MONETARY POLICIES AND IMPLEMENTATION IN NIGERIA

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APPROVAL PAGE

This project titled "Monetary Policies and Implementation in Nigeria (1988-1998) by Amina Ardo Galadima meets the regulations governing the award of Master of Business Administration of Ahmadu Bello University, Zaria and is approved for its contribution to knowledge and literary presentation.

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DECLARATION

I hereby declare that this project is original and a product of my research findings.

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ABSTRACT

This study is designed to find out the overall effectiveness of monetary policies in promoting economic development in Nigeria.

The unique characteristics of policy tools are highlighted, so also the problems Associated with their implementation.

From the analysis, it was discovered that most of the policy tools are either not properly implemented or not properly chosen, as they cannot adequately take care of the economic problems on the ground. This is because statistical data required for policy setting are either received very late or unreliable from main operators which are banks and other financial institutions, so also government budgets deficits financed through borrowings.

It was concluded therefore that for the tools to be effective;

(1) Data should be realistic, reliable and timely received by the policy makers.

(2) There should be proper harmonization of fiscal and monetary policies to reduce yearly budget deficits which are mainly due to lack of coordination between fiscal and monetary programs.

(3) CBN should undertake deliberate strategy for rebuilding confidence in the banking industry.

(4) There should be due attention given to timing sequencing, appropriateness and complementariness of policy choices to make them more effective.

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DEDICATION

This Project is dedicated to my late parents and my entire family. May the almighty Allah bless us all with paradise Amin.

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Amina Ardo Galadima.

PREFACE

The main purpose of this project is to examine the monetary policies for promoting economic development in Nigeria and assess the extent to which the monetary policy tools were used in the last one decade.

This project is not only confined to what have be known as market oriented policy tools but also selective and direct tools that have been used hither to the development of deregulated monetary policies. The procedure generally adopted or followed is first to give a general background of the objectives of monetary policy generally as applicable to the macro-economic management. This is intended to deal with four sets of the major economic objectives and the applicable tools or combination of tools that is appropriately used to achieve such objectives. The policy tools as used in various stages of our economic development, were analysed, the strength and weakness of each were compared. In the end I concentrated on usefulness or otherwise of indirect monetary policies since deregulation of the economy, when structural adjustment programme (SAP) was introduced in 1986.

The Project is divided into five chapters. Chapter one deals with general introduction of monetary policy in Nigeria. In away the scope of monetary policy was evaluated against the context of the structure and stages of development of Nigerian economy. I went on to define the general concept of the tools used in achieving the stated objectives. It also addressed the legal and regulatory environments. Above all the chapter highlighted the statement of the

problem, the objective of study, significance, scope and finally definition of terms.

Chapter two explains the general approach followed in this project identifying and analysing the monetary policy tools In the management of Nigeria economy. The chapter concentrated on the literature review in respect of the tools and how they have been used before and after the Structural Adjustment Programme of 1986. Each tools was discussed as to its usefulness, relevance and achievement in the attainment of monetary policy. Chapter three looked at the methodology of the study and reviewed the historical background of the Central Bank of Nigeria (CBN), the regulatory and supervisory authority of the Nigeria Financial System. This chapter also looked at the structure of Central Bank of Nigeria.

Chapter four is devoted to problems associated with each monetary policy technique. The Chapter also deals with the data presentation and analysis and the problems associated with the Management of liquidity of the economy. We then provide a rough, sketch of the technique required in achieving the control of inflation, induce economic growth and reduction of unemployment. A number of statistical tables the chief purpose of which is to illustrate the arguments advanced in the text and provide factual information are made available. These tables are compiled from the data published in reports of CBN and banks from which interested readers can in future obtain more up-to-date information.

Chapter five summarise the project. I have drawn heavily from CBN publications and paper presentations of financial experts and banks financial reports. I have by no means lacked the benefit of advice particularly from my supervisor Mr. Karwai who went through the project thoroughly and made necessary corrections. The acknowledgement to the project is left to the appropriate sections.

CHAPTER ONE

1.1 Background

In general, monetary policy refers to the combination of measures designed to regulate the value, supply and cost of money in an economy, in consonance with the expected level of economic activities. As excess supply of money would result in an excess demand for goods and services which would cause rising prices and or a deterioration of the balance of payment position. On the other hand, an inadequate supply of money could induce stagnation in the economy thereby retarding growth and development consequently the monetary authority must attempt to keep the money supply growing at an appropriate rate to ensure sustainable economic grow and maintain internal and external stability.

Monetary policy in any country must be evaluated against the structure and stage of development of economy. These factors together with the characteristics of general financial system within which monetary policy operates combine to determine the limitation and effectiveness of monetary policy actions in all open economy, monetary policy is pursued with the aim of ensuring optimum and balanced real growth of the economy as well as achieving a healthy balance of payment, position this objectives may differ slightly for a developing economy like Nigeria which will want to attain, sustain and maximise its economic welfare. In this regard, it becomes necessary to establish priorities and set forth plan of action consistent with the available

resources which will provide guidance to all the participants in the economy-the actors and executors.

The Nigerian government for example proposes two major plans, the long term (development) and the short term (budget) plans. The long term plan is usually cast in broad terms while the budget merely adds to focus on specific short term objectives which are essential for achieving the long term broad based objective of the nation's economic vision. This is not to say where the need arises, occasional official policy decisions outside the frame of the long and short term plans cannot be built into existing plans. It needs only to be ensured that such " in between" or medium term decisions falls in line with the broad objectives of the economy both in long and short term. A living example is the structural Adjustment programme (SAP) adopted in 1986 which is turned "a medium term economic recovery programme" FBN.

The budgetary process involves the translation of economic problems into policy objectives, for example the problem of inflation could be translated into policy goals of achieving price stability or reduction in or credit supply. However the mere translation of problems into goals does not automatically bring to function the very economic objectives, and thus the main relevance of policy instruments. In trying to achieve policy objectives, the authority could inject policy instrument which are in them at curbing inflation such as reduction in opposition of desire to reduce unemployment. A restrained credit system has no doubt, an effect of reducing credit-investment-production cycle and hence increasing unemployment. Another problem which appears most central is that

of identifying the appropriate policy option suitable for achieving a particular economic objectives.

In a given situation, should monetary or fiscal policy measure be more appropriate? faced with these conflicting objectives the authority have two options, in the first place, they may accept the existence of an irreconcilable conflict and trade-off the achievement of one policy objectives against the achievement of the other. Another option is to adopt one policy measure to the exclusion of others. A successful trade-off can produce a preferred combination of policy objectives even though no single objective is fully attained. The potency of both monetary and fiscal policies have been a subject of debate between the monetarist and neo-keynesian economists. It has however been suggested that the job of engineering economic recovery from a serious depression could be achieved by a simple mixture of the two policy measures Odizi.

In Nigeria, the Central Bank of Nigeria's monetary management strategies are effected through the use of monetary policy tools, the instruments available to the Nigerian monetary authorities include:-

i. Rediscount rate and interest rate structure.

ii. Moral suation

iii. Reserve requirements

iv. Direct credit controls

v. Open market operations

vi. Exchange rate measures.

Most of these policy instruments were non starters for the Nigerian economy with relatively undeveloped money and capital markets prior to introduction of SAP in 1986. However, because of the limited nature of the instruments and their limited application it has not been very possible to realise most of the budgetary policy objectives hence the problems continue to surface year after year.

Monetary policy since 1986 adopted SAP against the crash in the international oil market and the resultant deteriorating economic conditions in the Country. It was designated to achieve fiscal balance and balance of payment viability by altering and restructuring the production and consumption patterns of the economy, eliminating price situations, reducing the heavy dependence on crude oil exports and consumer goods imports, enhancing the non-oil exports base and achieving sustainable growth. The other aims were to rationalise the role of the public sector. The main strategies of the programme were the deregulation of external trade and payments arrangements, the adoption of a market determined exchange rate for the Naira, substantial reduction in complex price and administrative controls and reliance on market forces as a determinants of economic activity.

The main objectives of monetary policy since 1986 have remained as in the earlier periods in line with the general philosophy of economic management under SAP monetary was aimed at including the emergence of market oriented financial savings and efficient resources allocation.

The adoption of market based frame work such as open market operation in an economy that had been under direct control for long required sustained improvement. Such improvement on macro-economic stability involved the management of excess, liquidity which include the reduction in maximum ceiling on credit growth allowed for banks, the recall to CBN from banks of special deposit requirements against outstanding external payment arrears, abolition of the use of foreign guarantee/currency deposit as collateral for Naira loan and the withdrawal from banks to the CBN public sector deposits. Also effective August 1990, the use of stabilisation securities for the purchase of reducing the bulging size of excess liquidity in banks were reintroduced commercial banks cash reserve requirement were increased in 1989,1990 and 1992. The rising level of fiscal deficits was identified as a major source of macro-economic instability, consequently government agreed not only to reduce the size of its deficits but also synchronise fiscal and monetary policies.

In the legal aspect, the Federal Government promulgated the CBN Decree No. 24 of 1991 and banks and other financial institution Decree (BOFID) No. 25 of 1991, to replace CBN Decree enhanced the banks powers and discretion in the design and conduct of monetary management by bringing the non-bank financial intermediaries which hither to were entirely outside the control of CBN under supervisory control of CBN. The decree streamlined and simplified produce for licensing and controlling other financial institutions including discount houses and financial companies.

To induce efficiency and encourage a good measure of flexibility in the banks credit operations, the regulatory environment was also improved. Consequently the sector specific credit distribution targets were compressed into four sectors in 1986 and to only two in 1987. The commercial and merchant banks were subjected to equal treatment since their operations were found to have similar effect on the monetary process. Hence Merchant banks hitherto excluded from cash serve requirements, were subjected to same cash ratio with commercial banks, also the liquidity ratio of merchant banks was raised to the level applicable to commercial banks. In August, 1987, all controls on interest, rates were removed. However, in 1991 banks maximum lending rates were paged at 21% while minimum savings deposit was fixed at 13.5%. from 1992, the market was freed of interest rate controls. However, control measures were re-introduced and removed again in 1996.

In recognition of the fact that well capitalised banks would strengthen the banking system for effective monetary management, the monetary authority increased minimum paid-up share capital of commercial and merchant banks in February, 1990 to N50 million and N40 million from N20 million and 12 million respectively. In high of Naira depreciation, persistence of inflation any pressure evasion capital funds of banks by non-performing credits as well as need to ensure consistency with intonation standards, the minimum paid-up capital of commercial and merchant banks was raised to a uniform level of 500 million Naira in 1996 (FBN) effective January, 1999.

The abolition of mandatory credit allocation to preferred sectors by commercial and merchant banks took effect in 1996. Also in 1990 the CBN introduced a set of prudential guidelines for licensed banks which were complementary to statement of accounting standards. The guideline among others, spelt out the criteria to be employed by banks for the purpose of classifying non-performing loans.

In a related manner, the Nigerian Deposit Insurance Corporation (NDIC) came to being through the NDIC Decree No. 22 of 1988. The principal objective among others include: insurance deposit liabilities of banks, giving assistance in the interest of depositors where suspension of payment is threatened, guaranteeing payments and assisting the implementers authorities in formulating and implementing sound banking policy.

The fore going has been an attempt to examine the scope, objective, tools, economic and legal background to monetary policy management since, 1986. There is considerable evidence to establish that the authorities have demonstrated a fair, will with regard to policy formulation and implementation.

1.2 Statement of the problem

Monetary Policy was described as measures which deal with discretionary control of money supply by the monetary authorities with a view to achieving stated economic objective. It involves policy actions designed to influence the cost and availability of money and credit. In order to achieve monetary objectives the policy making may close any of the instruments which may have conflicting desire to achieve the stated objective. Of major concern

were rapid expansion in money supply overtime, which fuelled inflationary pressures, high interest rates structure and depreciated exchange rates of the Naira vis-à-vis other traded currencies. Among the underlying factors which undermined monetary policy pursuits were excessive growth in domestic credit especially to the government, lack of timely data which could guide timely response of monetary authorities to any development, inadequate monitoring of financial system, given rapid expansion in the number of intermediaries and the above all, the unpredictable conduct of fiscal policies, which tended to compromise most of the monetary policies initiatives. These problems may continue to pose challenges to future monetary and banking policies, in addition to the need to create macro-economic incentives of appropriate interest and exchange rates which are conductive to investment and growth.

