lead in developing a comprehensive vision for the financial sector in 2006, which resulted in the Financial System Strategy 2020 (FSS2020). FSS2020 remains the most developed of the sector strategies cascading from the broader Vision 2020 and the one that is at the most advanced stage of implementation. The strategy was predicated on Nigeria's goal of becoming one of the top 20 economies in the world by the year 2020, and to successfully develop the financial sector, such that Nigeria would be the choice destination in West Africa for financial products and services as well as the gate-way for channeling investments to other parts of the continent.

On March 2, 2010, the CBN granted liquid asset status to eligible State government bonds to promote investments in these securities, encourage the regular issuance of the bonds by State governments, stimulate primary and secondary market activities in them, and thereby facilitate the development of the Nigerian Bonds Market. The initiative has eased transfer of ownership of the bonds issued and enhanced movement in the market by way of their being traded in an open market, while engendering best practices in debt management in the States.

In addition, The Nigerian Stock Exchange on the 1st of February, 2013 launched an initiative on retail bond market. The retail bond market is a follow up on the Over the Counter (OTC) Market and its aim is to encourage trading activities in the primary market which will allow retail investors into the fixed income market since prices at the OTC market are high. The NSE also identified Fixed Income Market Makers (FIMM), a platform that allows debt market participants to trade NSE-listed debt instruments issued by the federal and state governments or corporations on a transparent order book with firm orders. Overall, the aim is to provide liquidity and transparency in the market.

The Federal Government issued a five hundred million (US$500.00m) US dollar 10-year Eurobond in 2011 which 2.5 times oversubscribed and another issue of one billion (US$1bn) US dollars is in the offing. First Bank Plc and GT Bank have received approvals to issue foreign currency denominated bonds and convertible bonds respectively. More issuances of debt instruments in the International Capital Market (ICM) are in the pipeline. They include the US$100million Nigerian Diaspora Bond and the N80 billion federal government bonds in the form of Global Depository Notes (GDN), which had been approved. The International Finance Corporation (IFC) issued a $50million naira-denominated bond in February 2013 as part of its local-currency bond programme of about $1 billion. It is the hope of IFC that this would contribute to the expansion and deepening of the Nigerian Bonds Market.

To sustain the efforts at improving the bonds market and make it more attractive to investors, inflation should be kept low so as to ensure a positive real interest rate which in turn will boost yields and returns. Financial and macroeconomic stability is also essential to limit risk and build more confidence in investors. The bonds market should be transparent, accessible and liquid. These are very important prerequisites for the market to be aligned with the strategy of developing the country through financing.

The FGN Bonds Market Capitalisation was ₦4,663.70 billion and US$29.95 billion, as at June 17, 2013. As at end June 2013, the face value of FGN bonds was ₦4,032.90 billion.

CHAPTER 5
ECONOMIC OUTLOOK

5.1 Overview

Global output growth in the first half of 2013 remained weak on account of three factors: (i) less-than-expected growth in major emerging market economies; (ii) worse-than-expected recession in the Euro Area; and (iii) limited economic expansion in the United States of America caused by fiscal restraint. Compared with the annualised growth rate of 2.50 per cent recorded in the second quarter of 2012, global growth in the first quarter of 2013 rose by 2.75 per cent. The risks of recession in the Eurozone persisted alongside slow growth in China. The IMF (WEO, July 2013 Update) suggested that supportive macroeconomic policy was required to achieve stronger global growth.

5.2 Output Growth

5.2.1 Global Output and Outlook

IMF emphasized the need for a good policy mix, … that would provide some breathing space for boosting growth and creating jobs

Overall, global economic growth was projected to remain at 3.1 per cent in 2013 as in 2012. Real global output growth in the first half of 2013 was estimated to be 1.79 per cent, down from 2.50 per cent recorded in the second half of 2012. Provisional data from the IMF (World Economic Outlook (WEO) July, 2013) indicated that the annual output growth for 2013 in the advanced economies would be 1.2 per cent; in emerging markets and developing economies (EMDEs), 5.0 per cent and in sub-Saharan Africa, 5.1 per cent (Table 5.1). Notably, growth forecasts for Japan and UK were projected at 2.0 and 0.9 per cent in July 2013, respectively, up from 1.5 and 0.7 per cent, respectively in April 2013.

However, growth in advanced economies was 0.97 per cent in the first half of 2013, down from 1.4 per cent in the corresponding period of 2012 and was expected to increase to 1.60 per cent in the second half of 2013. In emerging markets and developing economies, growth was 5.47 per cent in the first half of 2013 as against 5.68 per cent in the same period in 2012 and is projected to increase to 5.70 per cent in the second half of 2013. Emerging economies suffered *massive investments in infrastructure would support food production*

slowdown in exports to advanced economies, as well as weak domestic consumption and investment. During the 2013 Spring Meetings, the IMF emphasised the need for a good policy mix, including fiscal consolidation, structural reforms and accommodative monetary policy that would provide space for boosting growth and creating jobs.

The downside risks to global growth prospects persist. While the risks of recession in Europe remained, additional risks have emerged. The first of the additional risks is slowing growth in China's economy characterised by high but increasingly unproductive investment, rising credit risk and low consumption. The second risk has to do with the possible impact of Japan's Abenomics - which required the sustainability of fiscal stimulus, aggressive monetary easing and structural reforms without undermining investors' confidence. The third risk is the possibility of tighter financial conditions when the anticipated exit from quantitative easing by the United States commences, which could lead to capital flow reversals. Global growth projection was expected to rise to 2.43 per cent in the second half of the year driven by improvement in the growth momentum in developed economies. As noted by the IMF, a stronger outlook for global growth in the second half of 2013 would require additional policy actions, combined with credible plans for reaching medium-term fiscal adjustment plans and reforms to restore weak banks' balance sheets and credit channels in major advanced economies, especially in Europe. Many emerging market and developing economies face a tradeoff between macroeconomic policies to strengthen growth and those to contain capital outflows arising from the possibility of the US ending quantitative easing.

Economic growth in Sub-Saharan Africa is expected to be boosted in the second half of 2013, as factors such as floods and drought which constrained growth in 2012 were unlikely to reoccur. Also, the gradual normalisation of activity in some post-conflict countries as well as massive investments in infrastructure would support food production. However, the downside risk to growth prospects could arise from adverse climatic developments, uncertainty in the Euro zone, foreign capital flow reversals and lower commodity prices.

Growth prospects in the Middle East and North Africa (MENA) remain weak with some economies experiencing difficult political and economic transitions.

