

**MONETARY, CREDIT, FOREIGN TRADE AND
EXCHANGE POLICY GUIDELINES FOR
2002/2003: CHALLENGES AND PROSPECTS**

BY

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**BEING A SPECIAL ADDRESS AT A
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**The National President,
Nigerian-American Chamber of Commerce,
The Board and Members of the Chamber,
Captains of Industry,
Distinguished Guests,
Members of the Media,
Ladies and Gentlemen.**

Let me, at the outset, thank the Board and members of the Nigerian-American Chamber of Commerce for the honour of inviting me as the Guest Speaker at this Business Luncheon. Coming up so early in the year, I am not surprised that I have been invited to discuss policy issues that impact not only on the business environment in Nigeria but also serve as major inputs in investment decisions.

I am aware that the NACC seeks to promote the growth of trade and commerce between Nigeria and the United States of America (USA), by fostering contacts between Nigerian businessmen and professionals and their American counterparts. There is no doubt that you would have made enormous contributions to the growth of economic relationship between our two countries. It is my view that the sustenance of this relationship is desirable for the mutual benefits of both countries.

As you know, the primary responsibility of the central bank is to maintain price stability, promote a viable balance of payments position, ensure financial sector stability and foster economic growth. However, the ability of the Central Bank of Nigeria (CBN) to achieve these basic policy objectives depends on the co-operation of all stakeholders, particularly the government and operators in the financial services industry. It is in this context that the CBN continues to play its advisory role to government and maintain close surveillance on financial institutions so as to ensure compliance with the regulations.

In retrospect, the CBN adopted the indirect method of monetary management since 1986, in line with the deregulatory stance of policy. The indirect or market-based approach relies on the power of the monetary authorities to influence the credit operations of banks through changes in bank reserves. Since 1993, open market operations (OMO) has been the dominant market-based instrument of liquidity management, complemented by reserve requirements and discount window operations. The merit in market-based techniques is predicated on their flexibility to even-out swings in bank reserves relative to demand to keep the inter-bank rate within the desired range.

Interest rates were deregulated in 1987, but re-controlled in 1991, 1994 and 1995. As controls had negative economic effects, total deregulation of interest rates was again adopted in October, 1996. The market-based approach to monetary management adopted since 1993 as well as the instrument autonomy granted the CBN in 1998 have greatly enhanced the conduct of monetary policy in Nigeria. This development has consequently engendered the initiation of new technique of management in line with

the dictates of contemporary economic and political environments.

Let me now focus on the theme of this address. You will recall that the CBN, with effect from 2002 fiscal year, adopted a medium-term perspective monetary policy framework, as opposed to the erstwhile one-year focus. The targets and policy measures, which would remain effective up to December 2003, were intended to enhance policy credibility, stability and rational expectation. This is consistent with the empirical evidence that monetary policy actions affect the ultimate targets with considerable lag. Thus, the shift was intended to free monetary policy implementation from the problem of time inconsistency, as well as help minimize the consequence of policy over-reaction due to temporary shocks.

In 2002, the economy recorded some improvements in macroeconomic aggregates as evidenced in the relative stability and moderation in inflationary pressures. Specifically, inflation rate, which was 18.9 per cent in December, 2001 decelerated to 13.2 per cent in November, 2002. However, the growth in monetary aggregates was

excessive relative to targets. Provisional data indicated that broad money (M2) and narrow money (M1) grew by 25.5 and 15.5 per cent, respectively, compared with the growth targets of 15.3 and 12.4 per cent for fiscal 2002. The excessive growth in monetary aggregates was induced by the expansionary fiscal operations of the three tiers of government, particularly the phased monetisation of the U.S\$1.5 billion draw-down on external reserves and the rapid draw-down on Federal Government's deposits with the CBN. The increase, however, represented a deceleration compared with the 27.1 per cent growth recorded in 2001.

Aggregate bank credit (Net) to the domestic economy increased by 26.5 per cent, compared with the permissible expansion rate of 57.9 per cent for fiscal 2002. The expansion during the year was influenced by increases in credit to both the private sector and the Federal Government. Bank credit expansion to the private sector, however, was modest during the year, as it increased by 18.1 per cent, compared with the growth target of 34.9 per cent for fiscal 2002.

Interest rates generally trended downward in 2002, reflecting the impact of excess liquidity in the banking system, the fall in inflation rate, the downward review of the minimum rediscount rate (MRR) by the CBN as well as the moral suasion employed by the government for banks to reduce interest rates. The rates on deposits of various maturities fell from a range of 13.5 – 21.9 per cent in January, to a range of 8.9 – 15.0 per cent by December, 2002, while the prime and maximum lending rates fell from 25.8 and 31.2 per cent to 22.6 and 27.0 per cent, respectively, during the period.