One other important problem is the constant manipulation of monetary control tools by the government of the day. As a matter of fact prior to 1986 the monetary authorities adapted three conventional tools, for instance, these were those tools which operate primarily on quantity or availability, those that operate primarily on cost or price of money, and credit and those that operate primarily on the direction of credit. It is important to note that the CBN did acquire all the powers to exercise the use of all the tools from its inception in 1958. Only discount rate changes, Open Market Operations (OMO) Cash and liquidity ratio requirements and moral suation were acquired. The powers to exercise the other tools such as variable reserve liquidity ratios, relative credit control, stabilisation securities etc. were confirmed on the CBN by subsequent

legislation in the light of the observed operational defects and changing conditions. In the real sense CBN was not using Open Market Operations since its inception, because buying and selling securities are not OMO in the traditional and technical sense of the word, since the aim of these operations has been continued to be raise funds for the government and service government debt. OMO undertaken as a deliberate policy and at the initiative of the CBN with the primary objective of influencing the cash base and lending power of commercial banks and the rest of the financial system. The arguments is that monetary instrument will be inoperative in a developing economy without developed money and capital markets.

1.3 Objectives of the study

The purpose of the study of monetary policy and implementation in Nigeria are:-

(i) To appraise the effectiveness of monetary policy and its implementation.

(ii) To identify the problems associated with monetary policy tools and the optimum combination of the tools towards implementation of the monetary policy objectives.

(iii) Make necessary recommendations and suggestions as to which monetary tools should best be used based on the present economic objectives and problems.

This will be guided by the monetary policy guidelines after 1986, the impact of such changes in the macro-economic effect the country's economic and socio-political being, generally.

The purpose of this project is to articulate the current approach to monetary policy management and implementation in Nigeria and the future direction of policy; to examine the prospect for greater effectiveness of monetary policy. The thesis in four chapters, chapter one has already dealt with the general introduction of the subject, the definition, objective of the study, the outline of the study. The rest of this chapter will with the scope limitations, methodology of the study, significance and the definition of terms.

While chapter two examines the literature on monetary policy and implementation in Nigeria, in particular the major objectives and tools of monetary control in Nigeria both during and after SAP. Chapter three deals with the data presentation and analysis during the period under review. The implementation of monetary policy appraisal of the Nigerian experience between 1989 to 1998. Chapter four deals with summery , conclusion and recommendation of the study.

1.4 Significance of the study

this study is first and foremost intended for the partial fulfilment for the award of Masters in Business Administration (MBA). It is also intended to guide us understand the basic objectives of monetary policy, the tools applied towards the achievement of monetary policy, the effectiveness or otherwise of each tool set on the particular target, the problems of implementing the monetary policy objectives and proffer solutions to each of these problems. Such study is important to government functionaries, undergraduate and post graduate students of economics. It will also guide the general public in appreciating the

government policies and how they are implemented and possible effect on the general welfare of the public.

1.5 Scope and Limitation of the study

this study covers the monetary policy objectives, the tools, effectiveness and proffer the best combination of achieving monetary policy objectives. Here we would only limit ourselves to the monetary policy objectives under the following:-

(i) Reduction in the level of inflation.

(ii) Maintenance of healthy balance of payment.

(iii) Sustenance of growth in the economy.

(iv) Economic stability.

The above list constitutes the basic thrust of any country but the way in which they are stated may differ from country to country , in the same country differ overtime.

This study will also discuss the effect of direct and indirect monetary policies on economic targets. The tools available to monetary authorities are many and their transmission routes are different. OMO for example, will first effect reserves of the banking institution, through which it will affect the ability of the institutions to create credits affect money supply and therefore other economic variables. Interest rates manipulation on the other hand, will affect money supply and so on. The monetary authorities will therefore bear in mind the time lag, the side effects, the compatibility with other policies, the issue of

structural superiority etc. subject to the above limitations, however, the various tools available are discussed.

The study, given specification on the volume of the project, the time frame allowed, will review some related literature only on monetary policies, in Nigeria but not the general macr0-economic variables that affect monetary policy world wide.

1.6 Definition of terms

SAP (Structural Adjustment Programme)

This is essentially strategic management option adapted in the face of declining economic fortunes. It was a medium Term Adjustment Programme (July, 1986 - June, 1988). It sought to redness the distributions and in-balances inherent in the economy, by re-emphasising the country's unhealthy reliance on oil as its main source of finance.

Direct Monetary Control

The direct control instrument place restrictions on a particular group of institutions (especially deposit banks) by limiting their freedom to acquire assets and liabilities. This method is employed mainly in developing economies in which the financial infrastructure necessary for operating indirect monetary control is absent or under developed.

Indirect Monetary Control

The indirect method, used mainly in developed financial system, relies on the power of the monetary authority as a dealer in the financial markets to influence the availability and the rate of return on financial assets, thus affecting

both the desire of he public to hold money balances and the willingness of financial agent to accept deposit and lend them to users.

Monetary Authority

In formulating and executing monetary policy, the Federal government through a process outlined in the CBN Decree 24 1991 and the banks and other financial institutions Decree 25, 1991, the CBN formulate and execute monetary policy to promote monetary stability and sound financial system.

Capital Adequacy

The relations imposed on the banks both nationally and internationally that they should have sufficient capital to support the business and services that they offer in whatever currency such operations takes place.

Risk Asset Ratio.

The CBN's system for controlling the banks and financial institutions under its supervision has obliged it to make certain definitions, Risk Asset Ratio is defined as the free capital plus a figure for premises relative to all assets substantially the bank's loan port folio and its investment.

Control of Money Supply

A system of control that was put in places by CBN. CBN controls the level of liquidity in the banking system and influences the interest rates. This it does by buying and selling eligible bills.

Macro-Economic

The branch of economics that considers the relationships between the large scale movements of unemployment, gross national products, saving and investment etc.

Quantitative Directives

Directives from the CBN to the banks and other financial institutions under its control as to the total amount of money which they may lend.

Banks Liquidity

A banks ability to meet deposit withdrawals, maturing liabilities, and legitimate loan requests without delay.

Gross National Products (GNP)

The money value of goods and services produce in a year.

Inflation

A rise in the general level of prices.

Moral Suassion

The use of speeches, press releases, and directive by the Central Bank to influence banks borrowing, bankers willingness to lend, and the demand for credit.

Open Market Operation

The buying and selling of Treasury securities, agency obligations and bankers acceptances by the Central Bank in the financial market in order to

influence the volume of liquidity and level of interest rates which ultimately will affect money supply in an economy.

CHAPTER TWO

LITERATURE REVIEW:

2.1 INTRODUCTION:

This chapter will discuss among other things, the definition, the objectives and policy tools used in implementing monetary policy in Nigeria.

2.2 MONETARY POLICY:

Monetary policy may simply be described as measures which deal with discretionary control of money supply by the monetary authority with a view to achieve specific economic objectives such as full emolument. It involves policy actions designed to influence the cost and availability of money and credit.

2.3 OBJECTIVES OF MONETARY POLICY IN NIGERIA:

Monetary policy as adopted in Nigeria has four broad objectives depending upon the given situation named the following:

(I) Full employment

(ii) The promotion of an accelerated rate of economic development growth.

(Iii) Maintenance of relative stability in domestic prices.

(Iv) Maintenance of a balance of payments equilibrium.

2.4 THE TECHNIQUES OF MONETARY TOOLS

Like all other central banks in the world, the central banks of Nigeria posses an among of tools or techniques to control or regulate money and credit. Indeed (unlike most central bank), The UBN can be regarded as one of the most powerfully equipped.

It is the task of this chapter to examine the one made of there tools by the

UBN. It is conventional to classify tools of control into two main categories, quantitative and selector. However, since monetary policy is concerned with the availability, cost and direction of credit. It is more appropriate to classify and discuss the tools under. Three main needing according to their or concentration. For instance there are those tools which operate primarily on quantity or availability those that operate primarily on quantity availability those that operate primarily on cost or prices of money and credit and those that operate primarily on the direction of credit. These can be called quantitative tools, cost tools and directional tools, it is essential to emphasize the word primarily, while the classification is necessary for analytical purpose the impression should not be created that their effect or operation are limited or confound to their area of primary impacts on the availability cost and direction of credit. With this caveat given, let us now proceed to classify and analyze the instrument of monetary control available UBN.

The quantitative tools are open market operation (OMO), special deposits, stabilization securities, cash reserve requirements, variable liquid asset and liquidity ratios. The cost tools are discount rate and other interest rate changes, while the directional tools are the guidelines, moral suasion, which is another control instrument available to the bank, as well as to all central banks, partakers of the characteristics of the three classes because it can be applied quantitatively, directionally or on the cost of money and credit.

Most of these policy instrument are non-starters for the Nigerian economy with relatively underdeveloped money and capital markets. Some of

them are simply blunt and unresponsive and do not therefore make any meaningful economic-social impact. Because the set of monetary instruments have been limited in both scope and choice, the attempt has been for the Nigerian authorities to engage some of them in their classified forms and some in re-designed form a good example guideline regarded so far as the most effective instrument in Nigeria domestic monetary policies arsenal. It is important to note that CBN did not acquire all the above tools immediately from its inception in 1958' Only discount rate changes OMO, cash and inginidity ratio requirement and moral season acquired. The power to exercise the other tools, such as variable reserve and liquidity ratios, selective credit controls, stabilization securities e.t.a. Was conferred on the bank by subsequent legislation in light of observed operational defect or loopholes in existing power and in light of changing conditions.

In a predominantly market based economy, there is heavy reliance or indirect instruments of monetary control which are applied to take advantage of the relationship between the money supply and monetary base and the ability of the monetary authority to induce appropriate changes in the monetary base. Banks reserves constitute an important component of the monetary, base usually targeted by the monetary authorities to manipulate of the discount rate and the reserve ratio in support of open market operation (OMO) as well as the ratio in support of the open market operation. On the other hand, in un-development financial markets, the most common monetary tools are the direct instrument or quantitative, controls which set the monetary target at desired level. The

common example are interest rate regulations, credit ceiling and sectional allocation of credit.

In the Nigerian context, the application of credit ceiling was designed to ensure that domestic expansion and the monetary implication of the increase in total demand for liquidity in the (direct and indirect), a monetary control frame work begins by establishing a link between them and the ultimate target for output growth, inflation and the balance of payment, however, since direct relationship is not strictly possible, an immediate target such as growth in money supply to bank credit is set. In this setting, the appropriate level of money supply is determined by the public demand for money. In direct monetary control, the intermediate targe5t are fixed after the money demand function has been estimated and the monetary survey undertaken. In a regime of indirect monetary control, the operating variables which influences the intermediate variable in a predictable way, are controlled. The monetary statuary tools available to CBN will now be discussed in details.

1. QUANTITATIVE TECHNIQUES;

As we indicate above, the quantitative tools available to the CBN are:

(I) Open market Operations (OMO)

(ii) Variable reserve and liquidity ratio

(iii) Special Deposit.

(iv) Stabilization Securities.

From what we said above, the instrument of OMO is part and core of system of monetary management,

a. **The concept of (OMO)**

OMO in its classical form, is conducted mainly in the secondary market for government securities. Through the buying and selling of government securities, the central bank changes the level of bank reserves and indirectly reduces the level of interest rates, the terms of and availability of credit and ultimately, The money supply. When the CBN sells security in the market, the transaction leads initially to contraction in the reserve that banks have available to meet their cash reserve requirement . The contraction in reserve leads in turn to higher interest rates and a contraction in bank credit and money supply

Conversely when the CBN buys securities in the open market,. Banks reserves increase and their ability to extend credit and money supply to enhanced reserve is made clear by the accounting transaction that occurs when the pays for the securities is buyed or is paid for the security sales. When the CBN buys securities, it pays for them by their crediting the reserve accounts held at the bank, in turn, are credited. Conversely,. sales of security by the CBN involved debit to banks reserve account at the CBN and debit to the buyers account in their banks.

