

Standing Facilities and Liquidity Management in Nigeria: Progress so Far and Challenges Under an IT Environment

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I. Introduction

The ultimate goals of the central bank monetary policy are to achieve and maintain price stability, high employment and financial viability. Since the monetary policy instruments available to the central bank, however, can not directly impact on these macroeconomic variables, it usually deploys its policy instruments to influence some intermediate targets, which in turn will influence the ultimate targets. The central bank may decide to target inflation directly using the inflation targeting framework for monetary policy implementation. Many central banks have adopted this approach, which is believed to address the problem of inflation expectation and may even deliver a lower inflation rate if all the conditions are met. Most central banks, however, deploy their monetary policy instruments to influence some intermediate targets which in turn impact the ultimate target. The intermediate targets include monetary aggregates, short-term interest rates and exchange rates. The levels of these variables will essentially determine the levels of credit, interest and exchange rates in the economy. The monetary policy instruments available to the central bank under the indirect monetary management include open market operations, reserve requirements, repurchase and reverse repurchase transactions, discount window operations, and foreign exchange operations.

While the ultimate objective of monetary policy remains the achievement of price stability, the focus of monetary policy implementation is the achievement of stability of short-term interest rate or exchange rates around the operating targets announced by the central bank. The money market inter-bank call/overnight rates are operating targets of the central bank monetary policy implementation.

Through the conduct of open market operations, the central bank increases or

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decreases the level of money supply, which in turn influences the level of interest rates in the money market. If exchange rate is the intermediate target, the central bank buys or sells foreign exchange in order to stabilize the exchange rate around the central bank set target. The supply of settlement balances and overnight lending/deposits have become monetary tools in the hands of the central bank to influence intermediate targets. These instruments, which the central bank directly controls, will transmit through credit, interest rate, exchange rate and asset prices to impact money stock and the general price level ultimately.

In line with the global trend, the Central Bank of Nigeria introduced a new framework for monetary policy implementation on December 11, 2006. The overall objective of the new monetary policy framework is to be able to influence the short-term interest rates in the money market in an efficient and transparent manner. The main features include: setting of a policy rate (MPR), setting of a ceiling for banks' reserves determined by reserve-averaging mechanism over a maintenance period of two weeks, establishment of a standing facility for lending and deposits, and conducting open market operations including repo transactions, using money market instruments of 1 day to 182-day tenors.

In this paper, the CBN standing facilities and their effectiveness in reducing inter-bank interest rate volatilities are discussed as well as the challenges that have been faced by both the CBN and market operators in the implementation. For ease of presentation the paper is organized into six sections. Following this introduction in section II, the CBN indirect monetary policy instruments are discussed as a prelude to the introduction of the standing deposit/lending facilities in December 2006. The CBN standing facilities as instruments of liquidity management are discussed in section III. Some of the countries that have adopted the policy instruments are surveyed in section IV. In section V, the progress that has been made is highlighted while the challenges being faced in the implementation are mentioned in section VI. The paper is concluded in section VII.

II. The Present Monetary Policy Instruments of the CBN

The CBN adopted the indirect instruments for monetary operations in 1993 with the Open Market Operations (OMO) as the major instrument but complemented by reserve requirements and discount window operations. The statutory reserve requirements (cash reserve ratio, (CRR) and liquidity ratio, (LR) are not subject to frequent changes, hence, they are not suitable for the day-to-day management of liquidity in the banking system. The OMO is an instrument that can be used to

increase or reduce the free reserves of the deposit money banks (DMBs) very quickly. The free reserves of the DMBs are operational target because they are the reserves on which banks can create money with total disregard for the monetary policy stance of the CBN. The instruments are discussed in more details as follows:

i. Cash Reserve Requirement (CRR)

CRR is set by the CBN to meet its monetary policy stance. If the desire is to pursue a tight monetary stance, CRR is raised in order to limit the ability of banks to create money through credit and advances. If the desire is to pursue a loose monetary stance, CRR is reduced to enable banks to give more loans and credits. CRR in cash, is deposited with the CBN and does not earn interest. The use of CRR as a monetary instrument is usually regarded as “blunt” in that both the strong and the not-very-strong banks are equally treated.

CRR for banks is currently at 3.0 per cent, down from 11.0 in 2005 and 8.0 and 5.0 per cent in early and late 2006. CRR for banks are calculated every two weeks and are debited or credited as the case may be. If a bank's CRR is found to be short of the 3.0 per cent, its current account in the CBN is debited with the shortfall while the CRR account is correspondingly credited with the shortfall. On the other hand, if a bank's CRR is found to be more than the 3.0 per cent, its current account in the CBN is credited with the excess while CRR account is debited with the excess.

ii. Liquidity Ratio (LR)

Liquidity ratio is the percentage of banks' deposit liabilities that must be kept in liquid assets, mostly in government treasury instruments, which can be turned into cash as quickly as possible if and when the need arises. LR for banks is presently set at 40.0 per cent. The use of LR is more of a prudential requirement than for liquidity management instrument. The amount set aside for LR is domiciled with the banks but they are constrained from investing the money in other instruments not specified by the CBN.

iii. Open Market Operations (OMO)

The CBN moved from the use of direct to indirect monetary policy instruments for monetary management in 1993 with OMO as a major instrument. OMO entails the injection or withdrawal of funds from the banking system in order to achieve monetary policy objectives. OMO targets the free reserves of the banks by either selling bills to banks in order to reduce their free reserves or buy bills from banks in order to increase their free reserves. When the CBN sells bills to the banks, the CBN

debits the current accounts of those banks and increase their bill holdings by the volume of the bills sold. When the CBN buys bills from the banks, the current accounts of the banks are credited with the cash and their holdings of bills are reduced by the cash equivalent of the bills.

