Special Remarks

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It is my honour and pleasure to make this Special Remarks at the opening ceremony of the 23rd edition of the Annual Executive Seminar jointly organised by the Research and Human Resources Departments. The theme of this year's Seminar, "Exchange Rate Policy and Economic Management in Nigeria – Is there Need for A Paradigm Shift?", could not have come at a more appropriate time than now as the Bank continues to grapple with the challenges of severe foreign exchange pressure, contraction in foreign exchange receipts and slow recovery of the global economy as well as the reversal of short-term capital flows.

Ladies and gentlemen, you will recall that recent global trends suggest that Asia, the euro zone and emerging markets economies are contending with threats of recession and austerity measures, while commodity prices, including oil prices, are falling with negative impact on oil producing countries like Nigeria. Arguably, these developments show clear signals of: a potential second-round global recession in less-than a decade since the last melt-down and the delaying global recovery; weakening global demand; and increasing volatility of capital flows to emerging markets. Thus, thinking out of the box will provide us with unconventional ways of dealing with the on-going economic difficulties. It is against this background that we must engage in constructive and productive discussions to generate ideas and viable options that will drive our exchange rate policy in the near-to-medium term.

Historically, a number of emerging market economies that integrated into the international capital markets with soft peg regimes had experienced severe currency crisis and economic disruption in the 1990s. Consequently, an increasing number of countries are moving toward floating exchange rate regimes. Notwithstanding, it has been widely argued that some form of soft peg regimes would be more viable and more appropriate for poorer developing economies due to their limited involvement in international capital markets. However, as these economies develop over the longer-term and open their capital accounts, they move away from soft pegs towards more flexibility.

Ladies and gentlemen, permit me to make some distinctions between the common forms of exchange rate regimes adopted globally. First is the free float regime, which is purely market determined and the monetary authority does not intervene in the foreign exchange market. Monetary policy is, therefore, independent of the exchange rate

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regime and can be used freely to steer the domestic economy. Its main advantages include, but are not limited to: the ability to absorb adverse shocks; not prone to currency crises; and does not require high international reserves accumulation. Its disadvantages are: high short-term volatility; and large medium-term swings.

Second, is the managed float, where the monetary authority intervenes actively in the foreign exchange market without committing to a preannounced path for the exchange rate. Monetary policy under such circumstance is relatively independent and freely used to steer the domestic economy. The limited flexibility of managed float permits partial absorption of adverse shocks. It can also maintain stability and competitiveness, if the regime is credible, and is less vulnerable to currency crisis. The CBN has maintained this regime since the liberalisation of the foreign exchange market in 1986, because over the years, our exchange rate management policies have focused largely on the objective of maintaining stability.

Third, is the fixed or pegged regime, where the exchange rate is fixed to a major currency or a basket of currencies or Special Drawing Right (SDR). The peg is adjusted when the misalignment becomes unsustainable. The monetary authority stands ready to defend the peg through direct intervention and monetary policy. This regime can maintain stability and competitiveness if the peg is credible. However, the regime is prone to currency crisis if the country is open to international capital market because of the limited shock absorptive capacity. This regime was abandoned in Nigeria in 1986 following the liberalisation of the foreign exchange market with the adoption of the Structural Adjustment Programme (SAP).

In the developing world, the choice of an exchange rate regime stands as, perhaps, the most contentious aspect of macroeconomic policy. In Nigeria, the main objectives of exchange rate policy are to preserve the value of the domestic currency, maintain a favourable external reserves position and ensure external balance without compromising the need for internal balance and the overall goal of macroeconomic stability. According to the treatise on the impossible trinity, a country cannot have simultaneously a fixed exchange rate, free capital mobility, and an independent monetary policy. Only two of these objectives can be achieved at a time. Therefore, which objective should be given up depends on the country's macroeconomic policy and stage of development.

Different mechanisms had been implemented to manage the foreign exchange market in Nigeria. From the pre-1986 fixed exchange regime to a flexible and market determined regime in 1986. Since then, the Bank had operated different variants of the managed float regime to date, dictated by the prevailing economic conditions and market dynamics. However, on February 18, 2015, the Bank took the bold step to close the official window of the foreign exchange market. Furthermore, to deepen the market and enhance the efficacy of the demand management, the Bank gave specific directives on the effective monitoring and repatriation of both oil and non-oil export proceeds. In addition, the

utilisation of export proceeds was restricted to eligible transactions only, to minimise leakages.

It is important to note that the foreign exchange market has witnessed significant demand pressure and speculative attack from market participants, which led to volatility in exchange rates in the three segments of the market namely the official, inter-bank and Bureau-de-change (BDC). The declining oil price in the international market has challenged the Bank's capacity to accumulate reserves and defend the local currency in a bid to stabilise the exchange rate. There is therefore, need to come up with a robust exchange rate policy that will ensure stability at all times and guarantee sustainable and long-term growth and development. Definitely, overcoming this challenge is a possibility, but we must remain proactive in assessing risks and their associated costs, as well as, fashioning out ways to deal with the challenges.

Let me emphasise, that the selection of an exchange rate regime that is most likely to suit a country's economic interest would depend on country specific peculiarities namely: the size structure of the economy, openness of the country and the quantum of financial flows, structure of production, inflationary trend and the nature and source(s) of shocks among others. For any country to maintain a stable and competitive real exchange rate, it requires a supportive policy environment, which include: efficient and effective macroeconomic policies, strong financial sector and credible institutions. Monetary policy should be consistent with exchange rate objectives. Better managed and supervised financial system, adequate accounting standards and disclosure requirements, as well as, efficient legal and judicial systems.

Ladies and gentlemen, in the light of the foregoing, we have carefully selected subject area experts to make presentation around the topical theme of the Seminar. I therefore, urge you all to make use of this opportunity by devoting maximum time and attention to all the presentations and actively participate in all discussions in order to come up with an appropriate exchange rate framework that will guide future policy directions.

I wish all of you a very stimulating Seminar and fruitful deliberations.

Thank you for listening.