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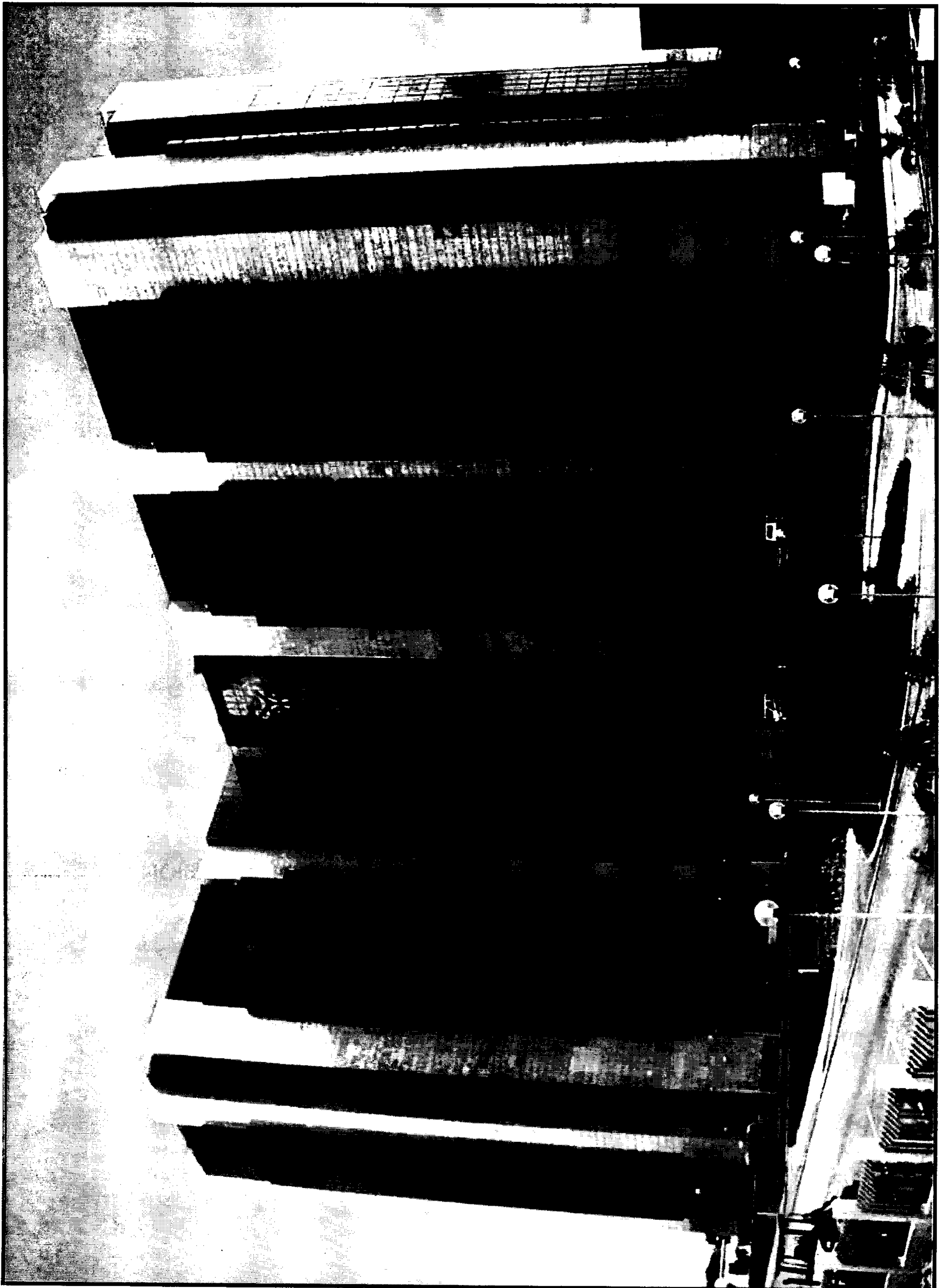

EXCHANGE RATE MANAGEMENT IN PERIOD OF ECONOMIC UNCERTAINTY

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1.0 Introduction

All over the world, central banks are mostly concerned with the primary responsibility of ensuring that prices (interest rate, exchange rate, and inflation rate) remain stable such that it does not endanger the achievement of macroeconomic objective. The spirit behind this goal is to manage system liquidity, encourage growth, attain both external and internal balance as well as steer the economy towards a sustainable growth path.