Table 5.1
Global Output and outlook, 2011 – 2014

	2011	2012	2013	2014
A. World Output				
World Output	**3.9**	**3.1**	**3.1**	**3.8**
Advanced Economies	**1.7**	**1.2**	**1.2**	**2.1**
USA	1.8	2.2	1.7	2.7
Euro Area	1.5	-0.6	-0.6	0.9
Japan	-0.6	1.9	2.0	1.2
UK	1.0	0.3	0.9	1.5
Canada	2.5	1.7	1.7	2.2
Other Advanced Economies	3.3	1.8	2.3	3.3
Emerging & Developing Economies	**6.2**	**4.9**	**5.0**	**5.4**
Central and Eastern Europe	5.4	1.4	2.2	2.8
Commonwealth of Independent States	4.8	3.4	2.8	3.6
Developing Asia	7.8	6.5	6.9	7.0
Latin America and the Caribbean	4.6	3.0	3.0	3.4
Middle East and North Africa	3.9	4.4	3.1	3.7
Sub-Saharan Africa	5.4	4.9	5.1	5.9
B. Commodity Prices (US' Dollars)				
Oil	31.6	1.0	-4.7	-4.7
Non-fuel	17.9	-9.9	-1.8	-4.3
C. Consumer Prices				
Advanced Economies	2.7	2.0	1.5	1.9
Emerging & Developing Economies	7.1	6.1	6.0	5.5

Source: IMF World Economic Outlook Update, July 2013

5.2.2 Domestic Output Growth and Outlook

Overall domestic growth rate for 2013 was projected at 6.91 per cent up from 6.58 per cent in 2012. Provisional data from the NBS indicated output growth of 6.64 per cent in the first half of 2013 compared with 6.37 per cent in the first half of 2012 with a projection of 7.10 per cent in the second half of 2013.

..risks to the growth outlook include slow economic recovery in major trading partner-countries; the effect of shale oil production in the US and decline in U.S. crude oil imports…

The relatively robust growth outlook despite the sluggish global economic performance reflects the favourable weather conditions for agricultural production, positive outcome in banking sector reforms, power sector reforms, ongoing efforts at restoring security in the North East, as well as various initiatives of government to stimulate the real economy. Key risks to the growth outlook include slow economic recovery in major trading partner-countries; the effect of shale oil production in the US and decline in U.S. crude oil imports and lower oil output and exports due to production losses.

5.3 Inflation Trend

5.3.1 Global Inflation and Outlook

Global inflation fell to 3.38 per cent in the first half of 2013 from 3.98 per cent in the corresponding period in 2012, and was projected to continue slowing as food and fuel supply developments would contain any upward pressure on prices of major commodities, despite the expected acceleration in global economic activity. In the advanced economies, inflation averaged 1.33 per cent in the first half of 2013 as against 2.11 per cent in the corresponding period of 2012, and is projected at 1.5 in 2013. In the emerging and developing countries, consumer price inflation was projected at 6.54 per cent in the first half of 2013 up from 6.34 per cent in the corresponding period of 2012 and is projected to ease to 6.0 per cent in 2013. Similarly, Sub-Saharan Africa recorded average inflation rate of 8.36 per cent in June 2013 as against 12.23 per cent in June 2012. Moderation in non-oil commodity prices, good agricultural harvests and appropriate macroeconomic policy mix are expected to reduce inflation in 2013 to below 8 per cent. Overall, the outlook for global inflation in the second half of 2013 is for further moderation.

5.3.2 Domestic Inflation Outlook

Inflationary pressure during the first and second half of 2012 at an average of 12.52 and 11.97 per cent, respectively, moderated in the first half of 2013 to an average of 8.93 per cent. Also, both core and food inflation decreased significantly to 5.5 and 9.6 per cent in June 2013, compared with 15.2 and 12.0 per cent in June 2012.

...expected moderation in inflation would be driven by growth in output and the use of appropriate monetary policy stance.

Staff projections suggest that headline inflation rate would lie between 8.32-9.96 and 6.72-11.16 per cent in September and December 2013, respectively. At a higher confidence level, headline inflation could lie between 9.08-9.20 and 8.77-9.11 per cent in September and December 2013, respectively. The expected moderation in inflation would be driven by growth in output and the use of appropriate monetary policy tools. The major upside risk to these projections is the possibility of elevated fiscal actions towards year-end, pressure on the exchange rate as a result of hedging by corporates against uncertainties in the 2014 fiscal year.

5.4 Outlook for Monetary Policy in 2013

Nigeria's monetary policy environment in the first half of 2013 was stable; inflation moderated throughout the period, fuel supply remained steady, and agricultural production reflected favourable outcome of macroeconomic policies. The maintenance of macroeconomic stability resulted from the continuation of tight monetary policy, which was informed by the need to stabilise the exchange rate and mitigate the risk emanating from higher benchmark oil price in the 2013 Budget.

...outlook for the second half of 2013 would be for continuation of existing policies to sustain the moderation in the general price level.

Given the salutary outcome of the current monetary policy stance, the outlook for the second half of 2013 would be for continuation of existing policies to sustain the moderation in the general price level.

Fancharts for Headline and Core Inflation

Figure 5.1: Fan Chart for Headline Inflation (%)

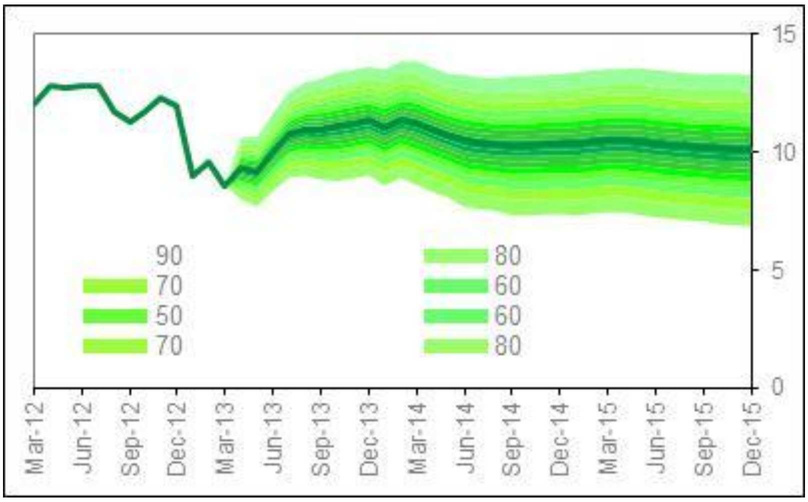
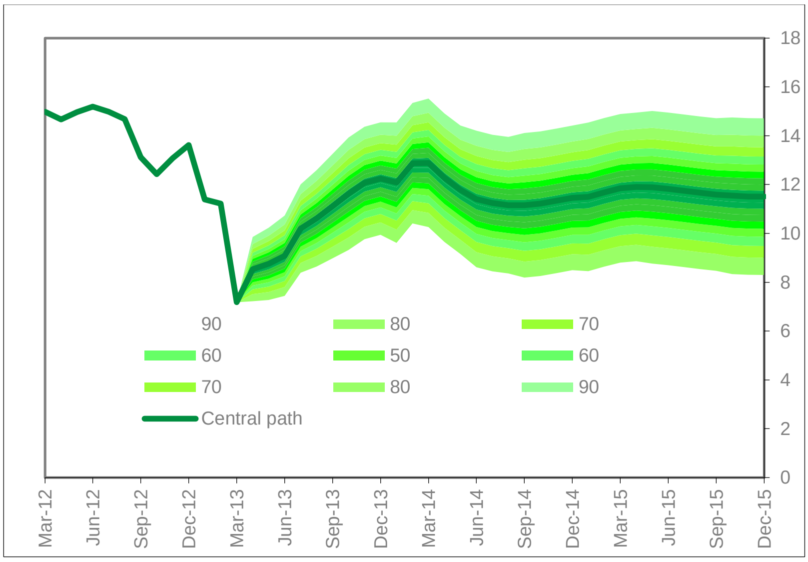