The CBN presently conducts OMO in four ways, namely: Bill auctioning (outright sale/purchase of bills), the Two-Way Quote Treasury Bill trading between the CBN and Money Market Dealers (MMDs) as counterparties, reverse repurchase agreement, and repurchase agreement between the CBN and the banks. The four are discussed as follows:

a. Auctioning of the Nigerian Treasury Bills (NTB)

When the CBN wants to withdraw funds from the banking system, it offers NTBs of various tenors to MMDs electronically. Interested MMDs bid for the offered tenors (bills) electronically, quoting their bid rates and volumes for each of the offered bills. The bids are collated electronically and when the deal rates for each offered tenor are determined by the CBN, the stop rates for each tenor is broadcast to the market. Allotment of bills, won by each bidder and the accrued interest, are done within thirty minutes of the close of the bid. Payment for the bills won at the auction is either done on the day of allotment or on the following day, depending on the terms of the auction. Most often, payment is done on the following day (that is T+1). Same day payment for bills usually occurs when the day following the allotment day falls on a non-working day.

Sometimes the MMDs may not take up as much as the CBN wants and the MMDs are called upon to underwrite the remaining portion of the offer at the stop rate plus 0.125 percent as underwriting incentive. The appointment and use of MMDs is to enhance the effectiveness of OMO as an instrument for liquidity management as they assist the CBN to withdraw as much liquidity as possible from the banking system. The MMDs serve as “middlemen” between the CBN and non-MMDs banks and other non-bank public. Instead of the CBN dealing with a large number of customers, it only has to deal directly with 20 MMDs, consisting of 17 banks and 3 discount houses.

b. The Two-Way Quote NTB Trading.

The two-way trading of NTBs was introduced in April 2007 in order to deepen the money market and improve transparency in the conduct of monetary operations. The

system allows the CBN to contact the MMDs individually on any day and ask for their bid and offer rates or prices for NTBs of any tenor traded in the money market. A MMD is under obligation, when contacted by the CBN or any bank for that matter, to quote its bid and offer rates for any given NTB of any tenor being traded in the market. The CBN can either sell to or buy bills from the MMDs at their own quoted rates or prices. Usually the margin between the bid and offer rate are very small, about 50 basis points at most. When the CBN wants to withdraw funds from the system, it sells bills to MMDs and buys bills from them when it wants to inject funds into the system. The two-way quote trading is presently done on Reuters trading and information system. Settlement is done either same day or on T+1 basis depending on the need of the CBN or the counterparty.

The two-way quote trading of NTBs has been found to be very useful for liquidity management. Whenever the system is found to be very liquid and funds need to be withdrawn quickly, the platform is used with a high degree of success. The drawback that has been noticed, however, is that the system can lead to high cost of liquidity management as MMDs tend to quote higher rates for bills being traded on the platform in order to avoid losses. Again as the minimum volume of the CBN trading on the platform is ₦2.0 billion, the MMDs have to quote rates that will not make them make losses when trying to trade those bills in the market at small volumes. The CBN, on a few occasions, has bought bills from the MMDs instead of selling bills to them but the motive was not actually to inject funds into the system but to calm the rates in the market. It was observed that high rates were being quoted for bills without any relationship with the marked-to-market rates, that is, the rates at which the bills were currently traded in the market. When the CBN offered to buy instead of selling bills, the rates dropped immediately. The CBN is still fine-tuning the use of the system in order to get its maximum benefits.

c. Reverse Repurchase Agreement (Reverse Repo)

Reverse repo agreement is another OMO to reduce liquidity in the system but for a shorter period than outright sale of bills through auction or two-way quote bill trading. A reverse repo agreement is entered into between the CBN and a bank to exchange bills for cash at agreed rates for an agreed tenor. At the expiration of the agreed tenor, the CBN releases the cash and the banks return the bills. Meanwhile, the banks have collected the interest upfront on the cash they have invested. The rates at which reverse repo are transacted are set by the CBN and not auction-based but the rates are made comparable with the prevailing rates in the inter-bank market for

similar bills of similar maturities in order to make them attractive to the investors (banks).

Reverse repo agreement is useful to the CBN in managing liquidity and to banks in managing their portfolio. A bank with short-term deposits will find reverse repo a good investment outlet as the CBN presently has reverse repo agreement for between 7 and 28 days. Moreover, reverse repo agreement is made available to MMDs and non-MMD banks alike.

d. Repurchase Agreement (Repo)

This is the opposite of reverse repo agreement. The CBN gives out cash to a bank at a rate set by the CBN and takes bills from such a bank as collateral. The value of the bills is usually higher than the amount given out as a cover against loss in the value of the collateral. The rate charged is usually at the prevailing market rate plus additional percentage points as “hair cut”. At the expiration of the repo agreement, the bank returns the cash and collects back its bills. Repo is another way of injecting money into the system and it is usually done when the banking system is short and banks need cash to square up their positions as the CBN will not allow banks to regularly overdraw their current accounts.