Thus when the CBN purchase security reserve decline. Within the frame work of factor affecting reserve the CBN follows a three-step procedure in conducting (OMO) as follows:

(I) Determination of the target level of reserves. Consistent with the

objectives of monetary policy

(ii) Estimation of net changes in the reserve that will occur due to movement in controllable factor (Portfolio of Securities)

(iii) Conduct of OMO that increase or decrease security holding enough, to bring about the target of reserve.

Owing to its character as a market based intervention mechanism, as well as the large scope that it offers piece meal and gradual adjustment of liquidity on daily or weekly bases, (OMO) is a dorminatant instrument of monetary policy in The regime of indirect controls in Nigeria. The flexibility that it provide permits it use in such a way as to avoid undue disruption and velocity in the financial market.

b. Instrument of Omo

The CBN conduct OMO in the federal government security, Treasury Bill (TB), Treasury Certificate (TC) and federal government development stocks (FGDS). However, the existence of an active secondary market security is necessary for its use in Omo. For this reason, (TB_s & TC_s Close to maturity appear to hold the best prospect for OMO. It should be noted that the security traded are neither limited to Government securities nor their maturates and actual practice varies from country to country and overtime. Three types of transaction in securities are possible in OMO. These are:

a) Out right sales and purchases of securities in the market.

b) Repurchase transaction involving purchase or sales of securities with obligation to reserve the transaction on an agreed date, and.

c) Matched sale purchased transaction which as the name implies, is a simultaneous sale and purchase of securities for delivery at a future date (Securities Option).

Instrument of OMO and transaction described above are employed to attain the desired objectives with term interest rate, money supply and exchange rate. The relevant interest rate in this regards in the inter-banks rate on overnight fund since this rate, in effect balance. The focus on this key interest rate would be appropriate if others rate in the system move in close sympathy with it and if the demand for credit is responsive to the movement in the interest rates.

If the interest channel for the monetary policy is not a powerful one, perhaps, interest rate elastituties of the demand for credit are small, the growth of money supply assumes greater significance on an intermediate target variable. In this case, while the management is short term interest rate will not be ignored, OMO will aim at influencing reserves in such money supply . In other words, there could be need to accommodate greater variation in short term interest rate. If the empirical situation suggest an emphasis on monetary growth target, a choice would have to be made between the narrow and broad measures of money supply at the primary target. Again this will depend on which of the two has the more reliable impact on the ultimate goals of policy such as output growth and inflation.

Similarly in the Nigerian setting where foreign exchange is a binding constraint on stable growth, the exchange, rate will be an appropriate target

variable for ensuring domestic and external sector stability. OMO could focus on keeping the exchange rate within a specific target range. All of these options could be explored to determine the most effective approach to monetary management and implementation (Ojo).[4]

ii. Variable reserve and liquidity ratios

The second traditional quantitative technique of monetary policy is the legal reserve ratio through which the CBN exercise considerable control over the cash or other reserves of banking institutions. Traditionally the aim of this instrument was to ensure that banks have sufficient cash or suitable liquid assets to meet daily demand for currency and reduce dependencies on the services of the CBN as a lender of last resort. It is known that all customer can not demand their deposit at the same time and even if some do, others are paying unjust as some and withdrawing, to earn income. The proportion retained is known as cash reserves as the case may be.

The CBN as the controller of the monetary sector is given the statutory power to regulate the reserve ratio in line with the state of the economy and this is why the ratio is often called the Alegal reserve ratio @ instead of using only cash as reserve. It is found that other assets are capable of being converted into cash at short call this will minimize the loss sustained by banks if all reserves will have to be held in non-interest bearing cash. The legal reserve shows the proportion liquid assets to deposit liabilities as must be maintained by the banks. Assets and liabilities are legible for inclusion in the computation of the ratio are clearly defined by the central bank and usually vary from country to

country. In the same country it may also vary from time to time and different types of bank or financial prescribed based on the type of bank or financial institution (Afolabi) [5]

However the list of assets acceptable in Nigeria as of now and the composition of liquidity reserve as defined by section 12 [5] of the 1969 Banking Act and as amended by banks and other financial Institutions Decree 25 and CBN Decree 24 all of 1991, include the following:

a. Notes and coins which are legal tender in Nigeria

b. Balance with the central Bank central Bank.

c. Net balance at any licensed bank excluding un-cleared effect and money at any

d. Treasury bills and treasury certificates issued by the federal Government.

e. Inland bills of exchange and promissory notes re-discometable at the central bank

f. Stocks issued by the federal government.

g. Negotiable instrument which may from time to time be prescribed by the central bank.

When the central bank wants to reduce the money supply using the reserve ratio it will only need to adjust the ratio, upward. The increase in reserve ratio will curtain lending activities. The reserve will be the case if the central bank wants to expand money supply.

The CBN discount window operations essentially fulfills the CBN=s function of lender of last resort to meet individual institutions unforeseen or unexpected funding needs in order to adjust their positions. The main goals of discount window operations would be to provide collateralised overnight accommodation that could not obtained on reasonable terms at Discount House (s) and or in the inter-bank market. The control Bank can also monitor the economy by giving directives to banks priorities to be observed in virtually al areas of their operations. These are called selective credit controls. They are many, diverse and can take any form as each country=s control Bank may selec (Ojo)[9]

One primary function of the central bank is to provide efficient mechanism for savings mobilization. However, the efforts will be fruitless if the hard-earned savings are directed to those sectors of the economy whose overall impacts are minimal. Some activities like importing, can actually be against the spirit of self reliance, economic development abed balance of payment viability which are duly acknowledged goals of any government. It is therefore important for the central bank to direct funds to those sectors of the economy that are in high priority and which have the greatest linkage with the overall development strategy of the country.

In many occasions, it has been found that banks are more favorably disposed towards lending to traditional sectors like trading. It has been noticed that banks prefer short-term self liquidating loans of medium and not long term loans that are curtail for economic development.

Moreover, lending especially by the new generation banks and those old non-indigenous banks are often in favour of well established foreign enterprises in urban areas while small scale indigenous enterprises and rural areas are totally neglected and almost inter-patted for lack of attention, credit-wise . There is therefore the need to direct funds from the propriety sectors to the high priority sectors. This is done through selective credit control.

2. **Selective controls could be grouped into three:**

a. The first includes credit ceiling and measures aimed at influencing sectarian allocation of credit to specific sectors. The allocation may be on percentage or maximum amount of loans to be approved for a particular sector. The credit ceiling and rationing may be made to be flexible by making it incremental, that is, after obtaining statistics on the existing patterns of lending, the central bank would impose ceiling on additional lending or distribute such additional lending to the different factors.

b. There is also the cost approach to selective control. This seeks to vary the re-discount rate of instruments coming from certain sectors or to specify some concessionaire interest rate on lending to favored sectors this making borrowing attractive in those and coupled with 1 (Omo) above stimulate investment in such sectors.

c. The third system of selective control is that which has to do with reserve requirement. Lending to high priority sector may be accepted as part of liquid asset for the purpose of computing liquidity reserves or some lending may be disregarded in computing sectional ceiling. During indigenisation exercise in

Nigeria in the 1970s for example, loans for purchase of shares were disregarded for purpose of computing sectional allocation of reserve requirement and in 1986/87, lending in excess of credit ceiling was approved for three favored sectors like, agricultural production, manufacturing and export. Also liquidity ratio lower than normal may be specified for high priority sectors.

Examples of selective credit controls in Nigeria are as follows:-

- Credit ceiling
- Sectoral allocation of credit
- Interest rate ceiling
- Indigenisation of credit
- Loans to rural borrowers
- Refinancing facilities
- Grace period on loans
- Small scale industrial loans

The main benefits of selective credit control is the intervention in the market system to alter the allocation pattern in favour of the sectors which are of high priority in the economy. This will ensure a planned used of the fruits of savings as the selective credit control are directives and because of the penalties attached to them and the monitoring process of the central bank, it is easier to enforce compliance.

We thus see that the Central Bank of Nigeria operated the selective credit control techniques which is used primarily in directing the allocation of credit. In the Nigerian context, this has been effected through the guidelines which

were first used in 1964.

3. **Moral Suasion**

This is the most passive of all the monetary tools and is for this reason that people sometimes ignore it as it is not a regulatory instrument. Moral usuasion is simply exhortation or an expectation by the central bank that other banks would reason along with it, appreciate the need of the economy and regulate their activities accordingly. In other words, it is based on the belief that banks would on their own initiatives and moral consciousness and without any guide or compulsion, act according to the dictates of the economy.

However commercial and merchant banks have three major corporate objectives-liquidity-solvency and profitability and would not be quite willing to pursue and action that will be inimical the fulfillment of these objectives; especially if such action is not compulsory. The Nigerian financial system depicts a good example of this situation. The earlier banks were foreign owned and their major motive was the profit element which they were prepared to fulfill under any circumstance. They therefore hardly considered the dictates of the economies in which they operate, the and were prepared to do anything to earn sufficient profits to repatriate to their home countries.

The use of moral suation has not of course, been left to CBN alone, nearly all government functionaries, from the president to military Administrators, federal and state ministers and commissioners particularly of finance, industry and economic development as well as Agriculture, have used the opportunities of their public addressees to urge he to pursue one type of policy or another

such as giving more loans to Nigerians, establishing branches in rural areas, embarking on medium and long term lending, supporting agriculture etc.

4. Interest Rate Structure and Monetary Policy

A good barometer to gauge the financial health of any economic system is the interest rate structure. Such rate is thus a cardinal reference point in the consideration of micro-economic policies as regards to intended level of investment and savings, while at the macro-economic level, it is the first detonator of action and the last line of defense for moderating inflation and engendering stability in the general price level.

However, interest rates as an instrument of monetary and financial policies must balance the interest of both investors and savers. Traditionally, there are three functions of interest rates in an economy in which individual economic agents take decisions on whether they borrow, invest, save and or consume. That is, interest dates as a return an financial assets, serve as incentive to savers, making them defer present consumption to the future. The relevant interest rates in this case is savings rate whites used as a hedged against inflation

Secondly interest rates having a component of cost of capital, affect the demand for and allocation of lovable funds. The applicable rate in this case is the lending rate which influences real investment. In this way the level of interest (lending) rate could influence growth in financial instruments, output and employment.

Thirdly, the domestic interest rate in conjunction with the rate or return

on foreign assets, expected change in exchange rate and expected inflation rate; determine the allocation of accumulated savings among domestic financial assets. Whatever interest rate structure that is adopted by a country, the expectations in the opinion of policy makers is that it will significantly assist in inducing savings, stimulate investment, create employment, raise output level and altain efficient resource utilization among other macro-economic variables UBA (8).

Up to 1987, interest rates structure in Nigeria has been managed by the CBN, making it possible to provide the much needed force associated with rate movements in money management. However, beginning from July 1987, as contained in the CBN monetary circular No. 21, inte4rest rates have been deregulated. Consequently, interest rates were freely determined by banks on their deposit and lending rates according to market forces. However a wider differential between savings and lending rates became a matter of great concern to monetary authorities (16.4% and 26.80%) led the accord reached with banks in November 1989, for fixed spreads between savings deposits and prime rate between prime and maximum lending rates and between inter-bank rates and prime lending rates Appendix >6'.

5. <u>Money Supply and Monetary Policy:</u>

To analyze the impact of a change in the supply of money as a result of change interest rate and prices, we will first consider the government monetary policy tool of open market operations, in which monetary authority buy from or well to the public government boards, provide a good starting point for such an

analysis on the money stock in the economy, since in the first place their influence is confined to the supply of money and the rates of interest, with no associated changes in income or in prices of goods and services. In a case of a developing economy such as Nigeria, which may lack market in government debt, one could equally start from a position in which the commercial banks are operating at minimum legal reserve requirements and the authorities by raising the level of such reserve requirements, can force the banks to reduce the volume of their credits.

In most other cases, however, changes in the supply of money are not only accompanied by, but actually caused by movements in other economic variables. This is true, for example, changes in the supply of money which resulted from the budgetary and the balance of payable position. It is also true of those changes in the volume of bank deposits which are made in response to changes in the demand by borrowers for credit. In such cases variations in the supply of money must be considered as passives and it would be wholly illegitimate to regard them as the cause of any movements in income and prices which may accompany them.