Figure 5.2: Fan Chart for Non-Food Inflation (%)



Source: Research Department, CBN

APPENDICES

Communique of the Monetary Policy Committee (January – June 2013)

Central Bank of Nigeria Communiqué No. 87 of the Monetary Policy Committee Meeting of Monday, January 21, 2013

The Monetary Policy Committee (MPC) met on, January 21, 2013 with ten (10) out of the twelve (12) members in attendance. The Committee reviewed the domestic economic conditions in 2012 and the challenges therefrom against the backdrop of the international financial and economic environment in order to chart the course of monetary policy in 2013.

The International Economic Situation

The Committee noted that global economic growth remained largely uneven and subdued in most economies in 2012. Latest data from the IMF indicate that global output was weaker than previously forecast due to continued contraction in the Euro zone and Japan as well as the less than anticipated growth in Brazil and India. The fragility in the global economy was further compounded by the uncertainties surrounding resolution of the "fiscal cliff" and debt ceiling challenges in the US and the difficulties associated with China's attempts to "rebalance" its growth.

These developments adversely affected private sector confidence, worsened the unemployment situation and further tightened financing conditions in both the periphery and core economies. In the euro area, economic and financial conditions remained severely weak. Although the European Central Bank (ECB) attempted, through its intervention scheme, to halt the downward trend in economic activities in the zone, the effort did not record much success. Overall, global output was estimated to have expanded by 3.2 per cent in 2012 against the earlier projection of 3.3 per cent made in the October 2012 IMF World Economic Outlook.

Growth in the advanced economies was estimated at 1.3 per cent in 2012 and projected at 1.5 per cent in 2013, reflecting an upward revision of 0.2 percentage point, respectively, from the initial estimates. The Committee noted that the decline in global investment was mainly traced to the fiscal standoff in the US and its implications for the paltry expansion in output of 2.0 per cent in Q3, 2012.

Emerging European economies, which had previously shown signs of strong rebound from the credit crisis, have now been hit hard by slow exports growth and a halt to real GDP growth. On the whole, the Committee is of the view that while the decisions of the ECB considerably reduced the probability of a Eurozone-wide financial crisis, the condition of country-level financial systems remained difficult and could constitute significant challenge to output expansion in 2013.

Latest data from the Asian economies suggest that a gradual recovery may be underway. China's economy, which had previously recorded a slowdown over seven consecutive quarters to Q3, 2012, witnessed improved economic activity in Q4, 2012. Recent fiscal and monetary easing operations have increased investment in infrastructure with signals of further spending into 2013. The Indonesian economy, after recovery from the severe flooding in 2011, continued to show resilience against the global slowdown as investment and strong domestic demand contributed more to growth. It is expected that these twin drivers of growth would further sustain output expansion in 2013, although recent reports indicate that severe flooding has once again hit the economy during January 2013. The sub-optimal performance of the Japanese and Indian economies, however, was a major drag on recovery in the region. The Indian economy was hampered by slow approvals for new projects, deterioration in business sentiment largely due to the rising current account deficit, uncertainty over the selling of government stakes in state owned enterprises, fiscal deficits, depreciation of the Rupee and a high debt burden, as well as slow implementation of structural reforms. Japan's drawback was largely due to a combination of declining exports and sluggish domestic demand. There are, however, expectations that the growth decline would bottom-out in 2013 as anticipated rebound in major trading partner economies like China and the US would translate to a recovery in the demand for Japanese goods and services.

The Middle East and North Africa (MENA) region continued to record mixed performance, evidenced by the divergence between the economies of oil-exporting and oil-importing countries. Oil-importing countries experienced subdued economic performance with an estimated growth of 2.0 per cent in 2012 while the oil-exporting countries grew at an average rate of 6.6 per cent. Growth in oil-exporting countries was driven largely by high oil output and prices coupled with the early post-conflict recovery of Libya. Growth for the entire region in 2013 has been projected at 3.75 per cent, which is 1.35 percentage points below the estimate for 2012. The Committee noted that the challenges confronting these countries is how to strengthen the resilience of their fragile economies against major oil price shocks through diversification and expansion of the private sector.

Economic conditions in sub-Saharan Africa remained generally robust despite the sluggish growth in the global economy. Prudent policies and improved fundamentals in most countries provided additional impetus for increased economic activity in the region. The Committee noted that the main risks to the outlook for the region come from their trading partners including the possible intensification of the financial stress in the euro zone and a sharp fiscal adjustment in the US.

In light of the uncertainty about the direction of fiscal policy in the US, particularly with regard to the yet to be resolved issue of debt ceiling, and the persisting euro zone financial and economic crises, the Committee was of the view that the global economic environment was still fragile and highly vulnerable to a further contraction, although the downside risks appeared to be less severe relative to conditions in the last two years.

Domestic Economic and Financial Developments Output

The National Bureau of Statistics (NBS) estimated real Gross Domestic Product (GDP) growth rate at 6.61 per cent for 2012, which is lower than the level recorded in 2011 by 0.84 per cent. The estimated real GDP growth rate at 7.09 per cent in the fourth quarter of 2012 was higher than the 6.48 per cent in the third quarter but lower than the 7.68 per cent recorded in the corresponding period of 2011. The non-oil sector remained the major driver of growth recording 8.23 per cent increase in contrast to the oil sector, which contracted by 0.17 per cent during the period. The Committee expressed concern about the continued decline in the contribution of the oil sector to growth due to lower production relative to the corresponding period of 2011 and enjoined the Federal Government to fast track the passage of the Petroleum Industry Bill to halt the trend.

