Keynote Address

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Director of Research and Statistics,
Departmental Directors/Their Representatives,
Branch Controllers,
CBN Executives,
Distinguished Resource Persons,
Ladies and Gentlemen,

It gives me great pleasure to be part of this important occasion of the 2007 CBN Executive Seminar organized by the Research and Statistics Department in collaboration with the Human Resources Department of the Bank. This Edition of the seminar, the 15th in the series is very important for the Bank as it is aimed at availing the Executives of the Bank the opportunity to brainstorm on contemporary monetary policy issues which form the central mandate of the CBN. Indeed, deliberations on the theme "Monetary Policy in a Changing Environment" is very apt given the Management's drive to reposition the Bank as a world class institution with expertise in appreciating and executing its core mandate.

The rapid changes in the global financial architecture and the role of central banks in driving economic reforms, particularly in emerging economies and developing countries have prompted the recent macroeconomic policy initiatives in Nigeria, especially in the financial services industry, beginning with the bank consolidation to the reforms in the payments systems, the introduction of new currency structure as well as the new framework for monetary policy implementation.

Monetary policy comprises a combination of strategies and instruments used by the monetary authorities to control money supply in an economy consistent with a desired level of short term interest rate, inflation and economic growth. In a changing economic environment, the choice of a monetary policy strategy is intertwined with the objectives of monetary policy which include ensuring price (inflation, exchange

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rate and interest rate) and financial stability. Thus, the conduct of monetary policy and the goal of price stability lie within the mandate of central banks, which underscores the importance and appropriateness of the theme of this year's Seminar, especially with the changing times.

Ladies and Gentlemen, as Executives of the Bank, I believe you are all conversant with the core mandate of the Central Bank of Nigeria (CBN). However, for the avoidance of doubt let me reiterate that the CBN Ordinance of 1958, CBN Act No. 24 of 1991 and CBN Act, 2007 mandated the Bank to:

- Issue legal tender currency in Nigeria;
- Maintain external reserves to safeguard the international value of the legal tender currency;
- Maintain price stability;
- Promote monetary stability and sound financial system in Nigeria; and
- Act as banker and economic adviser to the Federal Government.

These mandates are not different from the generic functions of central banks the world over and must be at the finger tip of every central banker.

In maintaining the price stability mandate, the CBN pursues its monetary policy based on the policy regime and targets set to achieve macroeconomic stability. In Nigeria the policy regime has changed from the fixing of interest rates, exchange rate targeting, and the targeting of monetary aggregates to the current implicit policy of steering overnight interest rates that will transit to the proposed inflation targeting regime. For over one decade and half, monetary policy in Nigeria has focused on the targeting of monetary aggregates. The evolution of monetary policy regimes showed that during the 1960s through the early 1980s, the Bank relied heavily on direct controls, mainly reserve requirements, sectoral credit allocations without recourse to market-based operations. The policy environment was rather static with no major change except for the annual discretional adjustments of interest rates among economic sectors. The money market experienced the dearth of instruments to effectively conduct monetary policy. Consequently, interest rate regulation hampered financial deepening and retarded the development of both the money and capital markets.

With the adoption of the Structural Adjustment Programme (SAP) in 1986, the Nigerian economy, and in particular the financial sector went through extensive structural changes encompassing liberalization of key macroeconomic variables such as interest rate and exchange rate, technological innovations and regulatory reforms. Consequently, the Bank now relies on indirect techniques such as Open Market Operations (OMO) as the dominant instrument complemented by the cash reserve requirement among others in the execution of its monetary programmes.

The reforms in the financial sector are on-going and the consolidation in the banking industry, a component of the 13 point programme to reposition the financial system, has resulted in the emergence of twenty-five (now twenty-four) well capitalized and sound banks in the country. In addition, the Nigerian financial markets have become more diversified and integrated into the global market and less vulnerable to systemic failures.

The changes in the monetary policy environment, particularly the structural changes in the financial markets have potentially far reaching implications for the design and implementation of monetary policy. While some argue that financial reforms in Nigeria have still not advanced far enough to warrant changing our monetary policy strategy, it is widely recognized that financial liberalization and interest rate deregulation have affected the monetary policy transmission mechanism as well as created daunting challenges for the effective conduct of monetary policy.