A simply analyses of open market operation will illustrate how a change in money supply is affected, that is to increase the supply of money by the authorities by buying securities from the public. The purchase of securities will tend to lower interest rates by bidding up the price of bonds, and at the same time there will be an increase in bank deposits and in the cash reserves of commercial banks and other financial institutions. Other things being equal, this

will increase the willingness of both things and investors. They will tend to raise the cashing of credit made available to borrowers and to cover the rate of interest changed on loans. There will also be an increase in the general liquidity of the money market which will made it easier for corporations to raise capital through the issue or shares and bonds (exchange) 9

In giving out credits among individuals and firms, banks are guided by their cost of funds and the prevailing condition in the market such as the demand situation and returns on other activities competing for funds. In modern day sense, M1 and M2 money supply and monetary policy commences with the simply assumption that there is a connection between the rate of growth in the money supply and the rate at which prices rise - inflation.

In United Kingdom, the government in its 1981 Green paper stated that while the money supply and prices may diverge in the short run, they do not in the long run. It therefore set itself the responsibilities of controlling inflation by controlling the money supply. The relationship between money supply and inflation has never been straight forward and various monetary targets and measurements of money supply have from time to time been called into question. Klem[10]

The monetary aggregate in the measurement of money supply in Nigeria are M1 and M2. M1 is termed a narrow measure of money, which consist of notes and coins in circulation with the public plus private sector bank deposit (including current accounts, call money and overnight deposits held in the banking system).

M2 is the broader measure of money which is the non-interest bearing components, plus private sector holding of retail building society shares and deposits. That is narrow money (M1), money for immediate spending and broad money (M2) money for transaction purposes and as a store of value. In Nigeria the main underlying sources of raise or expansion in M1 was the rise in CBN credit to the government reinforced by increased banking system credit to the private sector. This can be moderated by sharp fall in foreign assets (net) and the rise in guise-money. CBN Annual Report 1992[11]

CHAPTER THREE

RESEARCH METHODOLOGY AND THE HISTORICAL BACKGROUND OF THE CENTRAL BANK OF NIGERIA (CBN)

3.1 Research Methodology

As the research is of macro-economic perspective, the research will use the various macro data published in the country. Moreover most of the information and statistics required can be obtained in published government documents, journals, periodicals and publications of organizations and corporate entities. The study therefore intends to make maximum use of these materials.

However, as some information needs to be adequately and explicitly stated and verified, contact with the various agencies and organizations concerned will be made for such verifications when necessary. Personal contacts will thus be made in the course of the study. This will be done in form of face to face personal interview, letter where it is difficult to get to the appropriate officer(s) and the use of telephone calls will be implored where the need arises.

The bulk of the data used were obtained from books, articles written in journals and magazines and published empirical and statistical data from both government and the organized private sector, thus from secondary sources. The use of questionnaires proved difficult as the persons and organization contacted refused outrightly, arguing that information required could be conveniently sourced from publications which they readily provided. The study used simple

statistical techniques in the form of simple average, weighted average and percentages to analyse available data.

3.2 Historical Background of the Central Bank of Nigeria (CBN)

Nigeria was one of the newly independent countries in Africa where the wave of central bank formation following prospects of independent political status occurred in 1950s. Before the establishment of the central Bank of Nigeria in 1958, the country had banked for sixty six years without a central bank. The Bank of British West Africa, now first Bank of Nigeria Plc, as has been indicated performed some central Banking functions such as importation of British silver coins and their distribution in the British Colonial territories.

Nigerian Nationalist never lost sight of the deficiencies of a currency board as compared to the currency Board. This is why even when the currency Board was established and assumed the responsibility of issuing and redeeming the currency and maintaining adequate external reserves behind the currency, the Nigerian nationalists still intensified their demand for the establishment of a central Bank. A central Bank unlike a currency board is a banking concern if only an exclusive one. In its banking operations a Central Bank can grant loans to the government or to other banks or purchase securities. It can expand the currency without a corresponding increase in the external reserves conversely a central bank can demand repayment of loans already granted, or sell securities and thus reduce the currency in circulation without loss of external reserves.

A central bank unlike a currency board also constantly concerned with the size of the money supply and its components to ensure that excessive

demand for goods or services is not stimulated. Since a Central Bank can issue currency without external reserves it would not like the currency board, regard the money as purely a function of the balance of payment. It was due to these observed deficiencies of the currency board, that Nigerians pressed for the establishment of the Central Bank of Nigeria.

In November 1952, the colonial Administration invited J.L. Fisher, Adviser to the Bank of England, to report on the desirability and practicability of establishing a Central Bank in Nigeria as an instrument for promoting the economic development of the country. His report and recommendations were published in October 1953. In his report Fisher discussed the principles of Central Banking as developed in England and reviewed the Nigerian monetary system. He concluded that it would be inadvisable to contemplate the establishment of a Central Bank at that moment.

Fisher therefore recommended against the establishment of a central bank at that time because he believed that it would be difficult to establish a Central Bank Which could operate satisfactorily in such a narrow field @ and furthermore because he could not See how a Central Bank could function as an instrument to promote the economic development of the country. Alternatively he recommended a three-tier system of development that involve:

(I) The transfer of the West African currency Board from London to West Africa.

(ii) The establishment of a Nigerian currency Board.

(ii) The establishment of a Bank of issue which would gradually develop

into a full-fledged central bank.

The Report of Fisher also neglected any mention of the rapid changes in the political environment towards Independence of the country and assumed that absolute dependence on London money and capital markets would continue.

Two years after the publication of Fisher's Report the International Bank for reconstruction and Development recognized the increasingly rapid strides toward self-government in Nigeria and argued against the unduly cautions timing suggested by Fisher. The Bank's mission therefore proposed the establishment of a state Bank of Nigeria. The mission unlike the Fisher appreciated the important role which a Central Bank could play in the organization of a developing economy in channeling available resources and in assisting to ensure economic utilization of the country=s financial resources. The mission also recommended that before the establishment of the Bank, the Nigerian authorities should seek the expert assistance of the United Kingdom monetary fund. Following the missions Report, Sir James Robertson, the Governor General of the Federation of Nigeria invited Sir J.B. Loynes in 1957 to advise on among others, the establishment of a federal institution to perform appropriate central banking functions.

In his Reports, Loynes advised federal Government on various aspects of the powers of the Central Bank with special emphasis on its powers over the issue of National currency, its role as the banker to government and other banks and its responsibility to promote monetary stability. He also recommended that

the Central Bank must have appropriate capital structure and sound financial position. Its assets must be first class and liquid and must include ample starting resources. It most be wholly owned by the federal Government but it must be allowed to operate independently and above party policies. Its management must be entrusted to men of experience and the other directors should be appointed in the national rather than sectional interest.

On the basis of Loynes= Report the Central Bank of Nigeria was established after the enactment of the Central Bank of Nigeria Act 1958. The main objectives of the Bank is to issue legal tender currency in Nigeria, to maintain external reserves, safe guard the international value of the currency, to promote monetary stability and sound financial structure in Nigeria, to act as banker and financial adviser to the Federal Government. The CBN has a monopoly of issues of notes and coins throughout Nigeria. The CBN act of 1958 was amended in 1962 and further more in 1967 to adequately take care of the changing economic environment. The initial authorized share capital of the CBN is ₦3.0 million. It commences business on 1st of July 1959. Uzoaga[12]

3.3 The Structure of Central Bank of Nigeria (CBN)

At its inception the organizational structure of the Central Bank of Nigeria was understandably simple, consisting of two departments, namely, the General Manager=s and the Secretary's Departments with appropriate division of labour as then perceived. As the functions and activities of the Bank have increased. Its organizational structure has grown tremendously from the two departments to twenty three and one autonomous unit as at the end of 1994.

A Board of Directors whose chairman is the Governor is responsible for the policy and general administration of the affairs and business of the Bank. The Board formulate monetary, exchange rate and other economic policy proposals for approval by the presidency. The top management of the bank consists of the committee of Governors (the Governor and five Deputy Governors), which undertakes the day-to-day management of the Bank. Given the extensiveness of the functions and activities of the CBN, the committee of Governors is assisted by Heads (Directors) of Departments. These Departmental Directors, their deputies and assistants and other officers advise top management on various aspects of central banking as well as administrative matters.

The head office of the Bank formerly in Lagos is now in Abuja the Federal Capital. However, the bank continues to maintain significant presence in Lagos, the centre of the nation=s economic and commercial activities. To facilitate efficient execution of the bank=s function over Nigeria=s vast territory, some central banking activities are decentralized and operated through four Zones- Bauchi, Enugu, Kano, and Ibadan. In addition to the Zonal offices, there is a branch network whereby each state capital in the federation has a CBN branch. However, newly created states are expected to have currency centres, pending the establishment of full-fledged branches.

The respective head of each Zone, branch and currency centre is the Zonal Controller, Branch Controller and currency officer. The CBN Amendment Decree No. 3 of 1997 was repealed and replaced with CBN Amendment Decree

No. 37 of 1998. Decree No. 37 of 1998 provided the following composition for the CBN Board:

- The Governor as chairman
- The permanent Secretary, federal ministry of finance
- 4 Deputy Governors and
- 5 part-time Directors

The repealed Decree No. 3 of 1997 provided for a part-time chairman, 3 instead of 4 Deputy Governors and 4 part-time Directors. Under Decree 37, CBN no longer report to or through federal ministry of finance. However, CBN was till answerable to the President or the head of State. Section 8(2) of Decree 37 provides that "The president may in writing, direct the CBN as to the monetary and banking policy pursued or intended to be pursued and the directive shall be binding on the Board which shall forth with take all steps necessary or expedient to give effect thereto".

CHAPTER FOUR

DATA PRESENTATION AND ANALYSIS OF MONETARY POLICY TOOLS

INTRODUCTION:

In the preceding chapters, we discussed the general background of the objectives of monetary policy and the instruments used in achieving such objectives. In this chapter, we will attempt to identify which policy tools were adopted during the time of direct control and during the period of indirect control, using available date and analyze the effectiveness each tool as applicable in the period under review.

Monetary policy framework is usually formulated on the basis of the priority of government the existing problems in the economy and the direction that might be considered desirable for the economy, although the CBN is the Sole agent of monetary policy, the main operators remain the, commercial and merchant banks, Insurance companies and other financial institutions. With CBN, being responsible for implementation and supervision of the day to day is also directly responsible for money supply and administration of stipulated interest rate (prior to de-regulation in August 1987).

4.1 CBN=S PRE-SAP POLICY MEASURES:

As indicated in the previous chapter in line with the stand of the overall economic policy prior to the SAP, the CBN relied on direct controls to carry out its statutory and non-statutory responsibilities of contributing to the economic growth and development of the financial sector. The policy measures adopted by the CBN prior to the inception of SAP to tackle these responsibilities could be

grouped according to the major aims of monetary and banking policies under periods of which they were tried.

4.2 MONETARY AND BANKING POLICIES BETWEEN 1958 - 1985:

Monetary and Banking policies have been designed to foster macro-economic stability and a sound financial structure. In the pre-SAP period, there was a vast arsenal of instruments for the execution of monetary and banking policies which included the following:- cash reserver equipment liquidity ratio, special deposit, stabilization securities, Direct regulation of interest rate, Direct credit controls moral suasion and general directives. Furthermore, the CBN adopted a policy of influencing the development process by promoting money and capital markets, development banks and related institutions and schemes between 1959 - 1962. It is important and perhaps necessary to emphasis that CBN has had to rely mainly on non-price credit rationing and direct control measures instead of traditional market-related control devices such as OMO, reserve requirements and discounting. Within this limitation, the bank was further constrained to using selective control measures largely because of the problem of restraining private spending without discouraging capital formulation, and partly because of the deficit financing required by the government.

Let us illustrate with the example of credit ceilings and sectional credit dragooning. Under the credit ceiling the CBN found it increasingly difficult to achieve the stated monetary variable, the narrow money supply (M1).