The relatively robust growth projections despite the slowing global economy reflected the relatively favourable performance of wholesale and retail trade; the services sectors; outcome of banking sector reforms; and initiatives by government to stimulate the real economy. Despite the developments in the international oil market where the US is now the second largest oil producer, the Committee observed that the growth projection remained promising, anchored on the recent improvements in power supply. The Committee noted with satisfaction the Federal Government's efforts to sustain the current initiatives to boost power generation, particularly the progress made in reforming the power sector.

The Committee, however, observed that the severe flooding in several parts of the country in 2012, which damaged housing, agricultural and oil assets, could pose downside risks to growth and feed into food supply deficits and inflation in the near term. Also, the continuing security challenges as well as delays in reform of the oil sector could undermine investor-confidence and output growth in the near-term.

Prices

The Committee observed that, on the average, inflationary pressure was elevated in 2012. The year–on–year average headline inflation rate in 2012 stood at 12.24 per cent, while the average core and food inflation year-on-year stood at 13.87 and 11.32 per cent, respectively. The major drivers of headline inflation in December 2012 included food and non-alcoholic beverages, housing, water, electricity and transport. The pickup in food inflation in the later part of 2012 was accounted for by imported food items and food shortages due to the impact of flood on farmlands along the major agricultural belt of the country. However, the Committee was of the view that the pass-through effects of imported food inflation to domestic prices may have been subdued owing to the relatively stable exchange rate during the period under review.

Monetary, Credit and Financial Markets Developments

Broad money supply (M2) grew by 13.72 per cent in December 2012 over the level at end-December 2011. Aggregate domestic credit (net) grew by 1.98 per cent in December 2012, which was substantially below the benchmark of 52.17 per cent for the year. Credit to Government contracted between September and December 2012; occasioned by the sustenance of government as a net creditor to the banking system, reflecting more prudent fiscal measures, including the introduction of the Treasury Single Account.

Interest rates in all segments of the money market moderated between 19th November 2012 and 3rd January, 2013. This reflected in increased liquidity in the banking system including the release of statutory revenue to subnational governments, absence of repo transaction during the review period, repayments of matured CBN Bills and banks' desire to maintain optimum liquidity position on their balance sheets at the end of their common financial year. The interbank call and OBB rates, which opened at 13.99 and 13.95 per cent on November 19, 2012, closed at 10.32 and 10.45 per cent, respectively, on January 3, 2013. The average interbank call and OBB rates for the period were 11.09 and 11.03 per cent, respectively. The average prime lending rate increased slightly to 16.54 per cent in December 2012 from 16.48 and 16. 51 per cent in October and November 2012, respectively. In contrast, the average maximum lending rate fell marginally to 24.61 per cent in December 2012 from 24.65 and 24.70 per cent, respectively, in October and November, respectively while the weighted average savings and term deposits rate decreased to 5.50 per cent in December from 5.57 per cent in the preceding month. The Committee, therefore, encouraged the Bank to fast track the financial inclusion strategy to improve financial intermediation and the effectiveness of the transmission mechanism of monetary policy and to adopt ways of moderating the high spread between deposit and lending rates.

The Committee observed that the rally in the Nigerian capital market continued as equities market indicators trended upwards in the review period. The All-Share Index (ASI) increased by 35.45 per cent from 20,730.63 to 28,078.80 between December 30, 2011 and December 31, 2012. Market Capitalization (MC) also increased, by 37.38 per cent, from N6.53 trillion to N8.97 trillion during the same period. The positive performance of the ASI and MC was due to the sustained increase in the demand for blue-chip stocks particularly in the banking and consumer goods sectors following improvements in earnings and growing investor-confidence. The Committee, however, noted that the significant factor responsible for the recovery was strong portfolio flows and cautioned that the capital market remained structurally vulnerable to external shocks until its funding basis was changed.

External Sector Developments

At the Wholesale Dutch Auction System (wDAS), the exchange rate opened at N157.31/US$ on November 20, 2012 and closed at N157.33/US$ on December 31, 2012 representing a depreciation of N0.02 or 0.01 per cent. The average wDAS exchange rate during the period was N157.32/US$. At the BDC segment of the foreign exchange market, the selling rate opened at N160.00/US$ on November 20, 2012 and closed at N159.50/US$ on December 31, 2012, representing an appreciation of N0.50 or 0.31 per cent for the period.

At the interbank segment, the selling rate opened at N157.95/US$ on November 20, 2012 and closed at N156.25/US$ on December 31, 2012, representing an appreciation of N1.70 or 1.08 per cent. Overall, the relative stability recorded in the foreign exchange market could be attributed to the combined effects of improved supply of foreign exchange by the oil companies and enhanced capital inflows from portfolio investors during the period under review. Also, oil revenue increased at an average of 2.73 per cent monthly throughout 2012. In the first eleven months of 2012, oil receipts totaled US$40.087 billion.

The Committee noted with satisfaction that the premium between wDAS and the interbank rate narrowed towards the end of the review period. However, the premium between the wDAS and BDCs widened towards the end of the review period from N1.682/US$ to N2.172/US$ suggesting the need to sustain and further complement existing measures to discourage speculative activities in the foreign exchange market. In general, the Committee noted that decisions at previous MPC meetings were yielding the desired results.

The Committee expressed satisfaction with the sustained accretion to external reserves which stood at US$43.849 billion as at December 31, 2012, representing an increase of US$1.682 billion or about 3.98 per cent from the level of US$42.167 billion at end-October 2012. Relative to the end-December 2011 level of US$32.915 billion, the external reserves at the end of December 2012, had risen by US$10.934 billion or 33.21 per cent. The increase in the level of foreign reserves was driven mainly by proceeds from crude oil and gas exports and crude-oil related taxes as well as reduced funding of the wDAS on account of the huge inflow of foreign portfolio investments, which was about 77.0 per cent of total inflows through the CBN. The foreign reserves level could finance about 9 months of imports.

The Committee's Considerations

The Committee observed that the performance of the global economy remained largely subdued and was characterized by uncertainty and contraction in the Euro zone and Japan, as well as lower than expected growth in the large emerging and developing economies. The Committee notes with caution that the partial resolution of the Fiscal Cliff in the US offers some hope for gradual global economic recovery as indicated by the rebound of many global financial markets in the wake of the staving off of automatic tax increases and expenditures cuts on 1st January, 2013. The Committee further observed that the robust prospects for energy independence of the US could pose downside risk for global oil prices in the medium- to long-term which could threaten fiscal sustainability in many oil-dependent economies around the world.

