CENTRAL BANK OF NIGERIA

DOCUMENT OF THE MONETARAY POLICY COMMITTEE, NO. 1

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Consistent with the global acceptance of the principles of the Code of Good Practices on Transparency on Monetary and Financial Policies, the Monetary Policy Committee (MPC) of the Central Bank of Nigeria (CBN), at its Meeting held on June 26, 2001, resolved to embark on the monthly publication of key monetary and exchange rate policy decisions. The essence of the release is to inform the public (stakeholders and operators) about the policy objectives of the CBN, including the rationale for its decisions. It is expected that this initiative will minimize the problem of information asymmetry and thus foster market confidence, which is essential for macroeconomic stability.

This maiden communiqué of the Committee reports on the discussions of the Committee held on June 26, 2001, which reviewed recent developments in financial and macroeconomic conditions. Members recalled that the CBN had responded to the relative price and exchange rate stability and the need to enhance domestic output growth in fiscal 2000 by a policy of monetary ease. Specifically, the CBN's minimum rediscount rate (MRR), the nominal anchor of the Bank's interest rate policy, was reviewed downward from 18.0 per cent in the first quarter to 14.0 per cent in November, 2000. Similarly, the cash reserve requirement (CRR), was reduced from 12.0 per cent to 10.0 per cent, while the liquidity ratio (LR) was lowered to 35.0 per cent from 40.0 per cent.

However, the emergence of inflationary pressures and the need to sustain macroeconomic and price stability in fiscal 2001 have necessitated a review of the Bank's policy stance. In this regard, the MRR was raised by 250 basis points to 16.5 per cent, while the CRR and LR were raised to 12.5 per cent and 40.0 per cent, respectively, between January and April 2001. Despite the increases, the pressure intensified. The expansionary fiscal operations of the three tiers of government, particularly the monetisation of the proceeds of excess crude oil earnings, which exacerbated the problem of excess liquidity in the banking system, led to a rapid acceleration in the rate of monetary expansion, thereby putting intense pressure on domestic prices and the naira exchange rate. Broad money supply (M2) increased rapidly during the first five months of 2001, by 27.0 per cent, well above the 12.2 per cent target increase for the whole year, while inflation increased sharply from 6.9 per cent at end-December, 2000 to 13.9 percent by end-April, 2001. These negative developments clearly needed prompt, corrective measures.

In the Inter-bank Foreign Exchange Market (IFEM), the liquidity pressure was reflected in the sharp increase in the demand for foreign exchange. For example, aggregate demand rose from US$733.06 million in March to US$962.56 million in April, Equivalent to an average daily demand of US$33.8 million in March, vis-à-vis US$53.8 million in April. Given the magnitude of the demand pressure, the exchange rate of the naira depreciated in all the segments of the market, with the spread between the IFEM and parallel market rates hovering at 20.8 per cent as at end-June 2001.

While the Committee duly recognized that structural rigidities and market distortions also contributed to the macroeconomic imbalance, it nevertheless agreed that an accommodating monetary policy stance would only compound the problem.

It was against this background, and in anticipation of subsequent injections of excess liquidity via fiscal operations, that the Committee, at its meeting held on June 26, 2001, decided to further raise the MRR by 200 basis points to 18.5 per cent. The action was borne out of the need to avoid an accommodating monetary policy that would exacerbate inflationary pressures and precipitate exchange rate and macroeconomic instability, which are not only inimical to investment and sustainable output growth, but would also erode the economic gains made in the recent past.

The Monetary Policy Committee will continue to monitor developments in the leading macroeconomic indicators and will take appropriate measures for the interest of the economy.

June 30, 2001