Nigeria, like some other jurisdictions has transited from one regime of foreign exchange management to another; ranging from fixed to flexible exchange rate, accompanied by different institutional and legal frameworks. Notwithstanding the regime, the issue of foreign exchange management, especially with respect to the exchange rate of Nigerian naira, which is the price for the domestic currency vis-à-vis other currencies as well as the need to achieve a realistic exchange rate for the domestic currency have continued to pose a daunting challenge to the monetary authority.

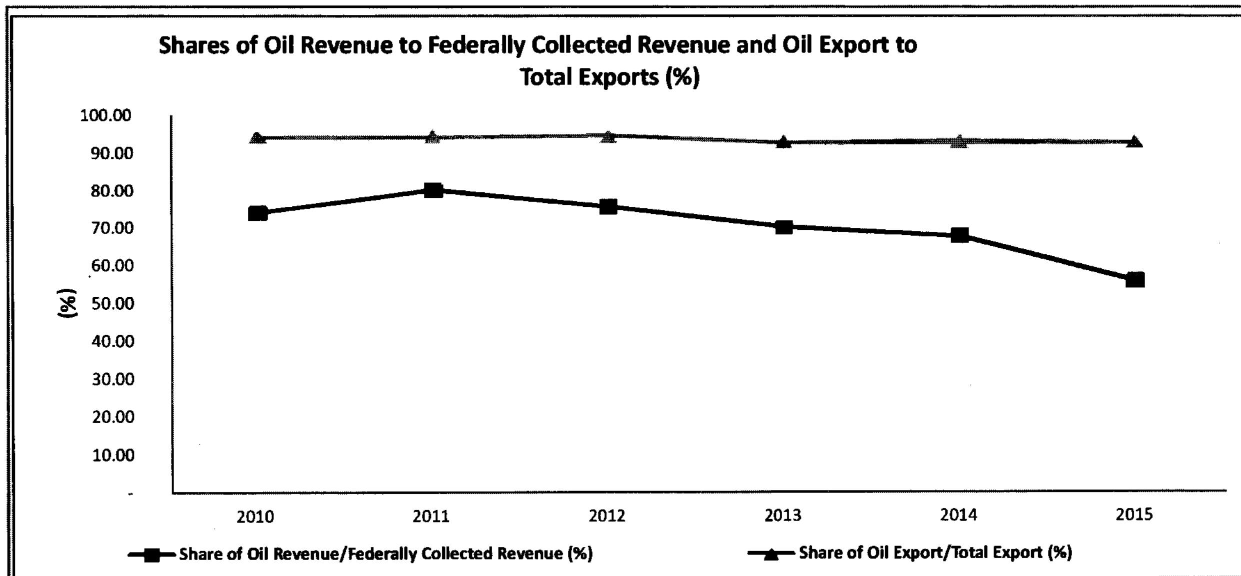
Therefore, the choice for, or against any of these regimes at any point in the economy's history is influenced by the desire of the monetary authority to maintain the external reserves that safeguard the international value of the legal tender currency. The Central Bank of Nigeria (CBN) experience in this sphere has been mixed, resulting in monetary policy implementation mix, adopting both the conventional and unconventional monetary policy measures as means of achieving policy goals.

