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1995 Monetary policy- press briefing

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1995 MONETARY POLICY

PRESS BRIEFING

By Dr. Paul A. Ogwuma, OFR, Governor, Central Bank of Nigeria on the 1995 Monetary policy.

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It is my pleasure to address this maiden press conference, which is aimed at providing detailed elaboration on the policy thrust and modus operandi of the monetary and foreign exchange policy measures for 1995. Let me start by welcoming all of you to the Central Bank of Nigeria, (CBN), and also wishing you all a very Happy New Year. Before we proceed, allow me to take this opportunity to review the performance of the economy in 1994.

Economic Performance in 1994

As you are aware, economic performance in 1994 was generally unsatisfactory, despite Government's efforts to restore economic growth and price stability. The major policy objectives were to encourage the real productive sector and reduce the level of inflation, under a pegged exchange rate and interest rate regime. However, the economy hardly recorded any growth during the year largely because of foreign exchange constraints and protracted industrial unrest following the political disturbances that were witnessed in several cities in the Federation.

In the real productive sector, the aggregate index of agricultural production increased by 1.6 per cent, compared with 2.5 per cent in the preceding year. Similarly, the index of manufacturing production declined by 5.0 per cent in contrast to an increase of 2.3 per cent in 1993. As a result, the rate of capacity utilisation stood at barely 30.5 per cent, compare with 36.7 per cent in 1993.

Inflationary pressures also intensified in 1994. The major casual factors were the adjustment in the prices of petroleum products, and the persistent depreciation of the naira exchange rate in the parallel market. Overall, inflation rate stood at 70.0 per cent by end-December 1994, vis-a-vis 57.2 per cent during the corresponding period in 1993.

In the monetary sector, there was generally a moderation in monetary growth, despite the sharp increase in the banking system credit. Overall, narrow money (M1) increased by 12.1 per cent that was witnessed in 1993. Similarly, broad money stock (M2) increased by 16.1 per cent, vis-a-vis 34.4 per cent rate of growth in preceding year. The sharp fall in foreign and "other" assets (net) of the banking system, and the increase in quasi-money were factors that were responsible for the moderation in the rise in money supply, despite the surge in aggregate domestic credit, which stood at 36.6 per cent, against the target of 9.4 per cent.

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Net claims on Government increased by 19.8 per cent, compared to zero per cent target for the year, while credit to the private sector rose by 78.8 per cent - significantly higher than the targeted maximum of 32.6 per cent and 23.5 per cent that was recorded in 1993.

Indeed, the explosive growth in credit to the economy as a whole, largely reflected the unintended consequences of the pegged interest and exchange rate policy. In particular, private sector borrowers took advantage of the cheap bank credit to buy cheap foreign exchange.

In the external sector, the pressure on the balance of payments persisted throughout the year; with the overall deficit amounting to N27.3 billion, compared with N13.7 billion in 1993. Under the pro-rata system of forex allocation, 60.0 per cent of the forex sold in the FEM went to the manufacturing sector, 20 per cent to agriculture, and 10.0 per cent each, to invisible and finished goods sectors.

Objectives of Monetary Credit and Exchange Rate Policies in 1995

In general, monetary, credit and exchange rate policies in 1995 have been tailored to reverse the adverse trends of: low growth in domestic production, declining capacity utilisation, rising unemployment, exchange rate volatility, and persistent high inflation rate that the economy had witnessed in recent years.

Consequently, the general stance of monetary policy in 1995 will be restrictive, while appropriate policy measures will be adopted to realign and minimise distortions in relative price. In this connection, the specific objectives of the 195 monetary policy include:

(i) Significant reduction in the rate of inflation (to 15%),
(ii) achievement of a realistic and stable naira exchange rate regime,
(iii) reduction of pressures on the external sector, and
(iv) achievement of balance of payments viability.

Ladies and Gentlemen of the Press, let me emphasis that the centre-piece of the monetary policy in fiscal 1995, is the introduction of the policy of "guided deregulation" in the areas of exchange and interest rate management.

With respect to interest rate policy, a major challenge which faced the monetary authorities was how to formulate a policy which will enhance financial intermediation and at the same time induce rapid recovery in the real productive sector.

In the area of foreign exchange management, lessons of experience have clearly shown that the regime of fixed exchange rate that was pursued in 1994 did not achieve the intended policy objectives. Against this background therefore, the major policy goal for 1995 is "the deliberate build-up and strengthening of external reserves to enhance confidence in the Nigerian economy, strengthen the naira an pave the way for its ultimate convertibility".

As announced by the Head of State, there will be no bidding or allocation of forex at the CBN. With the exception of the Government, every company, individual or organisation shall source their forex requirements in the autonomous market–and the CBN shall hold the official forex and would use same, to intervene periodically in the autonomous market in order to ensure exchange rate stability and to strengthen the value of the naira.

With respect to interest rate policy, a major challenge which faced the monetary authorities was how to formulate a policy which will enhance financial intermediation and at the same time induce rapid recovery in the real productive sector. Against this background, commercial banks and other financial institutions under the new flexible arrangements, are now required to maintain a maximum spread of 71.2 per cent between their deposit and lending rate subject to a maximum lending rate of 21.0 per cent.

Finally, I wish to state that over the last few years, the nominal naira exchange rate had drifted away from its equilibrium path, driven by high inflation and unmitigated speculative activity. The 1995 policy regime now offers a unique opportunity to introduce a rescue package for the naira, intended to restore it initially to its equilibrium level an bring about its appreciation. In this connection, I wish to leave you in no doubt about the firm resolve and ability of the Central Bank to restore and defend the international value of the naira through a combination of demand management measures, supply side initiatives and supportive complimentary action.

I shall stop at this juncture to attend to any questions you may have.

Thank you for your kind attention.