Repo agreement can be for overnight or for a number of days. The latter is known as tenored repo, which the CBN is yet to introduce. The overnight repo is similar to the CBN overnight lending facility currently being accessed by banks.

The CBN, in recent times, has used foreign exchange trading as an instrument to reduce excess liquidity in the banking system. As a complementary policy instrument, foreign exchange is sold to banks in order to withdraw excess liquidity from the system. The use of foreign exchange transaction as a monetary policy tool includes outright sale and swap.

There are other instruments that, if introduced, will further enhance the effectiveness of OMO as an instrument of monetary policy management. Deposit auctioning and securities lending are two notable ones. Deposit auctioning is a process by which banks with excess liquidity will “sell” such funds to the central bank at a rate set by the central bank. No exchange of bills is involved. The central bank buys the funds for a specified tenor and at a specified rate. At the end of the tenor, the funds revert to the bank. The process is used to lock in excess funds for a given period.

Securities lending is another instrument that can make the money market work relatively smoothly. A bank may have sold a class of bills that it does not have. To deliver the bills it has sold, it can borrow such bills from another bank, a custodian or the central bank at a cost. During the intervening period, the bank may look for the exact tenor of the borrowed bills and buy them in order to be able to return the borrowed bills at the expiration of the agreement. Without such arrangement, trading in the money market is constrained. A bank that is short in bills will find it difficult to operate well in the money market because it will not be able to borrow for lack of adequate collateral nor be able to access the central bank lending or repo facility for the same reason. But a bank need not hold all the bills it will require in the market if it can borrow such securities.

III. The CBN Standing Facilities

Standing facilities (deposit and lending) are instruments of liquidity management. They serve as avenues to invest surplus funds overnight and to square up whenever the system is short at the end of each business day. Ideally, the operators in the money market (banks and discount houses) are supposed to trade among themselves whereby those with surplus funds are to trade it with those that are short at a rate called the inter-bank overnight rate. After the needs of all the operators that are short have been met, the balance, if any, may be deposited with the central bank at a rate that is some basis points lower than the operation rate (monetary policy rate in Nigeria and cash rate in Australia) and most often less than the rate at the inter-bank market. On the other hand, if the surplus funds in the market is not enough to offset the debit positions of the operators that are short, the shortfall may be made available by the central bank in the form of lending facility at a rate higher than the operation rate by some basis points. For an operator to be granted a lending facility, it must have enough eligible securities to serve as collateral for such borrowing. An operator without eligible securities will find it difficult and costly to borrow from the inter-bank market or from the central bank.

The adoption of the standing facilities is to achieve some policy objectives among which are:

- i. To encourage inter-bank trading and thereby deepen the market. The punitive interest rate for lending is to discourage operators from coming to the central bank to borrow while the low deposit rate is to discourage the operators from depositing their funds in the central bank when they could get higher rates in the market. It is when an operator could not source funds in the market for non-availability of funds that it is expected to approach the central bank as the lender-of-last-resort. An operator with surplus funds is expected to lend to

others who are in need of such funds. It is when such an operator has no one to lend to that it is expected to approach the central bank for deposit facility.

- ii. To smoothen or eliminate volatility of short-term over night interest rates. This is a short-run objective. Without the standing facilities, inter-bank interest rates tend to rise extraordinarily when the money market is generally short. A few operators that have funds to lend are at liberty to charge very high interest rates and the operators that are short and are in dire need have little or no choice but to accept to pay the high rates. The standing facilities are expected to eliminate this difficulty. A few operators cannot hold others to ransom knowing that the central bank's lending facility is available to those in need. When the system is long, those with surplus funds need not lend at ridiculously low rates when they can deposit such funds in the central bank at some reasonable interest rates. Following this knowledge by all the operators in the market, the inter-bank rates tend to fall within the interest rate corridor of the deposit (floor) and the lending (ceiling) rates.
- iii. To provide liquidity in the money market. The standing facilities provide liquidity in the market. Whenever the market is short, the central bank is ready to provide liquidity (funds). The provision of liquidity, especially to an operator who has securities but short of funds, makes the inter-bank market to operate smoothly.
- iv. To reduce or eliminate excess banks' reserves. Liquidity management strategy is to reduce banks' reserves to the minimum in order to control excessive creation of money by banks. By offering to remunerate banks reserves through deposit facility, the central bank is able to withdraw banks excess reserves to its coffer.
- v. To influence other rates in the economy. The ability of the central bank to curb excessive volatility in the short-term interest rates, paves the way for it to influence other rates. It is expected that operators in the economy will adjust their rates to reflect the movement in the inter-bank overnight rates.