Economic uncertainty impedes monetary authority's ability to achieve its goals. Literature has it that following the Great Financial and Economic Crises (GFC) in 2008, central banks in major economies adopted a range of new measures to influence monetary and financial conditions. These measures include: quantitative easing; extension of credit lines to banks; stimulus packages; etc. These measures, aside from the normal policy measures that are adopted by the monetary authority in order to influence the economy (growth, inflation, exchange rate) during unusual financial and economic conditions are referred to as unconventional monetary policy (UMP).

Presently, monetary policy implementation of the CBN has witnessed some challenges, owing to the interplay of domestic and external factors, namely; dwindling government oil revenue, fragile recovery of developed economies, declining foreign exchange reserves, increasing inflation; and declining growth, which triggered the economic recession that started in 2016. During the period, aside other negative impact on the economy, foreign exchange rate seems to be worst affected, owing largely due to its unique place in monetary policy implementation – it is inextricably linked to interest rate and inflation rate. Mordi (2006) asserts that changes in exchange rate could have direct and indirect effects on inflation rate. He posited that exchange rate directly affects inflation and other prices faster through imported goods and services, whereas it impacts indirectly on inflationary pressure, usually

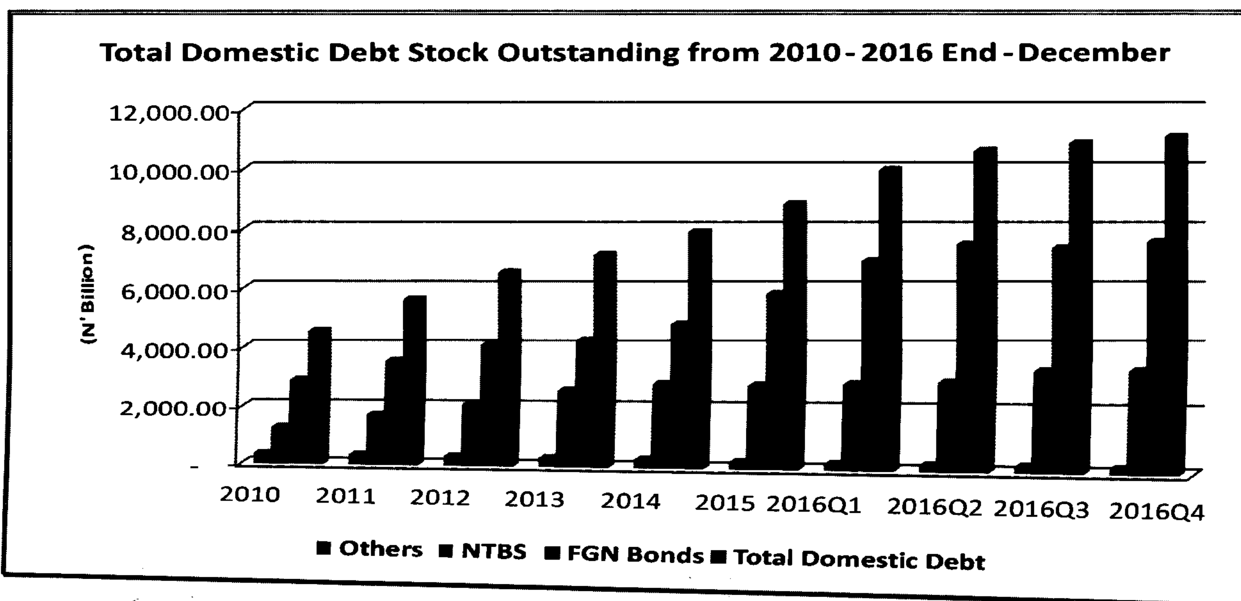
This, in turn informed the fiscal policies undertaken during the pěriod with its attendant effect on monetary policy. The shares of oil revenue to federally collected revenue and oil export to total exports declined to 73.88 and 94.08 per cent in 2010 from 85.88 and 98.54 per cent, respectively in 2005. In 2015, they declined further to 55.41 and 92.58 per cents, respectively.