The credit ceilings were initially effective but as the banking sector and

the economy expanded, some problems set in. For instance, in order to satisfy certain needs many items of credit were excluded from the credit ceilings. These only served to erode the implementation and effectiveness of the ceilings as some operators used such avenues to high credit transactions. Enforcement was made difficult by the lags in obtaining and processing monetary data. This has been a potential problem of the Nigerian economy. Above all, the credit ceilings encouraged inefficiency in the banking system, permitting banks, irrespective of their efficiency, to grow by the same ratio as stated in the guideline, thereby restricting competition in the system. It protected the weak banks, while limiting the growth of the efficient ones. The practice also favored the large banks with large turn-over which permitted them to accommodate new borrowers. Under the circumstances, dynamic banks that aggressively mobilized savings were penalized. Credit ceiling also encouraged financial disinter-mediation. There used to be incessant allegations of banks trying to circumvent the ceiling by acting as brokers between owners and borrowers of funds.

Sectorial credit controls have been an important direct control monetary tool in Nigeria. This control aim, at giving easier credit access to the productive sectors. The most popular of this type of control in Nigeria is the sectorial allocation of banks loans and advances within the overall credit limit and specified ratios of loans to production, general commerce, services and others (appendix 4). Between the period 1959-1962,many people held the view that, the conscious monetary measures were taken in Nigeria until 1964, this view was not correct because for effective prosecution of monetary policy between July, 1959 when it was brought into the fore front of developmental financing, following the launching of the country's second National

Development plan (1962-1968) the Monty issues that needed attention were the need to have a Nigerian currency (since the country had hitherto Board), the need for a strong local credit base and to establish the domestic financial infrastructures, (e.g money and capital market institutions and instruments).

The most active policy instrument during the period was interest rate. The rediscount rate and the treasury bill rate were revised ten and thirteen times respectively between April, 1960 and December, 1961. This was after the first Nigerian treasury bill was issued in April, 1960. The use of this instrument was aimed at encouraging the commercial banks to repatriate short-term founds from London held in Nigeria in the context of the policy objectives of "Nigerianizing the credit base. In order to do this effectively, the two rates (rediscount and treasury bill) were revised periodically as interest rates varied in the London money market, in such a way as to make it more favorable for the banks to invest their short-term funds in Nigeria. Apart from the variable rediscount rate and moral suasion, no other instrument monetary policy was available to the CBN at that stage. Hence the CBN ACT 1958 was amended in 1962, giving the bank the power to use, the rest of the money market instruments deliberated upon earlier.

During the period 1962-1964, Developmental Plan and the expectation that the bank would assume a positive and dynamic role the objectives of monetary policy become that of providing adequate development finance since a substantial part of the domestic financing was expected to be generated within the banking system. Ojo(9).

The monetary policy instruments which were used to influence the financing of the development plan from internal resources were the variable rate and variable liquid assets. The variable liquid assets instruments was applied through fixing the share of commercial banks external assets in their liquidity ratio.

PERIOD OF CREDIT RESTRAINST POLICY OCTOBER, 1964 - OCTOBER, 1966

It may be said that 1964 marks a new stage in monetary management in Nigeria, a year when passive monetary policy in vogue since the days of the West African currency Broad, was replaced by a conscious effort on the part of CBN and the government to influence the rate of credit creation and pattern of expenditure.

Development of monetary policy was conceived mainly in terms of aiding the growth of the productive sectors of the economy, including export, at the expense of the less productive sectors. While balance of payments equilibrium was to be restored through minimization of internal demand pressures and its curtailment from the external sector. Since rapid expansion was known to be the cause of the rain on foreign reserves, following incessant demand for imports, a policy of credit restraints was adopted. Therefore the instruments used were direct control, interest rate, moral suasion and variable liquid assets. A ceiling of 15% annual rate of growth was imposed on commercial banks credit.

MONETARY EASE POLICY 1966 - 1969

The year 1968 was particularly a difficult one for monetary policy decision. The civil war which broke out in mid-1967 and the measures adopted to deal with its affair math, produced a major impact on the financial policy during 1968. The Civil War aggravated the problems posed by rising expenditures and falling revenue. The balance of payments position deteriorated owing to capital out flows, a steep rise in external spending for the armed forces and a reduction in the trade surplus called for monetary policy which relied on moral suasion and interest rate. The credit ceilings in force before then were lifted in November, 1966. The discount rate was lowered from 5 to $4^1/_2$ %, in

order to facilitate anticipated government borrowing and other rate on treasury bills and certificates.

MONETARY EASE POLICY 1970 - 1975

By the beginning of 1972 the economy had made substantial recovery from the dislocations caused by the civil war. Monetary conditions started returning to normal. The major objectives of monetary and fiscal political policies during this period were therefore to continue to conserve the country's scarce foreign exchange resources and to reduce unemployment and rate of inflation. Other objectives also aimed at ensuring that the bulk of bank funds went to the productive sectors of the economy. In pursuit of the above objectives, sectoral credit allocation was relied upon. At first the interest rate structure has left as it had been in the earlier period until 1975 when some revisions was effected.

From April, 1993, it was directed by the CBN that the analysis offered sectors be allocated 56% of aggregate banks loans and Advances while 44% would go to the less productive or less preferred sectors. Interest rate and exchange rate measure were also introduced in 1993 and 1974.

MODERATE MONETARY RESTRAINT POLICY 1976 -1985

Monetary policy during this period (1976-1985) was geared do towards attaining three major objectives:

I. A further moderation of inflation

ii. Greater mobilization of domestic savings restraining the overall level of credit expansion and expansion of credit to the more productive sector of the economy

iii. To correct the country's adverse balance of payment position.

To attain these objectives, the existing measurer of restricting banks credit and squeezing their liquidity were not only retained, but in some cases reinforced. Also

retained, but with minor modifications was the control on sectoral distribution of commercial and merchant banks credit. Most interest rates were increased and the general structure of interest rates revised.

Direct credit control, cash reserve requirements, stabilization securities exclusion of deposits against letter of credit from eligible liquid assets, credit ceilings were all brought in as policy measures to reduce banks liquidity credit expansion, consumers demand and the inflation rate.

As the economy continued to chomp inspite all the measures taken, a more stringent approach similar to SAP was introduced in 1979. It had the objectives of:

I. Intensifying fight against inflation

ii. Mobilizing increased resources to facilitate accelerates growth of output for domestic consumption and thereby reduce dependence on import.

iii. Achieving greater diversification of the economy and hereby reduce dependence on the petroleum sector.

iv. Improving employment opportunities through manpower training and active indegenization of the economy.

v. Restoring the balance of payment position.

This buttressed the fact that the SAP is not an entirely new concept in the economy.

According to CBN report, the broad policy of 1979 achieved substantial improvement in the economy and between 1980 and 1981 the economy was thought to have been on the path of recovery, but this was not so. Towards the

end of 1981, following the consequences of the glued that hit the international oil market the economy shampooed again (and as it appeared never to recover till date). The sump which occurred late 1981 continued till and indeed worsened in 1984 resulting into a severe stagflation (rising unemployment and inflation rate), external payment crisis with debt servicing ratio of above 62.5% of annual revenue of well over N1.5 billion per annum.

These developments formed the background of policy adoption in 1985 upwards. Basically, the 1985 policy prop was to stimulate agricultural production particularly in the staple food area. For the first time, economic policy was qualified in terms of goals, thus policy expectation were expressed as:-

- GDP growth rate of 1.00%
- Increase of N200 million in external reserve
- A reduction in the rate of inflation to about 30% etc.

At the turn of 1986, it was glaring that the targets of 1985 were completely far from being achieved and once again a sere policy option akin to that of 1979 was formulated and christened structural Adjustment program (SAP).

4.3 MONETARY POLICIES 1986 - 1998 DURING AND AFTER SAP PERIODS

The major objectives which became a new household knowledge include among other:

I. Restructuring and diversification of the economy and its productive base

ii. Achieving an improved balance of payment position.

Iii. Determining the realistic value of the Naira

iv. Building up of external reserved

v. Generation of employment.

To achieve these an IMF tele-guided demand supply equation approach to economic management was adopted. A policy which was clearly translated in the foreign exchange market through complete over hand and re-formulation of exchange rate policy. Policy objectives since then have apparently been the same with minor or yearly modifications.

The major monetary policy techniques used ranged from aggregate credit ceiling, sectional allocation of commercial and merchant banks loans and Advances, loans to small-scale wholly Nigerian owned enterprises, the deregulated interest rate policy, where banks and financial institutions were allowed to fix their rates an the level and structure of its deposit and lending rate, and legal reserve requirements among others.

I. **Legal Reserve Requirements:**

Cash reserve regime based on the classification of banks in respect of their deposit base. As a matter of fact under the monetary policy circular no.23 of 1989, the banks and financial institution were classed as follows:

CLASS	TOTAL DEPOSIT LIABILITIES	RATIO OF CASH RESERVE TO DEPOSIT LIABILITIES
A	=N=1 BILLION AND ABOVE	8%
B	=N=500 MILLION BUT LESS THAN =N=1 BILLION	7%
C	=N=100 MILLION BUT LESS THAN =N=500 MILLION	6 %
D	ANY AMOUNT LESS THAN =N=100 MILLION	5%

Source: Monetary policy circular No. 23 of 1989.

Effective 1st August 1996 merchant bank were excepted from reserve requirement while all commercial banks are still required to maintain a reserve ratio 8%.

II LIQUIDITY RATIO.

The minimum liquidity ratio expressed as a percentage of total banks deposit ability was fixed at 27.5% and 20% for commercial and merchant banks respectively in 1989. This was raised to 30% for both institution in 1990. The bank have maintained higher ratios (Appendix 1) until 1995 from 1996 the liquidity ratio for both commercial and merchant banks fail grossly below 30% to a deficit position see table below

Liquidity Position of Insured Banks

BANKS	AVERAGE LIQUIDITY RATIO		
	1996	1997	1998
MERCHANT	12.32	3.87	15.66
COMMERCIAL BANK	(38.42)	(50.78)	(25.63)
BANKING INDUSTRIES	(15.92)	(18.30)	(7.71)

Source: NDIC 1998 annual report page 16.

The average liquidity ratio improved from minus 18.3% in 1997 to minus 7.71 in 1998. Discount houses were also required, to invest 70% and 60% in 1997 & 1998 respectively, of their deposit liabilities in treasury bills. Government also introduced medium to long term securities of 3.5% years maturity outside the banking sector.

iii. BANKS CREDIT

The aggregate credit of banks recorded a substantial growth and indeed burst prescribed ceilings in the years 1988 (10%), 1989 (7%) 1990 (8.3%). In 1996 the growth rate of credit stood at 22.5% while it rose to 25.1% in 1997 and dropped to 22% in 11998. NDIC13. Money stock (M1) grew in percentage to 41.9% in 1989, dropped to 21.5% in 1990. In 1991 and 1992 it rose to 32.6 and 60.4% respectively. M1 has been on the increase since then through 1995 due to the implementation of the reflationary package. Broad money (m2) is not left out of the rising growth rate. It rose by 19.8% in 1990, 22.9% in 1991. As at 1998 the target growth rate of (m1) was fixed at 12% while that of (m2) 30%. NDIC13.