An important element in the transmission mechanism of monetary policy is the relationship between the Central Bank's policy rate and other money market interest rates. There is a relationship between the CBN policy rate and the money market rates, exchange rate, asset prices and bank lending. These ultimately affect aggregate demand, inflation expectations and the rate of inflation. The monetary policy transmission mechanism involves instruments to control the supply and cost of settlement balances (bank reserves), the interest rate at which these balances are supplied and the operating target. Before the introduction of the Monetary Policy Rate (MPR) in December 2006, there was substantial deviation between the CBN Minimum Rediscount Rate (MRR) and short term interest rates. The volatility in the short term rates introduced uncertainty and weakened the monetary policy transmission mechanism, which is an indication of inefficiency in the inter-bank market.

The adoption of the MPR as a monetary policy tool was expected to allow the Central

Bank influence inter-bank interest rates in a simple and transparent manner as well as ensure effective liquidity management. It was to encourage banks to trade with each other rather than rely on the Central Bank when they need to adjust their surplus or deficit position. Market conditions were expected to be easier to manage since market participants would not expect the inter-bank rate to move significantly away from the MPR. With the introduction of the MPR and the CBN standing facilities, the volatility in the inter-bank rates was contained.

Measures implemented to revamp monetary targeting as a framework for monetary policy included medium-term monetary policy programme, effective communication through the Monetary Policy Committee (MPC) releases and the Bankers' Committee meetings, zero tolerance on Ways and Means advances to Government and the sterilization by Government of crude oil receipts above the budget benchmark price to checkmate liquidity surfeit. The fiscal rule oil price benchmarking and the medium-term expenditure framework have thus far restrained fiscal dominance, which has helped in containing liquidity surfeit. Hence, the successive attainment of single-digit inflation rates in the last seventeen months.

Monetary targeting is affected by unreliable/unstable relationship between different measures of monetary aggregates and policy targets/objectives, financial innovation, advances in information and communication technology, globalization, and the inability of changes in monetary aggregates under monetary targeting to properly signal central bank's policy intentions/stance to the financial markets. While the Bank has implicitly acknowledged the need to change the framework for monetary policy, it is unclear what the nature of any new policy framework will be, although there is a wide spread recognition that inflation targeting is particularly promising as alternative framework for monetary policy. To this end, the Bank is considering Inflating Targeting as an alternative framework for monetary management.

Inflation targeting is relatively immune to some of the vagaries of monetary targeting. Inflation targeting as a monetary policy framework sets an explicit inflation target over a given time horizon and monitors inflation forecast to achieve the overall macroeconomic goals. The key challenges of inflation targeting are: public announcement of numerical target for inflation; institutional commitment to price stability as the primary goal of monetary policy to which other goals are subordinated; robust information/communication strategy; increased transparency and accountability on the part of the central bank in attaining its objective.

Distinguished ladies and gentlemen, in the face of these realities, the task may look daunting but it is doable. Thus, it will be highly appreciated if the participants in this seminar would examine the issues on ground and come out with credible suggestions that would help in the design of an appropriate monetary policy framework that will be in consonance with our ever changing policy environment. Redesigning our monetary policy strategy is anchored on the need for the Bank to achieve its core mandate of price stability in addition to a stable exchange rate, full employment and financial stability. Appropriate design and implementation of monetary policy by the CBN would help in the attainment of the objectives of the financial sector strategy (FSS 2020) strategy, a programme to catalyze growth through financial sector reforms that would launch the economy into one of the 20 largest economies in the world by 2020.

I believe that with the crop of seasoned resource persons who have been assembled at this seminar you will come up with resolutions that will help the Bank move forward in the execution of its monetary policy. You should examine the available monetary policy strategies, and in particular the current implied interest rate targeting through the standing lending facility and see how it can be perfected as transition to either lite or full inflation targeting regime, assuming that overwhelming evidence show that monetary targeting should be discarded.

I urge you all to participate actively and make the best use of the opportunity availed by this seminar by making your contributions towards successful deliberations.

It is now my singular honour and privilege to declare this seminar open and to wish you very fruitful deliberations.

Thank you for your kind attention.