Figure 5: Shares of Oil Revenue to Federally Collected Revenue and Oil Export to Total Exports (%) from 2010 - 2015



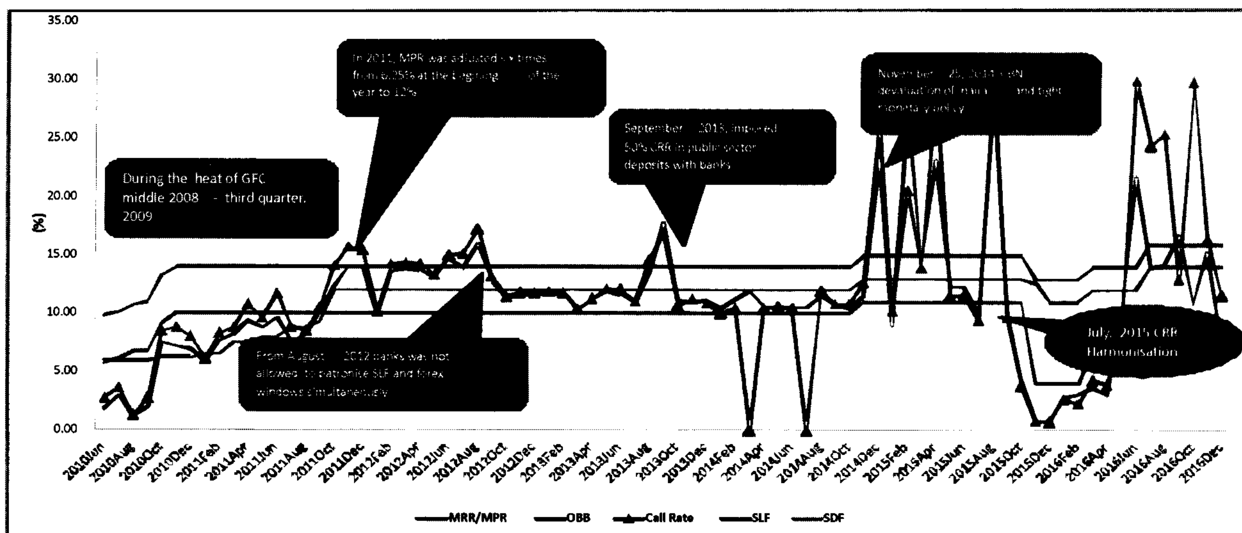
With declining government revenue, there was pressure on the fiscal operations of government culminating in the increasing financing of budget deficits through borrowing from the public either through FGN Bonds or Nigerian Treasury Bills, ranging from 91-day, 182-day and 364-day tenors that have the potentials of crowding-out private investment.

Figure 6: Movements in the Total Domestic Debt Outstanding from 2010 - 2016



Apart from the foreign exchange demand pressure at the market, short-term money market rtaes trended in line with liquidity situation in the banking system. The interbank call and Open-buy back rates trended upwards, reflecting markets reactions vis-à-vis the decisions of the monetary policy committee (MPC).