The Committee noted that in spite of the slow progress made in the resolution of the Euro zone crises, the prospect of a deepening recession in the near term has not been completely averted. Developments in the domestic economy in the past three months highlighted some new pressure points to macroeconomic stability. The Committee was of the view that shocks to the economy could come from significant fall in the demand for oil, leading to a fall in oil prices and government revenues, weaker exchange rate, rising inflationary pressures and depletion in external reserves. The Committee also noted the drop in headline inflation in December 2012, although it also recognized that core inflation had risen; driven mainly by cost-push factors even in the face of sluggish growth in the monetary aggregates.

With regard to the budget of the Federal Government, the Committee cautioned against complacency over government revenues; despite the high level of oil prices. The Committee noted uncertainty in global demand and supply of crude oil, and weak performance of non-oil and VAT revenues. The Committee, however, noted with satisfaction the efforts the Federal Government aimed at keeping deficits within the threshold prescribed by the Fiscal Responsibility Act and advocated sustenance of the effort. On expenditure, the Committee noted that there was still the need to continue to drive down recurrent expenditure in favor of capital expenditure in view of the infrastructure deficit that continued to constrain growth performance. The Committee noted that the oil price benchmark for the 2013 budget which was increased from US$75 to US$79 may pose downside risk to the inflation objective and, therefore, constituted a pressure point for the low inflation objective and effective monetary policy in 2013. The Committee reaffirmed its commitment to respond appropriately if public spending in 2013 ultimately adds to inflationary pressures.

In view of these developments, the Committee was faced with three choices:

(i) An increase in the MPR in response to the higher oil price benchmark for fiscal 2013;

(ii) A reduction in MPR in view of the declining GDP growth trajectory and headline inflation; and

(iii) Retaining the current monetary policy stance in view of the conflicting price signals, global uncertainties and the need to preserve the stability of the system.

The Committee's Decisions

Given the stability achieved in the last twelve months with average year-on-year headline inflation rate at 12.24 per cent, in 2012, the MPR of 12 per cent was considered to be just about right. The Committee considered the calls for a reduction in the MPR because of the benign inflation outlook other things being equal. However, this may be undermined by the increased sub-national government spending and Federal Government high expenditure in 2013, the higher benchmark oil price in the 2013 budget and the US debt ceiling with possible impact on commodity prices.

In view of the foregoing, the Committee decided that it was prudent to hold and monitor developments between now and the next meeting of the MPC. The Committee, therefore, decided by a majority vote of 8:2 to maintain the current policy stance i.e., to retain the MPR at 12.0 per cent with a corridor of +/- 200 basis points around the midpoint; retain the CRR at 12.0 per cent; and to retain the

Liquidity Ratio at 30.0 per cent. Two members voted for a reduction of the MPR by 25 basis points.

Thank you.

Sanusi Lamido Sanusi, CON
Governor
Central Bank of Nigeria
January 21, 2013

Central Bank of Nigeria Communiqué No. 88 of the Monetary Policy Committee Meeting of Monday and Tuesday, March 18 and 19, 2013

The Monetary Policy Committee met on March 18 and 19, 2013 with all the 12 members in attendance. The Committee reviewed the conditions and challenges that confronted the domestic economy in the first quarter of 2013 against the backdrop of current international economic and financial developments with a view to reassessing the monetary policy options in the short- to medium-term.

International Economic Developments

At the outset, the Committee observed that global growth remained subdued throughout 2012 due to the softer than expected level of activities in the euro area and the slipping of Japan into recession during the second half of the year. Weak and fragmented growth was also recorded across major economies and regions including the US. The emerging market economies, however, showed a fair degree of resilience. The growth outlook, however, appears promising. The IMF January 2013 WEO Update, projected a global output growth of 3.5 per cent in 2013 compared with the 3.2 per cent achieved in 2012.

In the Advanced Economies, output was estimated at 1.4 per cent for 2013 compared with the 1.3 per cent achieved in 2012. Recession is expected to continue in the euro area although the magnitude of the contraction, estimated at 0.2 per cent in 2013, represents an improvement over the 0.4 per cent contraction in 2012. A slowdown in growth is also expected in the US in 2013, as output is projected to decline by 2.0 per cent from 2.3 per cent in 2012, owing largely to the short term effects of its fiscal consolidation regime as well as the weaknesses in the labor and housing markets.

The emerging Asian economies were projected to post a gradual recovery that would propel global output growth in 2013. China, which previously recorded a slowdown over seven consecutive quarters to Q3 2012, witnessed improved activity in Q4 2012; confirming that an upswing in growth was underway. The recent fiscal and monetary easing operations of the Peoples Bank of China led to increased tempo of investment in infrastructure with indications of further public spending in fiscal 2013. Thus, the economy is expected to grow strongly in 2013 amid gradual improvements in the external environment. Japan returned to growth in the fourth quarter of 2012, raising hopes of an end to the 15-year deflation. The major setback in the region is expected from India, with real GDP growth of 5.4 per cent in 2012 on account of the poor performance of the manufacturing, agriculture and service sectors.

The Committee noted that growth in Sub-Saharan Africa was still robust, although real output growth dropped to 4.8 per cent in 2012 from 5.3 per cent in 2011. The performance of Sub-Saharan Africa during 2013 would partly depend on developments in the euro area as well as the extent of recovery in China. With policy buffers weaker than they were prior to the 2008 crisis, the ability of governments to implement countercyclical fiscal policy may be constrained.

Domestic Economic and Financial Developments Output

The Committee was satisfied with the relatively robust output growth projections for 2013 despite the slowing global economy, on the back of favorable conditions for increased agricultural production, the outcome of banking sector reforms, as well as other initiatives by government to stimulate the real economy. The National Bureau of Statistics (NBS) reported that the real GDP growth rate declined from 7.43 per cent in 2011 to 6.58 per cent in 2012. The decline was partly driven by the oil sector which contracted by 0.91 per cent. The major driver of overall growth, therefore, remained the non-oil sector, with agriculture; wholesale and retail trade; and services contributing 1.37, 2.19 and 2.10 percentage points, respectively.