Credit of government sector rose from =N=19.455 billion in 1986 to =N=230.662 billion in 1995 an increase of 1185.6%. The figure dropped to =N=113124.0 billion in 1996, =N=128551.1 billion in 1997 and =N=105752.8 billion in 1998. Aggregate bank credit to private sector stood at =N=17.365 billion in 1986 and ros to =N=162.328 billion in 1995 an increase of 950%. In 1996 the figure rose to =N=478051.8 billion, =N=610811.5 in 1997 and =N=795916.1 billion in 1998 (Appendix 3&4 2). Sectoral allocation of commercial banks loans failed to meet stipulated targets. In 1989 it rose from 15.5% (target 17.5%) 1990 21% (target 10.6%) 1992 25.5% (target 13.2%) 1993 40.6% against (target of 7.7%) annual growth. Although higher than the policy targeted, the growth of banking system credit (net) to the economy showed some deceleration during the year 1995,1996,1997 and 1998 with growth rates of 23.1%, 22.5%,25.1% one 22.0% respectively (monetary policy circular No.30 of 1996). Sectoral allocation of banks credit was faced out via the 1997 budget

iv. INFLATIONARY PRESSURES

The inflationary pressures intensified with the rate of price increase rising from 010.2% in 1987 to 23.6% in 1988. There after it continued to gather momentum astronomically 1989 (40.9%), 1992 (44.5%), 1993 (54.2%) 1994 (54.2%) and by 1995 it rose to 72.8%. It dropped to 40% in 1996. There was a great improvement in 1997 when the single digit inflationary rate was recorded and maintain in 1998. This is partly due to the reduction in deficits and weak purchasing powers. The rate for 21997 was 8.5%.

v. INTEREST RATES AND EXCHANGE RATES

The deregulation of interest rates in 1986 allowed banks to determine their deposit and lending rates according to market conditions through negotiations with their customers. However, the minimum Rediscount Rate (MRR) continued to be fixed by the Central Bank stood at 12.75 in December 1987 while savings and deposit rate of commercial banks on the average was 11.5%. The prime leading rates of commercial and merchant banks in 1987 were 18.0% and 20.5% respectively.

Following the need to moderate monetary expansion in 1989, the MRR was raised to 13.25%. It was also observed that there were wide disparities in the interest rate structure of the various banks. In at bid to remove distortions in the structure of interest rates, the CBN reached an accord with the banks towards the end of 1989 on margins between their deposit and lending rates. Consequently, the spread between the saving deposit rates and lending rates was fixed at 7% points, while maximum of 4% spread was allowed between prime rate and maximum lending rates for each bank.

In 1991 CBN directed both commercial and merchant banks to maintain a maximum lending rate of 21% while deposit rates was fixed at 13.5%. The banking community was highly critical of the new policy claiming it was against the deregulatory

posture of the government. The ceiling on interest rates was removed in 1992 lending to high interest rates resulting in how investment in the productive sector of the economy while volatile inter-bank rates undermined the efficacy Open Market Operations and general stability in the financial system. In 1994 the central bank reintroduced regulatory measures in interest rate management. Deposit rate was set at 12.15% while a ceiling of 21% was fixed on lending rates. The cap imposed in 1994 was removed on 1st October, 1996. By 1998, banks pay lower than 6% on saving deposit and charged over 21% on lending, living a margin of about 16%. This trend has a negative effect on government policy of ensuring effective mobilization of financial resources and efficient initialization of such resource in the promotion of economic growth and development. So also is the increase in unemployment.

The relative stability of the Nigerian pound and its replacement with Naira was of no concern in the macro-economic development until the introduction of the exchange rate reform in 1986 which showed the gradual depreciation of the Naira. The Naira which exchanged for 0.9996 and 3.3166 Naira to dollar in 1985 and 1986 respectively depreciated to 9.7545 and 21.8861 in 1991 and 1995 respectively. The instability of exchange rate was attributed to increased demand for foreign exchange at a time when supply was declining and excess liquidity in the economy. The exchange rate shot to 80. Naira to a dollar in 1996 and settled at 84 Naira to a dollar. The high exchange rate is one of the reasons for the rise in inflationary trend in the past due to high cost of importation and thus manufacturing cost.

Vi. THE EXTERNAL SECTOR

In the external sector, analysis of available date for 1988 to 1992 showed mixed blessings. Nigeria's balance of payments deteriorated sharply in 1992. The overall position, as measured by movement in external reserves swing from surplus of $601.4 million in 1991 to a deficit of $3773.4 million in 1993. The reserve position witnessed some improvement and shot to surplus Os $4074.7 million (1996) $7700.0 million (1997) and $7100.0 million (1998) from as low as $1441.0 million in 1995. (Apprendix5)

The deficit recorded in the balance of payments n 1992, which contrasted with surplus recorded in the previous three years, was largely attributable to a deterioration of capital account. The widening of capital account deficit from $2773.4m in 1991 to $8921.2m reflected the huge payments due in respect of the scheduled amortization as well as the debt buy-back which resulted from the repurchase of $3.4 billion worth of the country's debt. By contrast the current account position remained strong reflecting a favorable trade balance as well as the narrowing of the deficit in the service and income account. The surplus on the current account valued at $2.278.9m was lower than the level of $5565.1m in 1990 but higher than the average of $2004.8m attained in the five years period 1988-1992. There was a great improvement in the balance of payment position in 1996 when the position stood at a deficit of $761.0m as against a deficit of $2774.4m 1995. This trend was sustained in 1997 with a surplus of $15.0m but seriously weakened in 1998 to deficit of $2873.0m (appredix7)

This was a reflection of the poor performance of the current account. While the current position deteriorated from surpluses of $3438.7m or 8.5% of GDP and $502.2m or 1.2% of GDP in 1997 to a deficit of $4297.8m representing 3.5% of GDP in 1998, the capital account position on the other hand, strengthened. The adverse development in the

current account arose specifically from the unimpressive performance of the merchandise trade account which for the first time in a decade recorded deficit. (CBN)14.

This chapter can cot be concluded without discussing exhaustively the impact of Open Market Operations (OMO) as a monetary policy tool on the reduction of liquidity in the economy and as a remedy in curbing inflation, economic stability and growth. A part from the exceptional cause where OMO affects money supply directly, the normal channel of influence of OMO on money stock is through the reduction or expansion in bank reserves and thereby bank credit. OMO is also more flexible and better suited for the day-to-day adjustment of the reserves in the desired direction using in most cases government and non-government instruments with issues ranging from very short term To long term maturities.

CBN commenced OMO in treasury securities with banks through discount houses from 30th June, 1993. The OMO is coordinated with discount window and reserve requirement policies to ensure the attainment of monetary policy objectives and targets. In particular OMO has been conducted every week by monitoring the growth in the monetary base which consists of currency in hands of the non-bank public plus total bank reserves. Since bank reserves can be influenced most directly by CBN instruments, the Bank's approach has been to adopt bank reserves as the operating target of OMO.

Indeed from the modest offers and sales of =N=250m at the initial session at end of June,1993, the level of OMO bills offered and sold increased several-fold to respective =N=44,950m and =N=49,265 million by the end of 1993. In 1994, the second year of operation, Amman to offered and sold stood at =N=121000.0m and =N=223,758.1m respectively. The substantial response to OMO by banks in the first year and its improvement a year later are due to a number of factors which include the search for

safer investment outlets following collapse of the inter- bank market boosted investment in treasuring bills. Also the requirement for dealing in the foreign exchange market encouraged banks to invest in treasury securities.

Despite the above the general review of the performance of OMO in checking liquidity grow is unsatisfactory . This is caused by some factors such as, the transfer of some money belonging to the petroleum (special) Trust Fund from commercial and merchant banks to the CBN, which ordinarily shrank cash volume in the banks.

Other factors are:-

I. Weekingly intervention in Autonomous foreign exchange market (AFEM)

ii. The supervision of the release of funds held in outstanding stabilization securities as well as the delay in the proposed transfer of government accounts from CBN to the banks.

iii. Inability of the CBN to establish the monetary aggregates. The CBN does not seem to have been able, as at now, to establish the correct monetary base or monetary aggregates upon which other major monetary policies are based. Consequently the tendency by the CBN is to concentrate attention on M1, which is just one of the constituents of the monetary aggregates. It is relatively easy for the monetary a tab on part of m1 because it is the primary money created by it through the management of its assets and liabilities. It is from the primary money that banks create secondary money through their credit activities - loans and advances to private sector.

In recent years the relatively low level of activities in OMO resulted

from,, the tight liquidity profile, the persistent low yield on the Treasury Bills in the first three quarters of the year and the increased confidence in the banking sector which continued to engender in AFEM activities. OMO transactions in terms of bids and sales sharply declaimed from N23287.0m and N13087.0m in 1996 to N7966.0m and N7716.0m in 1997 and N6474.0m and N5944.0m in 1998.

CHAPTER FIVE

5.1 CONCLUSION:

In the course of this project, I have highlighted the general scope of monetary policy which was evaluated against the background of the structure, legal frame work in which monetary policy is being operated by the CBN, how it was operated and in the later part of this chapter, how it will be operated in future in order to be able to affect the course of the economy, the constraints to which the Central bank is subject and the responses of the bank to the challenges of monetary management.

During the regulatory period, the monetary policy is pursued with the aim of ensuring optimum and balanced real growth, increased per capital-income, produce high level manpower and reduction of unemployment. Theses objectives could be targeted at a long term economic stability or short-term control of economic variables. The selection of monetary policy techniques in an effort to achieve policy objectives may result to the injection of policy instruments that are themselves conflicting. Other problems which appears crucial is that of identifying the appropriate monetary options. Certain economic objectives could be achieved by using combination of monetary policy tools, fiscal policy tools, exchange rate or income policy. Faced with these policy measures, the monetary authorities sometimes adopt a trade-off.

A successful trade-off can produce preferred combination of policy objectives even though no single objective is fully attained. However, the main instruments of monetary policy tools adopted include among others, the following:-

Direct credit control, reserve requirements, rediscount rate, interest and exchange rate structure, moral suasion and open market operation. Theses tools may be quantitative, qualitative (cost) or directio9nal. Although CBN is the sole agent of

monetary policy, the main operators remain the commercial and merchant banks and other financial intermediaries. While CBN is directly responsible for money supply and administration of stipulated interest and exchange rates, before the introduction of market base economic system, banks and financial intermediaries on the other hand are responsible for the operation of credit guidelines and maintenance of stipulated levels of reserve and money creation.

As indicated earlier, in line with the stance of overall economic policy prior to the SAP, the CBN relied on direct controls to carry out its statutory responsibilities of contributing to economic growth and development through the development of the financial sector as well as supervising and examining the financial sector to provide a means of enforcing the directives of monetary authorities. Further more, the CBN adopted a policy of influencing the developmental process by promoting money and capital markets, development banks and related institutions and schemes.

With the adoption of the economic reform package under the aegis of the structural Adjustment programme (SAP) by the government, the direction of CBN policies and measures increasingly reflected the deregulatory stance of the package. Consequently, the CBN started to rely more on market forces in the design and implementation of its monetary, banking and external sector policies. Under the monetary and financial sector management, the main objectives of monetary policy were: Moderation of inflation, increased domestic savings and efficient resources allocation, improved capital inflow, increased local production and emplo9yment, enhanced external res3erve through increased earnings from non-oil exports, and stable Naira exchange rate.

To achieve the broad objectives highlighted above, a number of policy instruments or measures were adopted which were grouped into three, namely, credit ceiling, a major

instrument of monetary prior to the SAP, remained important for banks whose performances were considered sound. To maintain appropriate monetary growth which will ensure stability in both the domestic and external sectors of the economy, credit ceiling was adjusted to deal with perceived excessive or deficient credit in the system as deemed necessary. Other indirect measures included the recall of Naira counter part of outstanding payment arrears from banks to CBN in 1987, mopping up excess liquidity by the re-introduction and modification of stablisation securities since October, 1990, which was suspended in 1993 with full refund of outstanding securities in the last quarter of 1998, increase in commercial banks cash ratio in 1989 and 1990 and the introduction of cash ratio for merchant banks in 1990. Discount houses to invest 70% and 60% of their deposit abilities in treasury bills in 1996 and 1998 respectively, while merchant banks were exempted from reserve requirement living commercial banks with 8% reserve requirement effective 1st August, 1996.

Further more, within the context of economic liberation, the sectoral credit guidelines were reformed to give banks the much needed flexibility in their credit operations. Effective September, 1992, indirect methods of credit and monetary control received a boost with the selective lifting of credit ceiling for banks which had met the performance criteria. In 1991, the base for calculating the cash reserve requirement (CRR) was extended beyond demand deposits to include time and savings deposit as well. Interest rate management under SAP when interest rates were administratively fixed. The current policy based on market forces was necessitated by the need to promote competition in resource allocation. In August, 1987, all controls on bank deposit and lending rates were abolished while CBN continued to fix the rediscount rate to indicated the direction of interest rate changes.