The Central Bank of Nigeria (CBN) adopted the standing facilities on December 11, 2006 as an important component of the new framework for monetary policy implementation that was introduced at the time. A monetary policy rate (MPR) of 10.0 per cent was set to replace the hitherto policy anchor interest rate, the minimum rediscount rate (MRR). The standing deposit facility was set at 300 basis points

below the MPR while the standing lending facility was set at 300 basis points above it, translating to 7.00 and 13.00 percent, respectively. The operators in the market, who always try to minimize cost and maximize profits, are expected to lend and borrow within the interest rate corridor. The MPR of 10.0 per cent was in operation until it was reviewed downward to 8.0 per cent in June 2007 and the interest rate corridor was reduced from +/-300 to +/-250 basis points following the observed downward trend in inflation rate, stability in the exchange rate, strong external sector reserves, and the sustained economic reforms by the government among other things.

IV. Country Experiences

Many central banks have adopted the standing facilities as monetary policy tool in recent times. They include the European Central Bank (ECB), Central Bank of Brazil (CBB); Bank of Canada (BOC); and Reserve Bank of Australia (RBA), to mention just a few. These are discussed here:

The ECB

The ECB carries out its mandate to maintain price stability by using monetary instruments at its disposal to affect market interest rates, regulate liquidity in the banking system and signal the general stance in monetary policy. Eurosystem monetary policy is conducted in a decentralized way, with the Governing Council of the ECB making the decisions and the national central banks carrying out most of the operations. Among the monetary instruments available to the ECB are:

- The interest rates on main refinancing operations which signals the stance of monetary policy;

- Open market operations which are used for steering interest rates, managing the liquidity situation in the market and signaling the stance of monetary policy;

- Standing facilities used to influence the short-term interest rate movement and signaling the stance of monetary policy; and

- Reserve requirements by which credit institutions are required to hold a certain amount of minimum reserves with the national central banks.

Institutions' holding of required reserves are remunerated at the rate on the Eurosystem's main refinancing operations. The ECB has two standing facilities: the marginal lending facility and the deposit facility. The counterparties can use the marginal lending facility to obtain overnight liquidity from the national central banks against eligible assets. The interest rate on marginal lending facility normally

provides a ceiling for the overnight market interest rate. Counterparties can use the deposit facility to make overnight deposits with the national central banks. The interest on the deposit facility normally provides a floor for the overnight market interest rate.

Central Bank of Brazil (CBB)

The monetary policy operating target chosen by the CBB is the short-term interest rate. The major policy instrument for the achievement of the set target is the standing facilities complemented by open market operations and discount window operations, which are used when it is absolutely necessary. Before 1996 when the CBB began to rely more on standing facilities as an instrument of monetary policy, it usually ensured that sufficient funds were available in the system so that participants in the money market did not need to turn to it for assistance. If necessary, however, banks could have recourse to end-of-day assistance which was granted at posted rates. Excess reserves were not remunerated. A bank with financial difficulty was expected to use the discount window facilities and if it could not meet its requirement from the discount window facilities, the CBB might contact the open market dealers and try to find a lender for the bank in financial difficulty. If there was no lender, the CBB was then under obligation to provide direct assistance to the bank through repo provided the proper guarantees were offered. Before the introduction of the lending facility, discount window rates were usually below the inter-bank rates, which encouraged the banks to recourse to the CBB for credit rather than borrowing from the inter-bank market. In 1996, some changes were introduced into the monetary policy operating procedure, which tend to make the CBB standing facilities the main monetary policy instruments. The Bank created a standby deposit facility, which remunerates deposits and a standing lending facility on December 2, 1998 following the relative stable internal and external economic conditions. An interest rate corridor, which stipulates lending (ceiling) and deposit (floor) rates, is set every five to six weeks by the Monetary Policy Committee (MPC) to serve to signal the trend of the main operating target of the CBB.

Bank of Canada (BOC)

The operating target of the BOC is the overnight interest rate. In order to be able to ensure sufficient liquidity in the banking system and at the same time eliminate excess liquidity, the BOC sets the Bank Rate which forms the ceiling or the standing lending facility interest rate. Institutions with debit balances at the end of the day can borrow from the BOC at the Bank Rate using eligible instruments as collateral.

Institutions with surpluses at the end of the day receive interest on these balances at 50 basis points below the Bank Rate which forms the floor for the overnight interest rate. The discriminating rates encourage market participants to deal or trade among themselves rather than approaching the Bank when they want to adjust their surplus or deficit positions. If the inter-bank overnight rate is above the Bank Rate (the target rate), that is an indication of liquidity shortage and the BOC can intervene with repo in order to inject funds into the system and if it is below, that is an indication of excess liquidity, the Bank will intervene with reverse repo to withdraw funds from the system. The operation of the standing lending and deposit facilities and the use of repo transactions enable the BOC to influence the short-term overnight rates which is its operating target.

The Reserve Bank of Australia (RBA)

The operating target of RBA is the overnight interest rate known as “cash rate” which is the interest rate on overnight loans among institutions in the money market. The Bank tries to keep the “cash rate” as close as possible to the overnight rate by influencing the supply and demand of funds in the money market by using open market operations and by lending “exchange settlement funds” to banks and remunerating bank reserves. Banks may borrow from the RBA at 25 basis points above the “cash rate” but banks reserves are remunerated at 25 basis points below the “cash rate”. When the system is short, inter-bank rate will rise above the “cash rate”. In order to bring the inter-bank rate to the target “cash rate” the RBA will have to inject funds into the market by buying securities from the market. By so doing, the supply of what is called “exchange settlement funds” will increase and overnight interest rate will fall. If the inter-bank rate is below the “cash rate”, the RBA will reduce “exchange settlement funds” in the market, and cause the overnight rate to increase toward the level of the “cash rate”.