The Committee was concerned that the declining contribution of the oil sector to growth, which became apparent in the second half of 2011, continued in Q4 2012. Crude oil production, including condensates and natural gas liquids, decreased by 37,000 barrels per day (bpd) in February 2013 to 2.054m bpd compared with the level of 2.072m bpd attained in December 2012. Oil theft in the Niger-Delta remained a source of concern. The Committee was also concerned that the decline in the growth rate of agricultural output which started in the 4th quarter of 2011 continued up to the end of 2012. The Committee was of the view that although the GDP growth projection remained high, there were a number of risk factors that were likely to affect output performance. These include perception of increased levels of corruption and impunity in the country, insecurity particularly in the northern part of the country, as well as mixed signals from power and petroleum sector reforms.

Prices

Headline inflation which had decreased to a four-year low of 9.0 per cent in January 2013 inched up to 9.5 per cent in February, driven largely by the food component. Food inflation, which was 10.1 per cent in January 2013, increased by 0.87 percentage point in February due mainly to increases in the prices of farm produce and imported food items. Core inflation, however, moderated slightly between January and February 2013. The Committee noted that the sharp drop in inflation in early 2013 compared with early 2012 is largely a result of the base effect of the partial removal of fuel subsidy in January 2012. With the tapering off of the first and second round effects of the increase, the prudent monetary policy stance and stable exchange rates are yielding lower headline inflation figures.

Monetary, Credit and Financial Market Developments

Broad money supply (M2) grew by 2.86 per cent in February 2013 over the level at end-December 2012, which annualizes to 17.16 per cent. Aggregate domestic credit (net) grew by 10.17 per cent over the same period (an annualized rate of 61.02 per cent). The significant growth in net credit in the period was due to the huge increase in credit to government (net), which rose by 108.18 per cent. Interest rates in the interbank money market declined between January 21 and March 14, 2013 owing to liquidity surfeit in the banking system. The interbank call and the OBB rates, which opened at 10.35 and 10.33 per cent on January 21, closed at 10.29 and 10.28 per cent, respectively, on March 15, 2013. The average interbank call and OBB rates for the period were 11.38 and 11.23 per cent, respectively. The average prime lending rate inched up slightly from 16.54 per cent in December 2012 to 16.56 in February 2013, while the maximum lending rate more or less remained flat at 24.60 per cent during the period. The weighted average deposit rate, however, increased from 3.77 to 5.37 per cent during the review period.

The Committee noted the upswing in activities in the capital market, as equities market indicators all trended upwards in the review period. The All-Share Index (ASI) increased by 17.3 per cent from 28,078.81 on December 31, 2012 to 32, 950.08 on March 15, 2013 while Market Capitalization (MC) rose by 17.5 per cent, from N8.97 trillion to N10.54 trillion. The Committee, however, observed that the improved performance was largely induced by the substantial portfolio inflows, as foreign investors took advantage of the favourable domestic environment brought about by the high yield on government debt instruments, and stability in the naira exchange rate.

External Sector Developments

At the Wholesale Dutch Auction System (wDAS), interbank and the BDC segments of the foreign exchange market, the exchange rate opened at N157.29/US$, N157.10/US$, and N159.00/US$ on 22nd January 2013 and closed at N157.32/US$, N158.65/US$, and N160.00/US$, respectively, on March 15, 2013. The average wDAS, interbank and BDC exchange rate during the period was N157.30/US$, N157.65/US$, and N158.94/US$, respectively. The Committee noted the slight depreciation in the exchange rate at the wDAS and interbank segments of the foreign exchange market. The BDC segment, however, appreciated during the period due to the low patronage by speculators on account of the improved supply of foreign exchange by oil companies, increased inflow from portfolio investors, and the effect of the prohibition of the simultaneous access to the CBN window (Repo and Standing Lending Facility) and wDAS transactions by DMBs.

The Committee expressed satisfaction with the significant accretion to external reserves which stood at US$49.38 billion as at March 14, 2013, representing an increase of US$ 5.5 billion or 12.68 per cent over the level of US$43.83 billion at end-December 2012. The increase in reserves was driven largely by the proceeds from crude oil and gas sales and crude oil-related taxes, as well as reduced funding of the wDAS. The reserves level could finance over 13 months of imports. The Committee urged the Bank to continue the monitoring of portfolio and foreign direct investment flows, while being conscious of the risks to financial stability of a rapid outflow of hot money.

The Committee's Considerations

The Committee was pleased with the prevailing macroeconomic stability despite shocks from both external and domestic environments; a development which informed the tightening stance of monetary policy since the third quarter of 2010. Having achieved a reasonable degree of moderation in the rate of inflation, there were compelling arguments to consider easing monetary policy, at least from the perspective of stimulating growth in the real sector. Given the slowdown in overall GDP and agricultural GDP growth, inability of the SMEs to borrow at the current lending rates and crowding out effects may require monetary easing. The Committee carefully weighed the option of relaxing monetary policy against the likely risks in the near- to medium-term, noting that reversing the current stance of monetary policy was not likely to produce a neutral outcome, as it may signal the preference for a higher inflation rate on the part of the CBN.

At 9.0 and 9.5 per cent in January and February, respectively, the price data, which largely reflected the base effect of the first and second round impact of the fuel subsidy removal in January 2012, sends a clear signal that there was still an upside risk to inflation in the near-to-medium term. Furthermore, yields on FGN bonds have been declining steadily, signalling the impact of increased inflows while equity prices have been trending upwards. Quantitative easing, especially in the US and the EU is already creating a potential new round of asset bubbles globally. The Committee was of the view that the growth in the domestic capital market was driven largely by the huge capital flows. The principal risk of stability in the medium-to-long-term can be addressed through diligent implementation of sound policies of fiscal consolidation and structural reforms. Without these, the economy will not be able to attract long term foreign capital inflow that makes the gains of monetary policy sustainable and insulate the economy from the risks associated with external shocks and capital flow reversals. Monetary policy will, therefore, seek to preserve the current gains of macroeconomic stability.

The Committee also noted the wide spread between deposits and lending rates, which it attributed to the inefficiencies in the market requiring institutional and structural reforms that would enforce behavioural change on the market, consistent with the long term needs of the economy. The Committee was of the view that sustainable low lending rates, could be achieved if the necessary infrastructure such as stable power and good roads, amongst others, were put in place. The Committee noted that the present infrastructural condition has always provided an incentive for asymmetric response on the part of the banks to the policy rate in a manner that was not always beneficial to the small and medium scale customers. With respect to the price level, the Committee observed that the rising pressure in February after a significant moderation in January, was indicative of the fact that there were some underlying factors that could constitute a threat to inflation in the medium term.