Other financial sector measures taken by the government to encourage the growth of banks and other financial institutions, the CBN stepped up. Its traditional and developmental functions and set in motion measures tap re-organise the sector so that it could play is role under a deregulated economy. Efforts made to strengthen the system include: raising of the capital base of banks to =N=500 million in 1996 effective 1st January, 1999, improving the structure of resolution of their problems, adoption of auction system for issuing treasury securities and the establishment of discount house who are directed to invest 6% of their deposit ability in 1998 as against 70% in 1997 in treasury bills.

CBN's foreign exchange management policy seeks to maintain adequate level of foreign reserves and an appropriate Naira exchange rate consistent with allocative efficiency. Under the deregulated stance of the SAP, the CBN's determination of the Naira exchange rate has been subjected to market factors. Several experiments and techniques of conducting the foreign exchange market were undertaken between 1987 and 1992 to facilitate the achievement of policy objectives without much success-second-tier foreign exchange market (SFEM) 1986, foreign exchange market (FEM) 1987 inter-bank foreign exchange market (IFEM) 1989. The CBN allocated foreign exchange to banks based on individual banks' quota since the inception of SFEM until march 5th, 1992. The constant fine tuning of the market calumniated in the complete floating of the Naira on March 5th, 1992 and the reversal of policy in January, 1994 when the Naira was pegged and a prorate system of foreign exchange allocation to end-users was adopted.

The Reversal of policy in 1995 to that of guided deregulation of the foreign exchange market necessitated the institution of the Autonomous foreign exchange market (AFEM) and further liberalisation of foreign exchange dealing through the active

participation of the bureau de change at the AFEM at the autonomous exchange rate. They are not Eligible for the channelling of CBN intervention funds to end-users. The bases for allocation of foreign exchange has not always been price or demand. At the early stages allocation was based on bank size with bigger banks getting the quantum share. Later allocation of forex was based on sectoral preferences with the quantum of forex going towards manufacturing activities. In all these cases demand was hardly ever met while for long time, demand was not being fully cash-baked by banks. AFEM represents perhaps the only market mechanism in which demand for forex is and has been fully met from the out-set. Many operators however still hold the view that the AFEM rate is not a market clearing rate and that the Naira is still over valued.

Reversal appear to have plaque our policy management efforts as a nation, and it has transcended virtually every regime for as long as one can remember since the policies changes after every new government. Interest rate liberalisation is easy to recall as one in which we kept on going forth and back. More recently, it has been pre-shipment versus destination inspection to take care of the external sector. Even the current government has taken steps to reverse the position held during the time of its predecessor. This approach in the view of Tunji Sobodu (UBA)[14] brought the Naira to were it is today as we move from one auction method to another.

By far the most important reason why CBN liquidity control seems to have been so unsuccessful is the point made earlier in chapter four above that the policy instrument used are focusing more o the systems of the excess

liquidity, rather that the primary causes. For the primary causes of excess in the Nigerian monetary system, until recently are huge government budget deficit. These large budget deficits were financed largely through borrowing from the CBN. However, government has planned to float medium to long term securities with relative attractive yields capable of mopping up excess liquidity in 1998 proceeds of which were targeted at funding small and medium scale enterprises 'credit schemes'.

The 1998 fiscal year recorded a number of success in the monetary policy implementation particularly in the objectives of controlling inflation rate, maintaining exchange rate stability and keeping interest rate low as much as possible. However the falling international oil price gives wrong signal for the ability of the government to adequately fund the foreign exchange market as to be able to sustain the stability of the exchange rate.

5.2 RECOMMENDATION.

From our observation in the previous chapter we saw that many problems affect the ability of the CBN to achieve its monetary policy objectives. We have also seem that the CBN has utilised a myriad of tools to control monetary growth and liquidity with little success to show for it.

In this section therefore, we will proffer the following recommendations:-

(i) Harmonisation of Fiscal and Monetary Policies

The fiscal deficits of the government are usually at variance with monetary targets mainly because of lack of co-ordination between the fiscal and

monetary programme. Since fiscal in-balance affects the monetary base adversely and thus the liquidity level, there must be a mechanism to regulate the level of fiscal deficits the economy can bear at any point in time. The question is also how long will the current government maintain its present position on deficit financing or will the civilian government, expected to come into power soon, be able to maintain the same budgetary discipline? One way to ensure this is to provide greater autonomy to the CBN, so that monetary policy targets are arrived at without undue reference to the government's fiscal and political objectives. Also in this regard, the CBN must be freed from underwriting the un-subscribed position of government debts or issues. This will subject the government to market discipline such that the amount that can be raised by the government will depend largely on the market perception of the viability of the debts. Once the idea suggested above is implemented, there will be no need for the CBN to levy stabilisation securities on the banks, an action that was preceded in the past by large deficit financing by the government. It is clear that the current distress in the banking sue-sector has its genesis in the liquidity crisis that befell the banks from mid 1998 to 1994 and the consequent constant mopping up of so called excess liquidity in the system.

(ii) **Statistical Data**

Any successful implementation of monetary policy requires timely and reliable data on the liquidity position of banks and the sectors determining the monetary base. Currently, these data are scantily available. The CBN, banks and other financial institutions must evolve a system of data collection, processing

storage and retrieval, which all of them must be able to access, at little or no cost to them. Up till now majority of banks do not render timely returns to CBN. The CBN should therefore put sanctions on such banks from biding at AFEM session or impose some penalties on such banks.

(iii) **Conduct of Monetary Policy**

The CBN should continue to inform its monetary control system and place a greater emphasis on market based instruments, particularly open market operations rather than direct controls. To make omo more potent toll for monetary management, the scope of the market should be expanded by making the pricing of Treasury bills and other government debts instruments market sensitive. We should undertake sufficient study of the causes of problems we are intending to solve and the implications of Candidate policy options. Policy makers and government sometime having conflicting interests with the lager public and this leads to wrong policy choices. Where the appropriate policy is adopted it may be implemented poorly with the hope that such poor implementation would cripple open to discredit. This should be stopped immediately in the interest of National Development.

The idea of adopting a particular policy by its application in many countries should be stopped because the people handing to the policy's efficiency in other countries may (and quite often do) not know much about the details of the policy as implemented in those countries. Also proponents may lack a good appreciation of the conditions in those economies which are often or re-requisites for policy effectiveness or success even the Briton woods

institutions and economists around the world have come to accept that widespread reforms without due consideration for regulatory and supervisory instructor. This has proven to be very costly yet it was avoidable.

The success of many countries today is explained by careful analysis of policy options with due attention given to timing, sequencing, appropriateness and complimentarily of policy choices. Perhaps one of the factors that need to be addressed in the very commendable vision 2010 committee is the timing of policies. What is not clear also are specific policy details. The generalizations may need to be further distilled to help and guide policy makers. We never have a problem of defining lofty economic continue to fought with mistakes. We can no longer afford them.

IV. <u>Fiscal In-discipline</u>

Government must learn to keep within its revenue in its spending. That we have not been able to achieve this on sustained basis over last ten years means that some discipline and resolve is required on our part to bring about its attainment. That we returned budget surfaces during the Abacha requires means that if we are serious enough the feat is not impossible to achieve. However, achievement in itself is not enough for how it is done is perhaps more important. Just retraining from spending money and when it is spent, so done on things with little or no positive multiplier effects will not do us any good.

There are a number of ways in which we could begin to set up ourselves for attaining this goal. First is to review the budget process. Items of expenditure and sources of revenue must be duly scrutinized, and based on realistic and

reasonable assumptions. Second, extra-budgetary spending must discouraged. Such could be done by setting up an approval process that makes it unattractive while rewarding compliance. Third, we should also draw up a contingency budget based on adverse and favorable revenue projections. This will enable us to plan for and manage unexpected deficit situations effectively. Fourth, further remoras should be carried out toward increasing our domestic revenue base while commercialization and privatization come up again here as useful ways of redirecting resources to where the will yield better results on aggregate.

V. **Confidence Building**

The CBN should undertake deliberate strategy for rebuilding the confidence in banking industry in particular and the finance industry in general, if it is to achieve any meaningful success in its overall monetary policy. It is a well known fact that a lot of dis-intermedation has taken place because of the funds from the banks. The confidence of general public in the banking, industry can be exhausted by the CBN through the following:

a. Resolving the crisis of confidence in the finance houses sub-sector by enforcing the legal and regulatory powers vested in it by BOFID
b. Resolving the problems of insolvent and distressed banks,
c. Evolving a system that provides timely information on banks reserves, government activities and money market conditions in order to time its intervention in the market appropriately.
d. Ensure that level of interest rate is determined by the transaction of the supply and demand for credit in order to bring back the funds

that are kept outside the banks due to law rates of interest.

Finally, at a time when the professional integrity of bankers appear to have been seriously called to question, it will be appropriate to mention that the chartered institute of bankers and economic society of Nigeria, need to work harder to restore public confidence in banking sector in particular and the economy in general.. it is also important to stress the need for increased self regulation, in the context of the continued movement to market based arrangements for macro-economic management. CBN should also play its role in this direction, through appropriate supervisory intervention.

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APPENDIX 1(a)

LIQUIDITY CASH RESERVE AND LOAN-TO-DEPOSIT RATIOS OF MERCHANT BANKS (PER CENT)

Year/Quarter	Liquidity Ratio 1/ (1)	Cash Reserve Ratio 2/ (2)	Loan-to-Deposit Ratio 3/ (3)
1986	14.6	5.1	118.4
1987	24.5	7.0	123.1
1988	35.1	5.3	91.7
1989	23.6	4.8	190.6
1990	32.8	8.2	158.6
1991	31.1	10.8	140.0
1992	22.4	17.2	92.3
1993	40.7	6.0	69.4
1994	58.7	6.0	84.0
1995			
1st Quarter	40.0	6.4	76.7
2nd Quarter	41.8	6.0	85.6
3rd Quarter	58.0	5.6	99.8
4th Quarter	41.6	5.9	91.4

Source - CBN BULLENTIN STATISTICAL VOL.6 NO.2 DEC, 1995 Pg. 43

APPENDIX 1(b)

LIQUIDITY CASH RESERVE AND LOAN-TO-DEPOSIT RATIOS OF COMMERCIAL BANKS (PER CENT)

Year/Quarter	Liquidity Ratio 1/ (1)	Cash Reserve Ratio 2/ (2)	Loan-to-Deposit Ratio 3/ (3)
1986	36.4	1.5	83.2
1987	46.5	1.4	72.9
1988	45.0	2.1	66.9
1989	40.3	2.9	80.4
1990	44.3	2.9	66.5
1991	38.6	2.9	59.8
1992	29.1	4.4	55.2
1993	42.2	6.0	42.9
1994	48.5	5.7	60.9
1995			
1st Quarter	40.8	5.2	57.1
2nd Quarter	39.4	5.6	64.2
3rd Quarter	32.9	5.4	66.1
4th Quarter	33.1	5.8	73.3

Source - CBN BULLENTIN STATISTICAL VOL.6 NO.2 DEC, 1995 Pg. 32

APPENDIX 2

BANKING SYSTEMS CREDIT TO THE ECONOMY

(Million)

		PRIVATE SECTOR CREDIT				CREDIT GOVERNMENT SECTOR			
Year/Quarter	Aggregate Credit Net.	Commercial	Merchant	CBN	TOTAL	Commercial	Merchant	CBN	TOTAL
1986	36,820.3	15,738.6	-	1,626.4	17,365.0	4,570.9	-	14,884.4	19,455.3
1987	46,926.5	17,899.7	5,659.1	1,917.3	25,476.1	6,866.3	290.3	14,293.5	21,450.1
1988	57,326.3	20,828.9	6,526.2	2,418.5	29,773.6	21,767.2	56.6	21,767.2	43,591.0
1989	49,259.1	22,325.8	7,114.8	1,502.2	30,942.8	3,035.8	90.7	15,189.8	18,316.3
1990	57,674.9	26,364.5	8,866.4	1,400.1	36,631.0	7,036.8	315.5	22,993.4	30,345.5
1991	83,823.7	31,763.2	11,270.7	2,291.3	45,325.2	5,883.7	492.1	32,122.7	38,498.5
1992	141,735.7	43,436.9	13,657.6	3,926.2	61,020.3	1,470.0	689.3	78,556.1	80,715.4
1993	274,134.3	67,959.2	22,666.1	4,659.7	95,285.0	28,457.4	9,452.2	146,939.1	184,848.7
1994	350,622.7	94,761.5	21,917.1	5,597.7	122,273.3	37,885.7	8,271.0	182,192.7	228,349.4
1995									
1st Quarter	342,746.6	93,584.3	24,175.5	5,006.6	122,766.4	29,568.0	6,329.2	184,082.5	219,979.7
2nd Quarter	370,062.1	119,689.4	25,291.1	4,701.4	147,709.8	27,553.6	5.118.3	187,680.3	220,352.2
3rd Quarter	397,099.1	136,655.1	28,158.2	4,571.1	169,384.4	22,316.2	1,646.4	203,752.1	227,714.7
4th Quarter	396,891.5	124,475.1	27,255.7	10,598.7	162,328.9	20,296.4	3,710.4	206,655.7	230,662.5

Source - CBN BULLENTIN VOL.6 NO.2 DEC, 1995.