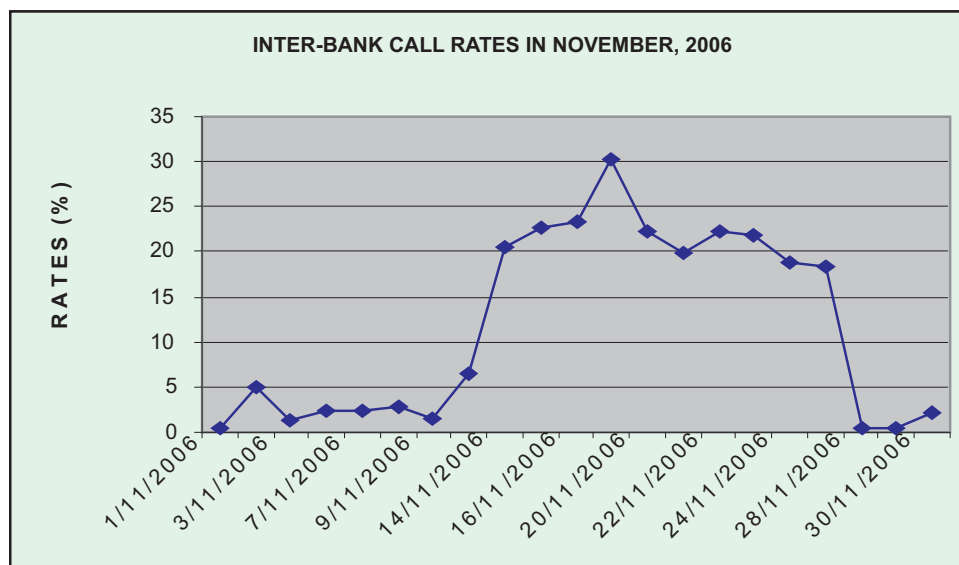
V. The Progress so Far

In this section, an attempt is made to appraise the progress that has been made since the introduction of the standing facilities as monetary policy tool by the CBN. As stated earlier, the facilities were put in place to address, among others, the wide swings that characterized inter-bank interest rate movements in the money market. We start the appraisal by looking at the rate movement prior to the time the new instrument was introduced.

In November 2006, inter-bank call rates ranged from less than 5.0 per cent to 30.0 per

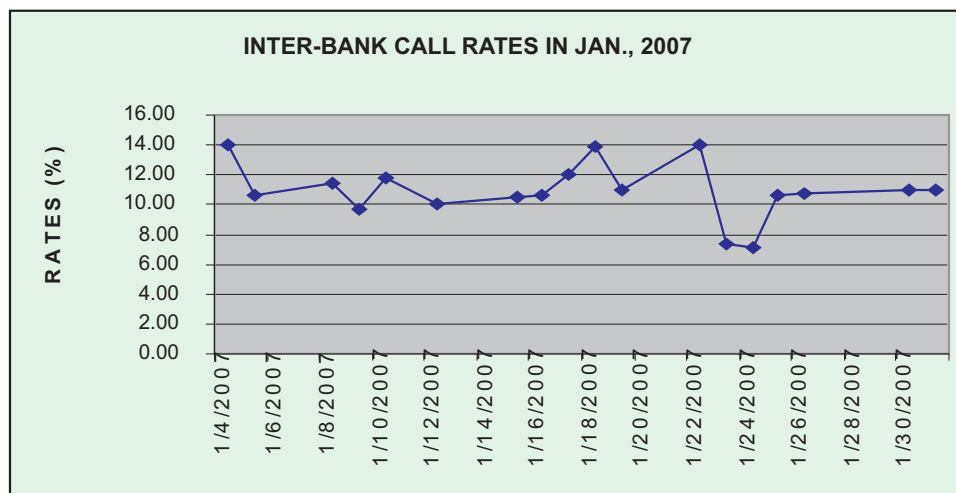
cent. This pattern was typical of the rate movements in the inter-bank market before the adoption of the new framework for monetary policy implementation in December 2007 (Chart 1). At the beginning of each month the rates were usually low indicating sufficient or excess liquidity in the system. The rates would increase toward the middle of the month as banks in custody of government revenue began to remit such funds to the CBN for the Federation Account toward the Federation Account Allocation Committee (FAAC) meeting that usually holds in the middle of the month. Immediately after the FAAC meeting, the revenue allocations to states and local governments are credited into their various accounts in the banks. As a result, inter-bank rates would begin to fall, reaching as low as 2.0 per cent at times before increasing again until the cycle was complete.