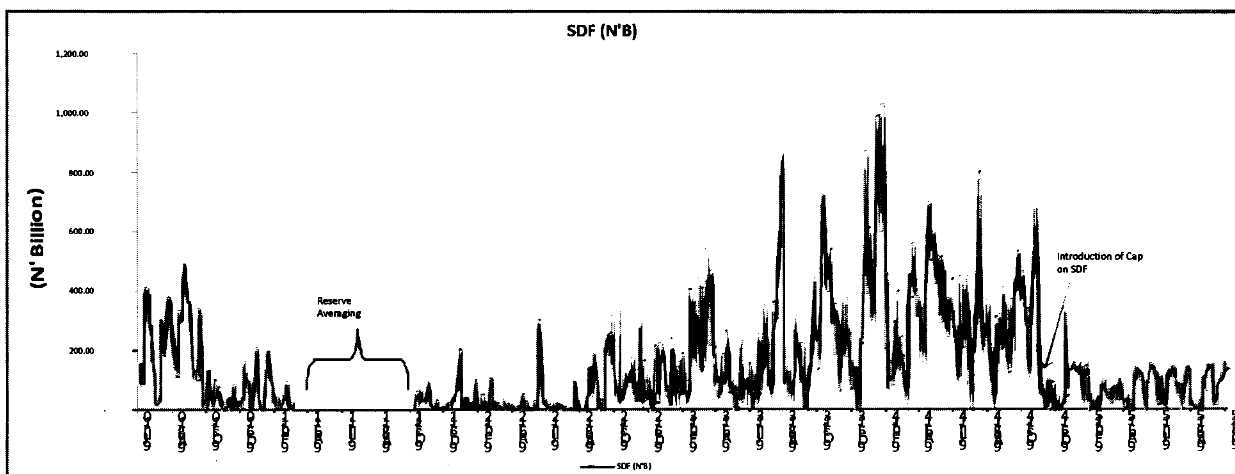
Figure 7: Monetary Policy Rate (MPR), Open Buy Back (OBB), Call Rate, Standing Lending Facility (SLF) and Standing Deposit Facility (SDF) from June 2010 – Oct. 2015



Furthermore, the liquidity surfeit in the banking system as well as its use by banks to attack the foreign exchange market posed serious threats to the effective management of exchange rate in Nigeria. To this end, the Bank held frequent open market operation (OMO) auctions to sustain monetary policy effectiveness, thereby, increasing the cost of liquidity management.

Also, it introduced a limit of the amount of remunerable SDF following observations that banks and discount houses preferred to keep funds at the SDF instead of lending such funds to the real sector. Consequently, the remunerable daily placement was pegged at N7.5 billion at the prevailing SDF rate. This was done to encourage the banks to increase lending to the productive sector and reduce the cost of managing liquidity. The fall out of this laudable action by the Bank was a drastic drop in the amount deposited at the SDF window.

Figure 8: Volume of Standing Deposit Facility (SDF) Transactions



The standing facilities were designed to encourage inter-bank trading, in order to deepen the money market, reduce or eliminate volatility of short-term over-night interest rates, as well as provide liquidity in the money market.

Nonetheless, with the introduction of the flexible foreign exchange management, the Bank has conducted series of forwards and swaps transactions, thereby, reducing the foreign exchange demand pressure. At the interbank foreign exchange market, the Bank's occasional interventions in the market through the two-way quote trading system to ensure a measure of liquidity to the foreign exchange market.. Other than this, there are the forward and futures markets that are traded on the Financial Markets Dealers Quote (FMDQ) platform. At the forwards market, the Bank has executed contracts worth US$5,902.3 million whereas it entered into the futures contract worth US$3,655.16 million, and all these measures have helped in reducing the foreign exchange demand pressure at the interbank window.

4.0 Policy Issues and Challenges of Foreign Exchange Management under the Current Economic Uncertainty.

Foreign exchange management is crucial for ensuring the stability of domestic currency vi-s-vis other currencies. Embedded in this, is exchange rate management that is a very important macroeconomic instrument that influences the level of economic activity in a country. For example, in an open economy, when the domestic currency appreciates against another currency, it makes the foreign goods imported into the country cheaper relative to those produced domestically. By so doing, it affects the domestic prices, interest rate and inflation rate. The impact of these instruments is transmitted to the rest of the economy through the monetary policy transmission mechanism and could be effective where there is clarity in the transmission process and a well-developed financial sector. Presently, the Bank is faced with the daunting challenges of managing foreign exchange in a mono-cultural economy, especially under current economic uncertainty with its attendant effects on the other macroeconomic instruments.

(i) Unconventional Monetary Policy

Presently, the Nigerian economy is faced with uncertainties that the monetary policy tools at the disposal of the Bank may not be able to address alone, hence the use of unconventional monetary policy. These uncertainties range from dwindling oil revenue, low accretion to the foreign reserve, removable and downgrading of Nigerian bonds from the JP Morgan Global Bond Index and Barclays index and lack of economic programme for the country. Also, the challenge of increasing inflation and retarding economy form the core of issues that reinforces economic uncertainties.