The Committee noted the 2013 Federal Government Budget of N4.9 trillion, passed by the National Assembly and signed into law by the President, represents an increase of about 5 per cent. Furthermore, the budget, predicated on an oil benchmark price of US$79/barrel as against US$75/barrel, proposed by the Executive, potentially slows down the pace of fiscal consolidation with implications for accretion to the Excess Crude Account and gross external reserves. In addition, the Committee observed that the foreign exchange market has started experiencing pressure in March 2013, mainly reflecting compression of yields in the fixed income credit as well as outflows to pay dividends by multinational corporations. However, the Committee noted that the exchange rate has remained within the target range and also that the current monetary conditions are conducive to further tightening using Open Market Operations without recourse to an increase in the MPR.

In view of these developments, the Committee was faced with three choices:

(i) An increase in rates in response to the uptick in headline and food inflation; and pressure on exchange rates;

(ii) A reduction in rates in view of declining core inflation and GDP growth;

(iii) Retaining current monetary policy stance to sustain the gains of monetary policy while utilizing the existing space in the corridor to influence yields and exchange rates in the short term.

The Committee's Decisions

The Committee considered and rejected option 1 as being potentially unnecessary since there are no major inflationary concerns at this time. While acknowledging the merit of the arguments in favour of option 2, it was also rejected because it could send wrong signals of a premature termination of an appropriately tight monetary stance. The Committee, therefore, decided by a majority vote of 9:3 to accept option 3 and maintain the current policy stance i.e. to retain the MPR at 12 per cent with a corridor of +/- 200 basis points around the midpoint; retain the Cash Reserve Requirement at 12 per cent and Liquidity Ratio at 30 per cent with the Net Open Position at 1 per cent.

Thank you.

Sanusi Lamido Sanusi, CON
Governor
Central Bank of Nigeria
March 19, 2013

Central Bank of Nigeria Communiqué No. 89 of the Monetary Policy Committee Meeting of Monday and Tuesday, May 20 and 21, 2013

The Monetary Policy Committee met on May 20 and 21, 2013 with 10 out of the 11 members in attendance. The Committee reviewed the conditions and challenges that confronted the domestic economy in the first five months of 2013, and reassessed the short-to-medium term monetary policy options in the light of the fragile global economic and financial environment. The Committee noted that one of the members, Professor Sam Olofin has left the Board of the Central Bank and, therefore, ceases to be a member of the MPC. The Committee recognized his tremendous contributions to its deliberations over the years and thanked him for his services.

International Economic Developments

Global economic recovery continues to be fragile due to suppressed growth and weakness in key financial markets, including the euro area and Japan. However, the emerging market economies and Sub-Sahara African (SSA) countries continued to show resilience. Global growth outlook remains subdued but promising. It is forecast to average 3.2 per cent in 2013. In the advanced economies, output is estimated to grow by 1.2 per cent in 2013 compared with 1.3 per cent in 2012. In the US, budget deficit figures are better than projections due to automatic spending cuts and improved revenues boosted by dividend payments to the Treasury from mortgage banks bailed out during the crisis. Unemployment figures are also improving. Although the European Central Bank has commenced a wave of monetary easing, the euro area is expected to remain in recession with output contracting by 0.3 per cent compared with a contraction of 0.6 per cent in 2012. The EU made steady progress in establishing a Banking Union, pursuing a 2 three-pronged initiative of the Single Supervisory Mechanism; Deposit Guarantee System; and a Recovery and Resolution Scheme. The development has been adjudged as an important step towards recovery. The regime of quantitative easing commenced by the Bank of Japan holds prospects for Japanese recovery arising from a weaker Yen and improved competitiveness of Japanese exports. However, the downside risk lies in Japan‟s demographics whose key feature is a low propensity to consume, given its large population of pensioners-about 30 per cent. With slowing growth momentum in the emerging markets, global output is forecast to remain around the 2012 level.

The emerging and developing economies as a group are forecast to grow by 5.3 per cent in 2013, with SSA growing at 5.6 per cent. These economies have continued to face the challenge of adjusting macroeconomic policy to compensate for the weak external environment, particularly shocks induced by developments in the advanced economies. The IMF suggests that with the prospects of improvements in the global economy, policy recalibration in a number of emerging market economies should address risks from sustained rapid credit expansion and high asset prices. Growth in these economies has somewhat moderated compared with last year. The strong GDP growth rate of 7.7 per cent recorded in the first quarter of 2013 for China was countered by weaker rates in the other economies.

Domestic Economic and Financial Developments Output

The National Bureau of Statistics (NBS) forecasts real GDP growth rate of 6.72 per cent for Q2, 2013, an improvement over the Q1 estimate of 6.58 per cent. The major driver of overall growth remains the non-oil sector led by services; agriculture; and wholesale and retail trade. The Committee noted that the relatively robust output growth projection for 2013 was hinged on expected favourable conditions for increased agricultural production and other policy initiatives aimed at stimulating the economy. However, the Committee noted with caution, the high GDP growth projection in view of the extant risk factors such as widespread insecurity, weak infrastructure and probable flooding from the projected heavy rains in some parts of the country. In addition, the state of emergency in the North East and the accompanying military operations in that axis have the potential to adversely affect economic activities generally, including agricultural production and food prices, as well as consumer demand. The Committee also noted that although most sectors of the economy showed improved growth performance in Q1 of 2013 when compared with Q1 2012, this was not the case with respect to the key sectors like agriculture, telecommunications and distributive trade. Concern was also expressed over short-term prospects in the oil sector, mainly around possible reduction in oil prices and continuing leakages in oil production due to bunkering and other illegal activities.

Prices

Headline inflation increased from 8.6 per cent in March to 9.1 per cent in April, remaining within the target range for the fourth consecutive month. Food inflation was 10.0 per cent year-on-year in April compared with 9.5 per cent in March, while core inflation declined further to 6.9 per cent from 7.2 per cent in March. On a month-on-month basis, inflation showed broad-based moderation across almost all components with the exception of imported food which may be largely a reflection of the new tariff regime.

The inflation outlook remains relatively benign with projections of headline inflation remaining in the single digit range for the next six months. This result reflects a combination of base effect and the success of tight monetary policy leading to muted growth in the monetary aggregates and exchange rate stability. The principal risks to the outlook remain fiscal spending and possible pressures on the exchange rate from any attrition to reserves caused by declining revenues as a result of output leakages.

Monetary, Credit and Financial Market Developments

Broad money supply (M2) grew by 4.44 per cent in April 2013 over the level at end-December 2012. When annualised, M2 grew by 13.3 per cent, compared with the contraction of 0.03 per cent in the corresponding period of 2012. The growth in M2 was slightly below the growth benchmark of 15.2 per cent for 2013. Aggregate domestic credit (net) grew by 17.46 per cent in April 2013 which annualized to a growth rate of 52.38 per cent over the end-December 2012 level, compared with the contraction of 6.12 per cent recorded in the corresponding period of 2012.