Chart 1



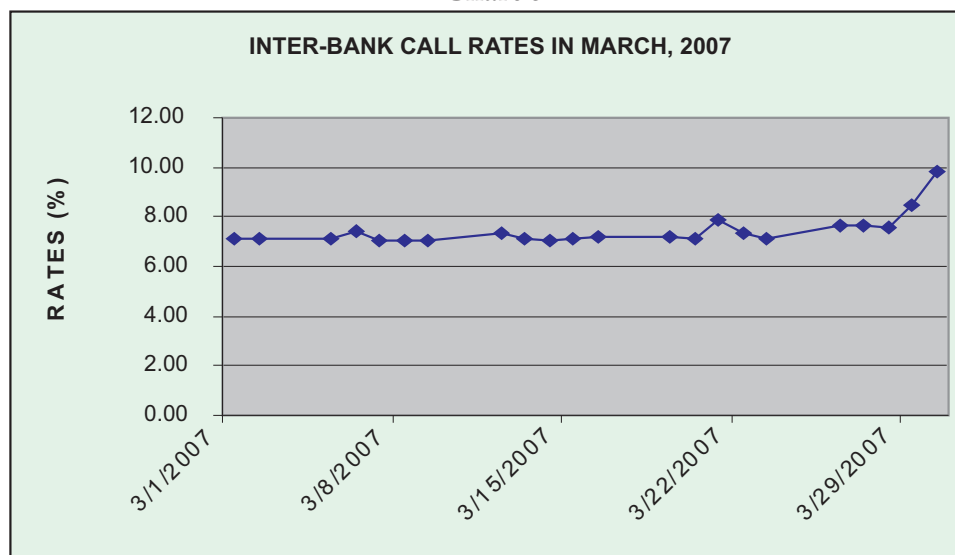
The operation of the standing facilities in January, 2007, which was the first full month of the operation, gave their effect on the inter-bank call rates as shown in Chart 2. The MPR was set at 10.0 percent at the inception of the standing facilities with lending and deposit interest rates at 13.0 and 7.0 percent, respectively. In January, it was observed that inter-bank call rates ranged from 7.0 to 14.0 per cent. Between 14 and 22 January, 2007 rates increased but not beyond 14.0 per cent, (100 basis points above the CBN standing lending rate). When the accounts of the beneficiaries of the statutory revenue allocations were credited, the inter-bank rates dropped and ranged from 7.0 to 11.0 per cent, falling within the interest rate corridor of between 7.0 and 13.0 per cent.

Chart 2



The movement of the inter-bank call rates in March 2007 indicated clearly the effectiveness of the monetary policy tool (Chart 3). The rates fell within 7.0 and 10.0 per cent throughout the month. Despite the need for banks to remit large sums of money for the FAAC meeting in March, the inter-bank call rates did not increase beyond 10 per cent because the banks that were short in liquidity were able to access the CBN lending facility at 13.0 per cent. The banks that had excess reserves were able to access the CBN standing deposit facility at 7.0 per cent.

Chart 3

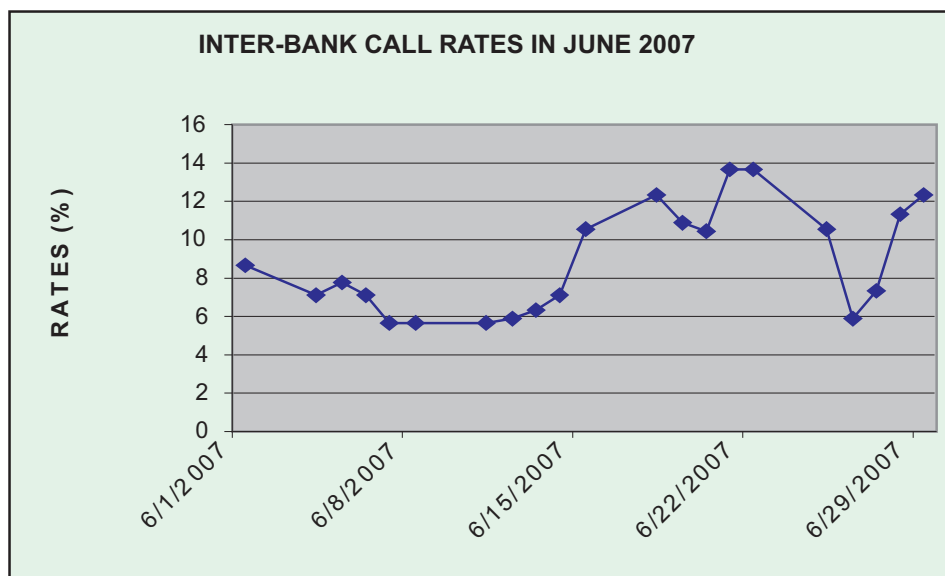


The banks and discount houses traded among themselves, most often within the interest rate corridor, with the full understanding that the CBN facilities were available to any bank or discount house that needed them.

Banks with excess reserves needed not lend such funds at a rate lower than the CBN standing deposit interest rate of 7.0 per cent while banks that were short needed not borrow at a rate higher than the CBN standing facility interest rate of 13.0 per cent

Following the downward trend in the rate of inflation which stood at 6.4 per cent in May 2007, the MPR was adjusted downward by 200 basis points from 10.0 to 8.0 per cent in June 2007. The interest rate corridor was also narrowed to 500 basis points with deposit lending facility rate at 5.5 per cent and lending facility at 10.5 per cent. The monetary operations in June brought a lot of pressure on the inter-bank call rate which is depicted in Chart 4.