(ii) Ensuring Foreign Exchange Stability By Increasing Cost of Liquidity Management

The need to deliver on the mandate of monetary and price stability is at the core of central banking. Unlike in developed countries, central banks in the developing countries are often faced with liquidity surfeit that often requires Banks' intervention by mopping-up the excess liquidity in the banking system. In Nigeria, the banking system has been faced with excess liquidity since 2005 post-banking consolidation era, except for the period of the global financial and economic crises, and this has facilitated the industry's attack on the foreign exchange market.

Consequently, the Bank has continued the use of open markets operation (OMO) as part of measures to manage the excess banking system liquidity, thereby, minimizing the authorized dealers' ability to use the excess liquidity to attack the foreign exchange market. Nonetheless, such action leads to increasing cost of liquidity management that constitutes a burden on the Bank's balance sheet. To this end, it has become an issue as to what extent the Bank is willing to incur heavy costs in order to prevent the growing banking system liquidity from being used in attacking the

that its stability is consistent with the overall macroeconomic goals of the Bank. It establishes that economic uncertainty poses a challenge to both fiscal and monetary policy operations of government and this is more pronounced in the present situation. In particular, foreign exchange management has been very challenging, a situation compounded by dwindling resources and the inadequate diversification of the economy, which contributed to impeded the Bank's monetary policy capability.

Notwithstanding the recent developments in foreign exchange management, the Bank has developed initiatives that helped to reduce the persistent foreign exchange demand pressure at the interbank foreign exchange segment. No doubt, there are still policy challenges to overcome. To this end, there must be genuine commitment and strong will by the fiscal and monetary authorities to ensure a conscious buildup of fiscal buffers to shield the economy from wide swings of the current oil shocks as well as the need to ensure the diversification of the economic away from primary commodities to industrial base with value-added production which will enhance productivity and unlock employment potentials of the economy. Against this backdrop, the current coordination between fiscal and monetary authorities remains paramount and should be sustained.

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foreign exchange market.

(iii) Structure of the Economy

Foreign exchange management in a mono-cultural economy like Nigeria could be a rather herculean task for the authority. The Nigerian economy is not sufficiently diversified and this has adversely affected the country. The economy is largely mono-cultural and its foreign exchange receipts dominated by crude oil sales. To worsen the situation, the price of the crude oil sales is exogenously determined. This, however, poses a threat to monetary policy implementation through its effect on foreign reserves and monetary aggregates as well as exchange rate management.

In recognition of the need to diversify the economy and increase its foreign exchange earnings, the Bank initiated several intervention programmes aimed at making the real sector more productive and export-oriented. Some of these includes the provision of funds to small and medium scale enterprises (SMEs), power, aviation intervention funds (PAIF), agricultural credit guarantee scheme (ACGS), Nigeria electricity market stability facility (NEMSF), among others. Nevertheless, there is a limit to which the Bank can intervene in the economy without endangering its primary goal of ensuring monetary and price stability. In that regard, the government, through its fiscal actions has a greater role to play, while the Bank's developmental function should only be complementary.

(iv) Exchange Rate Stability

Stable foreign exchange rate is very crucial for monetary policy implementation and economic growth. Exchange rate volatility has implications for economic growth, owing to the risks of uncertainty it portends. Central banks are concerned with foreign exchange rate volatility; given that deviations of exchange rate from the market determined rate or the fixed rate could send wrong signals to the market, especially where the productive capacity of such economy is in doubt and its major export earnings driven by commodity price that could be subject to shocks. Under such circumstance, the monetary authority is compelled to apply some unconventional policy measures to ensure stability in the foreign exchange market.