APPENDIX 3

COMMERCIAL BANKS' ASSETS BY SIZE AND OWNERSHIP CATEGORY

Asset Size	1997					1998				
	Ownership Category					Ownership Category				
	Private	State Government	Federal Government	Total	% Of Total	Private	State Government	Federal Government	Total	% Of Total
Below ₦200m No. of Banks	1	1	1	3	4.7	-	-	-	-	-
Amount (₦' M)	146.2	145.7	120.3	412.2	0.1	-	-	-	-	-
₦200m -₦500m No. of Banks	1	-	1	2	3.1	-	-	2	2	3.9
Amount (₦' M)	457.3	-	391.3	848.6	0.1	-	-	808.0	808.0	0.1
₦500m - ₦1Billion No. of Banks	2	2	3	7	10.9	1	1	-	2	3.9
Amount (₦' M)	1654.2	1603.9	2,010.4	5268.5	0.9	527.4	705.2	-	1,232.6	0.2
₦ 1Billion - ₦5Billion No. of Banks	12	9	6	27	42.2	4	7	4	15	29.4
Amount (₦' M)	29,922.0	24,494.8	11,473.0	65,889.8	10.6	11,794.1	17,033.8	10,735.4	39,563.3	5.2
Over ₦5Billion No. of Banks	28	3	2	25	39.1	26	6	-	32	62.8
Amount (₦' M)	468,564.8	37,345.7	44,377.8	558,286.7	88.3	639,421.2	76,220.1	-	715,641.3	94.5
Total No. of Banks	36	15	13	64	100	31	14	4	51	100
Amount (₦' M)	500,743.2	63,590.1	58,372.0	62,270.3	100	651,742.7	93,959.1	11,543.4	75,245.2	100

Source: NDIC Annual Report, 1998

APPENDIX 4

MERCHANT BANKS' ASSETS BY SIZE AND OWNERSHIP CATEGORY

Asset Size	1997					1998				
	Ownership Category					Ownership Category				
	Private	State Government	Federal Government	Total	% Of Total	Private	State Government	Federal Government	Total	% Of Total
Below ₦200m No. of Banks	4	-	1	5	9.8	1	-	-	1	2.6
Amount (₦' M)	354.4	-	199.6	554.0	0.5	101.5	-	-	101.5	0.1
₦200 - ₦500m No. of Banks	9	-	2	11	21.6	2	-	1	3	7.9
Amount (₦' M)	3,408.8	-	956.5	4,367.3	3.7	885.4	-	250.3	1135.7	0.8
N500 - ₦1Billion No. of Banks	5	-	2	7	13.7	4	-	-	4	10.5
Amount (₦' M)	4,162.0	-	5,430.9	9,529.94	8.2	2,871.0	-	-	2871.0	2.0
₦ 1Billion - ₦5 Billion No. of Banks	22	-	-	22	43.1	21	-	-	21	55.3
Amount (₦' M)	48,407.2	-	-	48,407.22	41.5	58,255.4	-	-	58,255.4	40.3
Over ₦5 Billion No. of Banks	6	-	-	6	11.8	9	-	-	9	13.7
Amount (₦' M)	53,735.9	-	-	53,735.9	46.1	82,060.1	-	-	82,060.1	56.8
Total No. of Banks	46	-	5	51	100	37	-	1	38	100
Amount (₦' M)	100,068.3	-	6,589	116,657.3	100	144,173.4	-	250.3	144,423.7	100

Source: NDIC Annual Report, 1998. Page 38

APPENDIX 5

SOME SELECTED MACROECONOMIC INDICATORS

Variables	1995	1996	1997	1998
Real GDP (Growth Rate %)	2.2	3.25	3.77	2.4
Gross Domestic Savings As a Proportion of GDP (%)	10.7	11.6	10.6	9.9
Gross Domestic Consumption Expenditure As a Proportion of GDP (%)	89.3	88.0	87.2	79.4
Manufacturing Capacity Utilization (%)	29.3	32.5	34.0	28.0
Inflation Rate (%)	72.8	29.3	8.3	8.2
Net domestic Credit (Growth Rate %)	12.4	5.0	-2.6	55.7
Net Credit to Government (Growth Rate %)	8.6	10.1	-53.5	199.3
Credit to Private Sector (Growth Rate %)	51.8	21.9	33.9	23.5
Narrow Money (M1) (Growth Rate %)	8.1	26.3	14.4	17.2
Broad Money (M2) (Growth Rate %)	10.3	25.7	16.9	21.2
Current Account Balance (In per Cent of GDP)	-5.6	2.8	-0.8	-3.5
Overall Balance (In per Cent of GDP)	-3.1	-0.7	-0.9	-2.3
External Reserve (US $ Million)	1,441.0	4,074.7	7,700.0	7,100.0
External Debt Stock (In Per Cent of GDP)	32.64	28.0	27.04	28.8
GDP Per Capita (N)	1,073.6	1,090.7	1,081.3	1,051.0

Source - NDIC Annual Report 1998. Page 6

APPENDIX 6

NIGERIA: MAJOR MACROECONOMIC INDICATORS,
1982 - 1992

	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992
1. Aggregate Growth Rate of GDP (%).	-0.3	-5.4	-5.1	9.4	3.2	-0.6	10.0	7.3	8.3	4.3	4.1
2. Domestic Prices (% Changes in CPI)	7.7	23.2	39.6	5.5	5.5	10.2	38.3	50.5	7.5	13.0	44.4
3. Growth of Money Stock (M1; in %)	3.1	12.3	8.2	8.7	-1.2	13.7	41.9	21.5	21.5	32.6	60.4
4. Fiscal Deficit/GDP (%)	10.1	5.3	3.7	3.9	10.4	5.3	8.5	7.9	7.9	12.4	9.8
5. Average Prime Lending Rate (%)	9.3	10.1	10.4	9.2	9.6	14.0	16.6	25.5	25.3	20.0	29.8
6. Average Saving Rate (%)	7.9	7.5	11.5	9.5	9.5	12.1	12.1	18.0	18.0	13.8	16.0
7. External Debt Payment/GDP (%)	0.67							20	30	37.5	41.3
8. Average Exchange Rate (N/$)	0.79	0.72	0.76	0.89	1.27	3.59	4.50	7.38	8.03	9.90	17.3

Source - Central Bank of Nigeria Research Department, July/Sept. 1993.
Vol. 17 No3 Pg. 31.

BALANCE OF PAYMENTS - ANALTICAL STATEMENT
(US $ million)

Category	1983 (1)	1984 (2)	1985 (3)	1986 (4)	1987 (5)
A. CURRENT ACCOUNT					
Merchandise	-2,389.8	-2,644.6	3,438.7	502.2	-4,297.8
Export (F.O.B)	2.802.5	3,512.9	9,678.6	5705.9	-240.1
Oil	9,415.1	11,734.4	16,117.0	15207.3	8,971.2
Non Oil	9,170.7	11,448.7	15,829.8	14850.1	8,564.7
Imports	244.4	285.7	287.2	357.2	406.5
Oil	-6,612.6	-8,221.5	-6,438.4	-9501.4	-9,211.3
Non Oil	-1,935.0	-1,923.9	-1,997.1	-2043.9	-2,099.6
Services and Income (net)	-4,677.6	-6,297.6	-4,441.3	-7457.4	-7,111.8
Services and Income (credit)	-5,692.8	-6,890.1	-7,116.6	-7070.8	-5,572.9
Investment income (credit)	421.6	708.3	847.5	1044.9	1,216.6
Interest on reserves	48.8	100.7	114.9	258.4	332.9
Others	48.8	0.0	114.9	258.4	332.9
Non factor Services	0.0	607.6	0.0	0.0	0.0
Services and Income (Debit)	372.8	-7,598.4	732.6	786.5	883.7
Investment Income (Dedit)	-6,114.4	-2,979.2	-7,964.1	-8115.7	-6,789.5
Oil	-3,081.2	-1,338.8	-3,137.2	-1403.9	2,623.7
Non Oil	-1,323.5	-1,640.4	-1,544.2	-1767.5	-1,369.3
Interest DUE on Loans	-1,757.7	-1,510.3	-1,593.0	-1636.4	-1,254.4
Direct Investment	-1,661.0	-130.1	-1,539.1	-1590.6	-1,196.8
Non factor Services	-96.7	-4,619.3	-53.9	-45.8	-57.5
Unrequited transfer (Net)	-3,033.2	732.6	-4,8269	-4711.8	4,165.8
B. CAPITAL (EXCLUDED AND E)	514.1	-46.2	876.7	-425.0	1,515.2
Direct Investment	1,015.7	1,079.3	-4,154.9	1539.4	1,502.5
Portfolio Investment	-9.3	-82.2	1,593.5	-66.6	1,051.3
Other capital long term	-1,894.9	-1,535.4	-172.6	-2883.2	-8.3
Official (of which)	-1,894.9	-1,535.4	-3,039.0	-2883.2	-1,637.0
Amortisation (DUE)	-2,346.5	-2,674.8	-3,039.0	-3556.4	-1,637.0
Disbursement	451.6	1,139.4	-3,732.1	673.2	-2,413.4
Other Official	0.0	0.0	0.0	0.0	0.0
Private (Net)	0.0	0.0	0.0	0.0	0.0
Other Capital short term (Net)	1,402.7	492.1	-2,536.8	985.4	2,096.5
C. NETERORS AND OMISSIONS	-71.8	-83.5	44.8	-62.2	-77.6
D. OVERALL BALANCE = Total (A,B and C)	-1,947.5	-2,774.4	-761.0	15.0	-2,872.9
D. FINANCING	1,947.5	2,774.4	761.0	-15.0	2,872.9
a. Exceptional Financing	2,276.3	2,556.6	3,394.7	3491.5	0.0
i) Promissory Notes (arrears)	0.0	0.0	0.0	0.0	2,391.8
ii) Deferred debt service	2,276.3	2,556.6	3,394.7	3491.5	2,391.8
iii) Others	0.0	0.0	0.0	0.0	0.0
b. Reserves [2]	-328.7	217.8	-2,6337	-3506.5	481.1
Memorandum Items:					
Current Account Balance % of GDP	**-5.7**	-9.4	8.5	1.2	-3.5
Capital Account Balance % GDP	**1.2**	**-0.2**	-10.2	-1.0	1.2
Overall Balance as % of GDP	**-4.7**	-9.9	-1.9	0.0	-2.3
External Reserves - Stock (US $ million)	1,658.8	1,441.0	4,074.7	7581.2	7,100.0
Number of months of Import Equivalent	**3.0**	**2.1**	7.6	9.6	9.2
Debt Service Due as% of Exports of Goods and Non-Factor Services	40.9	339	31.3	32.2	36.6
Average Exchange Rate (N/$)[3]	21,8861	70,3632	69,8449	717505	76,8087

1 Provosional

2 Minus (-) sign indicates increase in reserves.
Plus (-) sign indicates decrease in reaerves.

3.The conversion exchange rates used from 1995 to 1998 were derived from the weighted average of Official and AFEM rates.

Source: CBN Annuala Report & Statement of Account 1998. Page. 139