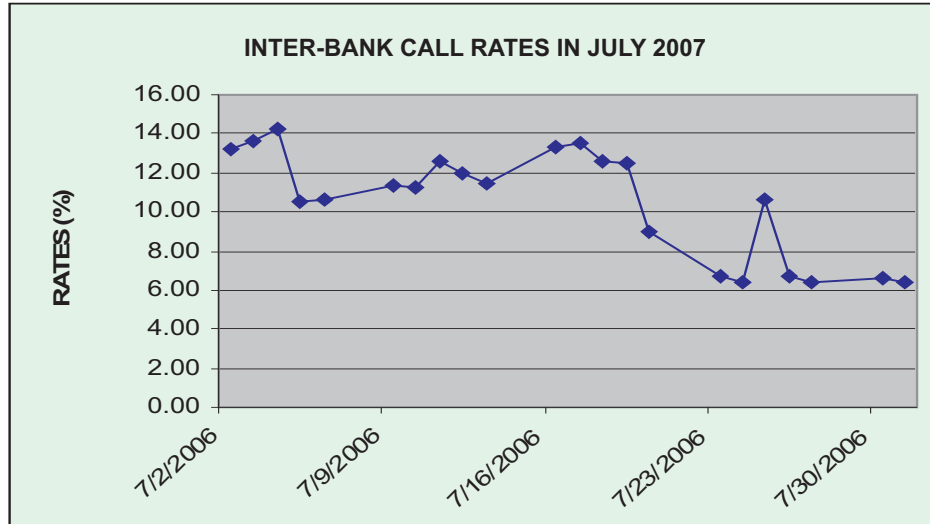
Chart 4



The need to meet monetary and economic targets of the third review of the Policy Support Instrument (PSI) led to the aggressive mop up of liquidity in the system. As a result the inter-bank call rates that ranged from 5.5 and 10.5 percent during the first two weeks of June 2007 rose to almost 14.0 per cent before declining and closed at about 12.0 per cent as at the end of the month. The outcome of the use of monetary instruments in June 2007 threw up some challenges for a need to have realistic liquidity forecast and monetary targets. While the estimates of liquidity in the system vis-à-vis the targets indicated the existence of excess liquidity in the system, the rise in the inter-bank call rates as well as the opinions of the operators in the money market clearly showed that the excess liquidity was grossly exaggerated.

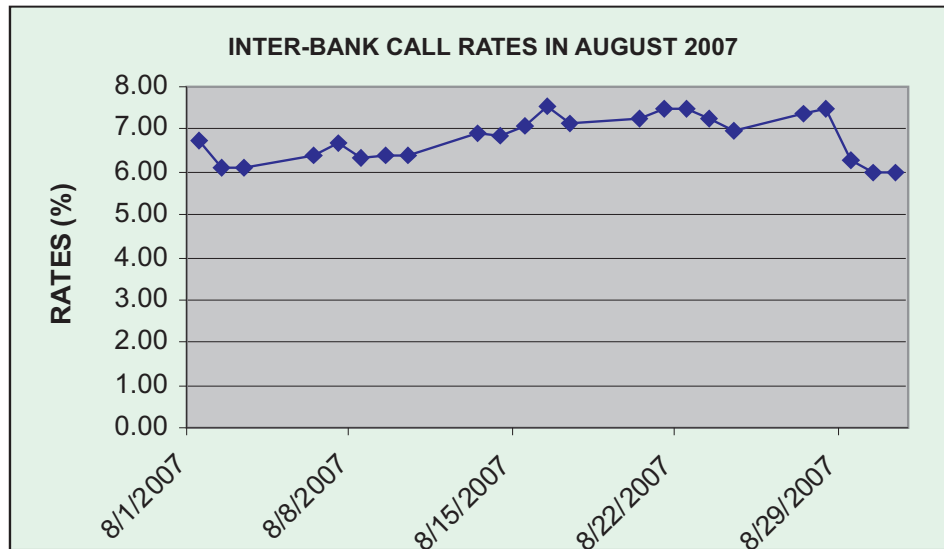
The ripple effect of the excessive mopping of liquidity in the banking system in June continued into the first three weeks of July as shown in Chart 5. The liquidity in the banking system was tight throughout during the period and only eased after the release of FAAC revenue allocation and the payment of matured bills. The inter-bank call rates declined to about 6.2 per cent during the last week of July 2007.

Chart 5



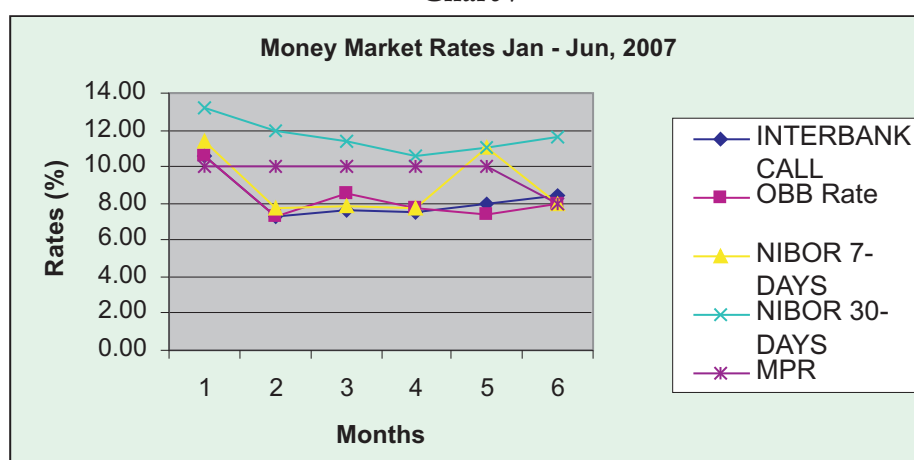
In August 2007 the market had re-adjusted and inter-bank call rates had moderated hovering between 6.0 and 7.5 per cent as shown in Chart 6.