(v) Globalized Economy

Economic globalization has its attendant challenges, especially on developing countries, given that markets most times undergo cycles of fluctuations and corrections. During periods of fluctuation, monetary authorities in developing countries are confronted with the daunting tasks of ensuring stability of their currency vis-a-vis other currencies as such economies suffer from capital flight. However, in periods of correction, monetary authorities are faced with the challenge of capital inflows that could lead to exchange rate appreciation, which in turn increases importation.

(vi) Market Expectations

Exchange rate is a significant predictor of inflation rate and output. In a volatile exchange rate environment, market expectations are often very high and driven by expectations of future rise in prices of goods and services that fuels inflationary pressures and worsens the exchange rate situation. Managing market expectations by the Bank is very crucial for restoring confidence in the market. Such could include forward-looking public communications and forecasts that would discourage public apprehensions.

5.0 Conclusion

The paper examines current developments in the management of foreign exchange by the Central Bank of Nigeria in the period of economic uncertainty. It explains how the Bank has implemented different regimes of foreign exchange in order to maintain the external value of its currency as well as ensure

them.

By the same token, disease is destabilizing and unhealthy population is detrimental to human capital development and the cultivation of requirement for the pursuit of innovations or technologies that drive growth. An economy raveling in huge burden of disease imposes huge cost and risk on the rest of the population, leading to less productivity. The challenges of poor health and poverty are not only daunting, but prohibitively resources intensive and ultimately impede growth and development. On the other hand, economic agents who are free of illness, disease and other health related challenges are able to pursue their economic activities or opportunities, and boost the economy's productive capacity. Thus, health issues are fundamental for a resilient and dynamic economy. "Poor health is more than a threat to any one country's economic viability; it is a threat to the economic and political interest of all countries." (Primarolo et al (2009)). In poor nations where low income is prevalent, high medical expenses can lead to debt and sale of assets. Short-term health issues can thus contribute to long-term poverty (Van Damme et al, 2004; Annear et al, 2007). As a result of the limited ability of these households to borrow, high-value care services are often compromised for low quality ones (Das et al 2008), which can lead to poor health outcomes.

Government intervention in healthcare is therefore imperative to ensure quality healthcare inclusion and equity in service delivery. This is premised on the need to eliminate, or at the least, minimize avoidable illness or death and improve national health conditions. This can be achieved by ensuring speedy and quality delivery of health care services, which unfortunately are usually expensive and unaffordable to the poor and marginalized.

Health insurance is often a mechanism available to gain access to expensive healthcare, and designed to protect against the financial risk and expenses associated with the heath service delivery. With insurance, the effective price of medical care is lower, as it is usually structured such that it reduces the consumers' price at the time they purchase medical care. However, most developing countries have only recently endeavored at adopting health insurance as a mechanism toward exploiting the opportunities it has to offer.

One key factor driving the demand for health insurance is an access to group insurance. Belonging to some groups—for example, being an employee of an establishment that offers health insurance benefit—increases the chance of having insurance coverage. This underpins why most health insurance is not sold to specific individuals or families, but to large groups. Phelps (1997) noted the advantages of the economies of scale and avoidance of adverse selection for preferred group health insurance over individual insurance. Group insurance allows for economies of scale since many of the costs of an insurance policy are nearly the same, irrespective of the number of people enrolled. The gains from the economies of scale are also considerable that it helps reduce the price of insurance. With group insurance, adverse selection—which arises because the people with particular health problems or higher susceptibility to be sick are more likely to buy health insurance—is avoided. Adverse selection risk is avoided by selling insurance to a group of people that exist for purposes other than buying insurance. For instance, the premium for the insurance policy on an employment group is calculated based on averages, for people having shared good and bad health risks.

In Nigeria, no universal healthcare coverage exists, while access to healthcare is very limited due to the inability to pay its services. As articulated in the UNICEF Report, "health, healthcare and general living conditions in Nigeria are poor, especially for children and women. Infant and under-five mortality rates are