Interest rates in the interbank money market moved in tandem with the level of liquidity in the banking system. The average inter-bank call and OBB rates which opened at 10.21 and 10.23 per cent on March 19 closed at 10.86 and 10.91 per cent, respectively, on May 16, 2013. The average maximum lending rate rose marginally to 24.53 per cent in April, 2013 from 24.49 per cent in March, 2013. Similarly, the average prime lending rate, rose to 16.65 per cent in April 2013, from 16.61 per cent in March.

The Committee noted the continued recovery in the Nigerian capital market as equities market indicators were positive in the review period. The All-Share Index (ASI) increased by 31.4 per cent from 28,078.81 on December 31, 2012 to 36,907.81 on May 17, 2013. Market Capitalization (MC) also increased by 31.5 per cent from N8.97 trillion to N11.80 trillion during the same period. Improved earnings, increased capital inflow and portfolio investments as well as investor confidence in the economy contributed to the up-swing in stock prices. The Committee also noted the reported increase in the share of domestic players in the capital market, thus reducing the risk of major shocks due to slowdown in foreign participation.

External Sector Developments

At the Wholesale Dutch Auction System (wDAS), interbank and the BDC segments of the foreign exchange market, the exchange rate opened at N157.32/US$, N158.70/US$, and N160.00/US$ on 20th March 2013 and closed at N157.30/US$, N158.33/US$, and N159.50/US$, respectively, on May 18, 2013. In all three segments, the naira exchange rate appreciated in the review period. This development reflected the effects of improved supply of foreign exchange to the market. Both the average and monthly premia for the review period remained insignificant, indicating the effectiveness of current policy measures.

The Committee also expressed satisfaction with the significant accretion to external reserves which stood at US$49.13 billion as at May 16, 2013. This represents an increase of US$5.3 billion or 12.1 per cent above the level of US$43.83 billion at end-December 2012. This level of reserves could finance approximately 13 months of import.

The Committee's Considerations

The Committee was pleased with the prevailing macroeconomic stability-moderation in all measures of inflation on month-on-month basis; stable banking system and exchange rate and robust external reserves. It commended the agreement reached between the CBN and AMCON on the settlement of outstanding AMCON obligations to all private sector investors by December 2014 and to repay the N3.6 trillion debts held by the CBN under a new refinancing and restructuring arrangement within a period not exceeding ten years at single-digit interest rate.

The Committee noted that the repayments and refinancing arrangements would have no adverse monetary policy implications; but rather increase confidence in the financial system. Also, under this arrangement, it is unlikely that banks will be required to contribute more than 0.5 per cent of their Balance Sheets annually to the sinking fund. By October 2014, the CBN will be the sole creditor to AMCON, holding bonds guaranteed by the Federal Government of Nigeria. The Federal Government will therefore have no contingent liability to any party other than the CBN, and the Bank will recover its debt from AMCON recoveries and contributions to the Sinking Fund by the banks. Since the CBN supervises and regulates the banks and AMCON, this exposure is considered a fair risk.

The Committee was concerned about the threat posed by developments in the oil sector arising from uncertain oil market environment, high output leakages arising from oil theft which has negatively affected the oil sector's contribution to GDP and the prospects for declining output if the state of affairs continues. The Committee observed that the accretion to reserves resulted principally from increased portfolio capital inflows. The Committee noted the potential effect of this development on exchange rates, reserves and the capital account in the event of capital flow reversal, and thus stressed the need to maintain stability and retain confidence of investors in the consistency of monetary policy.

The Committee also expressed concern over the low level of credit growth to the private sector and traced this to the crowding out effect of high growth in credit to the public sector. The Committee noted the N1.02 trillion increase in claims on government and the N1.11 trillion drawdown on savings between January and April 2013 and particularly the monetization of US$1 billion in April 2013, being proceeds of the Excess Crude Account. The combined effect of new borrowings and reduced savings was an increase in net credit to the central government of over N2 trillion in the first four months of 2013. The evidence points to an increase in the rate of government expenditure in 2013 when compared with 2012. In addition, the recent military action in the North-East will result in additional spending. Although the Government has announced that there will be no supplementary budget, the Coordinating Minister for the Economy and Honorable Minister of Finance has already announced that there will be a drawdown on a Contingency Vote embedded in the 2013 Budget to cover emergencies. Overall, the Committee is of the view that government spending will constitute a major risk to the inflation and exchange rate outlook, thus advising prudence in monetary policy action at this time.

The Committee further noted that in spite of increased borrowings, yields on FGN bonds have been declining steadily, signaling the impact of increased inflows while equity prices have been trending upwards. The evidence does not, therefore, support claims of monetary policy being too tight. The Committee was of the view that the principal risks to long-term stability can be addressed through diligent implementation of sound policies of fiscal consolidation and efficient sectoral policies underpinned by structural reforms. These are required to attract long term foreign capital inflow that would make the gains of monetary policy sustainable, and also support credit extension to the private sector players.

Consequently, the Committee weighed the following options:

(i) A reduction in rates in view of declining core inflation, stable exchange rates and relative reserve accretion. Against the backdrop of sustained pressure to ease the stance of monetary policy, the Committee considered the imperative of signaling its sensitivity to the concerns expressed about high lending rates in the economy;

(ii) Retaining current monetary policy stance to sustain the macroeconomic gains of tight monetary policy and to continue to rein-in inflationary expectations.

The Committee's Decisions

The Committee considered and acknowledged the merits of option 1 but rejected it as being premature in view of the potential risk factors in the horizon posed by recent developments which would necessitate increased fiscal expenditure in the short-to-medium term, resulting in a resurgence of inflationary pressures. The Committee considered and decided by a majority of 7 votes to hold and 3 votes to reduce the MPR by 50 basis points. Thus, by a majority vote of 7 members to 3, the MPC voted to maintain the current policy stance i.e. retain the MPR at 12 per cent with a corridor of +/-200 basis points around the MPR; retain the Cash Reserve Requirement at 12 per cent and Liquidity Ratio at 30 per cent; with the Net Open Position at 1.0 per cent.

In the final analysis, the Committee was convinced that in view of the successes achieved in all fronts - banking stability, low inflation, exchange rate stability, strong reserve buffers and recovery in the equities market, there is no reason at this point to change a policy that has worked so well.

Thank you.

Sanusi Lamido Sanusi, CON
Governor
Central Bank of Nigeria
May 21, 2013