Chart 6



The inflow of liquidity mostly from the operations of the three tiers of government and from private foreign investors has continued to pose a challenge to the monetary operations of the Bank. It has been observed that the CBN deposit facility has been accessed by the operators in the money market than the lending facility as a result of excess reserves that banks closed with almost on daily basis. During the first six months of 2007, the CBN granted the sum of ₦608.01 billion as lending facility as against taking in ₦12,818.71 billion deposit facility during the same period.

Chart 7



One of the objectives of the standing facility is to be able to influence the short-term overnight interest rate and through it the other rates in the money market. From Chart 7, it can be seen that all the money market rates fell within the range of about 7.0 and 13.0 per cent. The inter-bank call rates and the rates at Open-Buy-Back (OBB) (the rates at which banks trade bills, lend and borrow among themselves) assumed the same trend and fell within the interest rate corridor. The 7 - and 30-day Nigerian Inter-bank Offered Rate (NIBOR) trended downward except in May when there was a spike, especially on the 7day segment.

Movements in interest rates in the money market are expected to influence rates in the economy such as lending rates, mortgage and other consumer credits. An analysis of the movements in these other rates will be worthwhile at the end of the first year of the adoption of the instrument.

VI. Challenges

The implementation of the CBN standing facilities has not been without its own

challenges, which have limited its achievements. The monetary policy framework pre-supposes that banking system reserves will be accurately determined at all times in order to be able to know if there is going to be a need to withdraw from or inject funds into the system. For this purpose, banks' current account and settlement account balances must be available, not only to the banks but also to the central bank on real time. The framework also pre-supposes that an efficient payments system is in place as a vehicle to transmit the transactions that take place in the money market. It is pertinent to note that some of the conditions that are required for efficient and effective operation of the CBN standing facilities are still lacking. The major challenges are directly related to information technology (IT) as they are presently in the Bank. The challenges include but not limited to the following:

- i. None or limited interface between the CBN Temenos T24 banking application and the CBN Inter-bank Fund Transfer System (CIFTS), leading to the inability of banks to accurately determine their balances at end of business each day. A bank that has a debit balance in its current account (T24) but a credit balance in its settlement account (RTGS) is unable to transfer fund from RTGS to its T24 account. Such a bank may come for lending facility at the close of business but only to discover the following day that it actually closed with a surplus;
- ii. Inability of the IT system to execute mandates leading to failed transactions and supply of wrong and misleading information. Sometimes the system fails to debit or credit counterparties as instructed thereby recording wrong balances for banks. In some instances the system had wrongly credited or debited a bank's account several times for the same transaction which necessitated manual reversal of such wrong postings whenever they were detected.
- iii. For efficient and effective operation of the standing facilities, especially for liquidity management purposes, the CBN must be able to forecast accurately the level of excess liquidity in the banking system on a daily basis. However, due to the difficulty with IT, that has not been possible;
- iv. Frequent out-of-order being experienced by the counterparties. The CBN counterparties (banks, discount houses, etc) always complain of breakdown in the system which causes much delay. The CBN had to provide some internet outlets at its office in Lagos for banks that are unable to have access to

the CBN from their own ends to post their transactions to the Temenos Internet Banking (TIB).

- v. Long communication channel between the users and IT personnel/service providers. Most often, problem that requires to be attended to within a few hours may take two or three days to receive attention due to the layers of authorities a desk officer will have to go through to get attended to;
- vi. Inadequate number of skilled IT personnel sufficiently empowered to fix IT problems as they arise. A lot more IT personnel need to be employed, trained and given the required authority to do certain things without compromising the overall interest and security policy of the CBN;
- vii. Insufficient number of the IT equipment. Users are most often unable to communicate to counterparties due to lack of functional telephones. Most often the internet server do not work or may be very slow in responding to given instructions, leading to delay and frustration.

VII. Conclusion

In this paper, we have examined the CBN standing facilities as instruments for liquidity management. The specific objectives the instrument is expected to achieve were also stated. Some central banks including the ECB (the Eurosystem), that have adopted the instruments were surveyed. The progress that has been made with the use of the standing facilities with respect to its stated objectives was appraised. It was shown that the instruments have had some moderating effect on the inter-bank call rate volatilities that was hitherto noticeable. The challenges that have made the implementation of the standing facilities very difficult and limited their achievements were highlighted. Most of the challenges are IT related. For an effective monetary policy implementation, an efficient payment system and good IT infrastructure are required.

It is pertinent to note that a standing facility, as an instrument of liquidity management, is essentially a short-term measure. Huge and persistent inflow of liquidity from within and outside the economy will require other measures that will help the policy makers to sterilize or eliminate excess liquidity in the system on a more permanent basis in order to be able to achieve stable prices, interest and exchange rate levels.

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