Distinguished ladies and gentlemen, in our continued effort to stabilize the exchange rate of the Naira and conserve external reserves, the CBN overhauled the operational framework of the Inter-bank Foreign Exchange Market (IFEM) by re-introducing the Dutch Auction System (DAS) on July 22, 2002. As you are aware, the IFEM which was initially conceived as a two-way quote system failed to achieve the objective of broadening and deepening the foreign exchange market. Thus, the CBN remained the major supplier of foreign exchange to the market, meeting all the demand for foreign exchange by authorized dealers.

Nonetheless, the demand pressure persisted with negative effect on the nation's external reserves necessitating the re-introduction of the DAS aimed at conserving external reserves, narrowing the gap between the official and parallel market rates and achieving a realistic exchange rate for the naira. Since its introduction, the naira exchange rate has been relatively stable in the official segment of the foreign exchange market. Between July and December, 2002, the average exchange rate at the official market hovered between ₦127.89/\$1 and ₦126.88/\$1. However, the level of reserves, which fell sharply from U.S.\$10.4 billion in December 2001 to U.S.\$8.3 billion at end-July, 2002 declined further, though at a slower pace, to US\$7.7 billion as at end-December 2002. It is also noteworthy that the DAS was complemented by intensified surveillance of the foreign exchange market by the CBN and the imposition of severe sanctions on errant authorized dealers.

In view of these developments, amendments were made on two occasions to the current monetary policy guidelines during the year. The amendments were specifically designed to increase the level of bank credit for productive activities in the private sector of the economy.

The CBN will continue to monitor macroeconomic and financial market developments closely and will fine-tune the guidelines when necessary.

The conduct of monetary policy will continue to rely on market-based techniques, with open market operations (OMO) as the primary instrument of liquidity management, supported by reserve requirements and discount window operations. Interest rate will also continue to be market-determined, while the CBN's minimum rediscount rate (MRR) will be adjusted as the need arises to indicate the direction and level of interest rate changes.

Other highlights of the current monetary, credit, foreign trade and exchange policy measures include:

- The CBN rediscounting and refinancing facility (RRF).
- Abolition of foreign guarantees as collateral for naira loans.
- Financing the development of small and medium scale enterprises through the Small and Medium

Industries Equity Investment Scheme (SMIEIS), initiative of the Bankers' Committee.

- Coordinating the framework for the introduction of the National Savings Certificates (NSC) to facilitate savings and investment growth, while enhancing liquidity management on a sustainable basis and engendering healthy competition in the banking system.
- Encouraging the re-introduction of the Federal Government development stocks to provide long-term non-inflationary sources of finance capital; and
- Maintenance of the Dutch Auction System (DAS) of exchange rate management in order to enhance efficient allocation of foreign exchange, minimize arbitrage premium and shore-up the external reserves.

Overall, monetary policy has been constrained by a number of problems such as the unconducive operational environment, vulnerability to external shocks and the structure of the financial system. In Nigeria as in many

developing countries, these have been major factors militating against effective management of monetary policy. Experiences have shown that the efficacy of monetary policy is usually constrained by the fiscal operations of the government. However, the CBN will continue to persuade governments to moderate their fiscal operations in order to stabilize the economy, while efforts should be sustained by the Federal Government to put in place an enduring enabling environment that would minimize the cost of doing business in support of rapid economic growth.

Also, it should be noted that the transmission mechanism of monetary policy instruments is generally influenced by the structure of the financial system. The more competitive the financial system, the faster the speed of transmission and the greater the effectiveness of monetary policy. It has been observed that the oligopolistic structure of the financial system poses a threat to monetary policy implementation. The CBN will sustain efforts at promoting a competitive, healthy and stable financial system that will facilitate the effectiveness of monetary policy and evolution of an investor-friendly interest rate regime that will promote savings and investment growth.

Furthermore, the vulnerability of the Nigerian economy to external shocks has a pervasive implication for the implementation of economic policy. Thus, the achievement of monetary policy objectives can be undermined if the price of oil falls below the benchmark of \$18.00 a barrel. Throughout fiscal 2002, however, the price of crude oil showed steady increases. It is hoped that this development will continue in 2003.

These challenges notwithstanding, the prospects for the success of the policies contained in the 2002/2003 monetary, credit, foreign trade and exchange policy guidelines remain bright. Developments in the international oil markets are quite encouraging. The rising export price of crude oil above the budget price has positive implications for export earnings and government reserves. However, there is a compelling need to diversify the productive base of the economy in order to ensure the achievement of sustainable growth.

Ladies and Gentlemen, the CBN will continue to promote macroeconomic stability and ensure improved

policy coordination with the fiscal authorities. In other words, complementary fiscal policy, anchored on financial discipline by the governments, is imperative in 2003, given the fear of liquidity injections into the economy arising from the electioneering campaigns, in order to avoid a reversal of the gains made in the war against inflation and to ensure exchange rate stability.

Once again, I thank the organizers of this forum and wish to assure you of our continued effort towards achieving a conducive and stable macroeconomic environment to facilitate investment growth in the country.

I thank you for your attention.

Chief (Dr). J. O. Sanusi, CON
Governor
Central Bank of Nigeria

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