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Keynote address at the policy seminar on the 2004 Federal Government Budget.

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KEYNOTE ADDRESS

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It is my honour and privilege to welcome you all to this year's Policy Seminar on the 2004 Federal Government Budget, jointly organized by the Central Bank of Nigeria (CBN), the National Centre for Economic Management and Administration (NCEMA) and the Nigerian Economic Society (NES). This seminar is the ninth in the series of the inter-agency collaborative effort, aimed at providing a forum for major stake-holders in the economy to critically analyse and evaluate the adequacy or otherwise of the current fiscal and monetary policy measures, in achieving the central objectives of the Federal Government.

As a background, the performance of the economy in 2003 is appraised in order to learn from the experience of the past year, which hopefully will guide the implementation of current year policies. It is expected that this year's seminar will also provide the opportunity for all stakeholders to discuss topical policy issues, such as the implications of the monetisation of public service fringe benefits, for the overall budgetary process and macroeconomic performance.

The overall performance of the economy in 2003 was mixed. Available data from the Federal Office of Statistics (FOS) revealed that the economy showed a strong growth performance during the year. The real gross domestic product (GDP), measured at 1990 constant basic prices, grew by an impressive 10.2 per cent, compared with the 3.5 per cent achieved in 2002. Both the oil and non-oil sectors contributed to the improved performance. Specifically, oil production, including condensates, grew by 23.9 per cent over the level a year earlier, while aggregate non-oil output rose by 4.5 per cent. The agricultural sector contributed substantially to the growth in non-oil GDP. Influenced by improved capacity utilization, and policy environment, the manufacturing sector also recorded a modest recovery.

The domestic inflation remained generally subdued during the first three quarters of 2003. The welcome development was, however, reversed in the last quarter of the year, culminating in the acceleration of the inflation rate to 14.0 per cent by December 2003, as against the single digit rate targeted and the 12.9 per cent recorded in 2002. The resurgence of inflation was attributable, largely to the excessive growth of aggregate demand, reinforced by the unintended impact of the deregulation of the downstream sector of the petroleum industry.

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The pressure on the external sector of the economy moderated considerably in 2003 as the overall balance of payments deficit narrowed from US$4.7 billion (N565.35 billion) or 10.3 per cent of GDP in 2002 to US$1.3 billion (N162.84 billion) or 2.2 per cent of GDP. The demand pressure in the foreign exchange market, however, intensified during the last quarter of the year, resulting in the depreciation of the naira exchange rate against the US dollar. Thus, the relative exchange rate stability that characterized the first three quarters of the year was reversed.

The problems of liquidity overhang in the banking system and depreciation of the naira posed serious challenges for monetary policy during the year. Notably, there was accelerated growth in monetary aggregates. Specifically, the broad measure of money supply (M_2) increased by 24.1 per cent which substantially exceeded the programmed target of 15.0 per cent for the year. To further enhance the effectiveness of monetary policy, the CBN increased the frequency of the open market operations (OMO) from bi-weekly to daily basis in November, 2003. The moderation in interest rates movements was sustained in 2003, as banks' deposit rates rose only marginally, while lending rates declined. This followed the downward adjustment in the minimum rediscount rate (MRR) by 150 basis points from 16.5 to 15.0 per cent, as well as the moral suasion by the CBN urging banks to reduce their lending rates to stimulate output growth. However, the structure of the banking system remained largely oligopolistic and continued to explain the wide spread between bank deposit and lending rates.

The 2004 budget represents a good starting point for the implementation of the Government's medium-term economic reform agenda, which aims at re-invigorating the Nigerian economy in order to return it to the path of sustainable growth, development and poverty reduction. The major assumptions underlying these laudable goals include targeting real GDP growth rate of 5 per cent, containment of the inflation rate to between 10 and 11 per cent of N136.00 to the US dollar. The task facing participants at this seminar is to determine the extent to which 2004 budgetary policies could help to achieve the set objectives. The CBN is encouraged that revenue projection is based on $25.00 per barrel, and the fact that the Federal Government deficit level would be considerably reduced to N181 billion or 2.1 per cent of GDP. More importantly, there will be no recourse to Central Bank financing. Our tentative assessment, therefore, is that the fiscal objectives outlined are achievable, if necessary financial discipline could be exercised by all tiers of government.

However, recognizing the good prospect of continued strong oil sector performance and enhanced revenue flow, the risks to revert to the old habit of spending all excess crude oil receipts is high but must be resisted. In this regard, the mechanism for sterilizing excess proceeds from crude oil exports should be put in place and faithfully implemented. This would help the CBN to meet its monetary and credit targets and obviate the need for monetary tightening and a hike in interest rates.

Consistent with the objectives of achieving price and exchange rate stability, the CBN will in fiscal 2004, sustain efforts aimed at containing the growth in monetary aggregates at levels consistent with the GDP growth and inflation targets. Against the backdrop of the need to curtail the persistent liquidity overhang in the banking system and high demand pressure in the foreign exchange market, the stance of monetary policy in 2004 would be non-accommodating. Moreover, the coordination and harmonization of monetary and fiscal policies will be given top priority.

The conduct of monetary policy will continue to rely on market-based techniques, with OMO as the primary instrument of liquidity management. It would be supported by cash reserve requirements and discount window operations to enhance its effectiveness. Interest rates will also continue to be market-determined, while the CBN's minimum rediscount rate (MRR) will be adjusted as the need arises to indicate the desired direction and level of interest rate changes.

Let me re-emphasize that the challenge facing the monetary authorities in ensuring macroeconomic stability in 2004 is daunting, given the continued liquidity overhang in the banking system and the risk of excessive injection of liquidity into the system arising from the monetization of crude oil receipts by the three tiers of Government. In this regard, we urge that the excess crude oil receipts over the budget benchmark of $25 per barrel be saved for future use. This important element of the fiscal rule should be observed in the national interest.

I wish to assure you that the CBN will continue to dialogue with key stakeholders in the effort to enhance transparency and accountability in the conduct of monetary policy. Thus, the CBN will, keep the public well informed of its monetary policy stance, goals and outcomes through regular press releases of key decisions of the Monetary Policy Committee.

Let me conclude by assuring all participants that due consideration will be given to the views and recommendations that will emerge from this seminar in the implementation of the policies outlined in the budget.