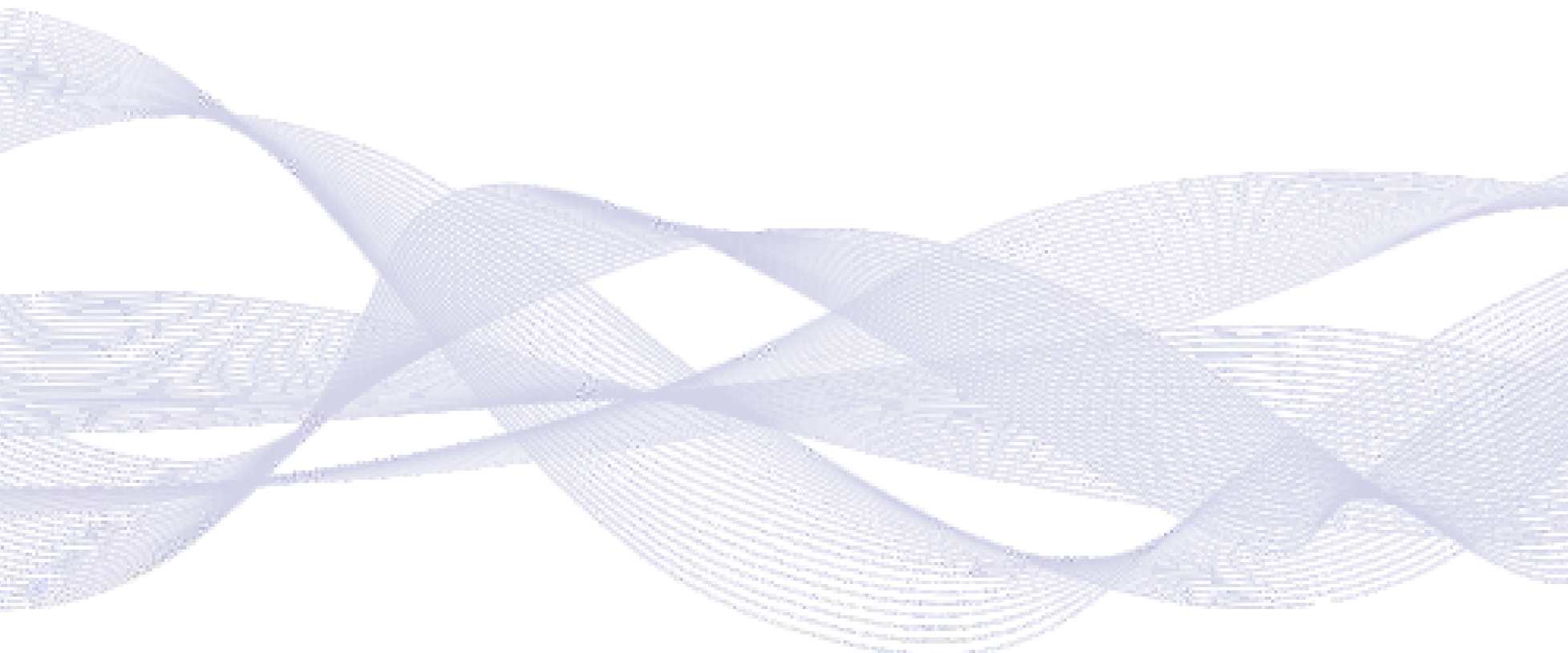
CENTRAL BANK OF NIGERIA

Monetary Policy Department

MONETARY POLICY AT A GLANCE



Monetary Policy at a Glance

Monetary policy at a glance explains selected monetary and financial policy concepts in a simplified, graphic and reader friendly manner. The concepts are carefully selected based on relevance to monetary policy, financial economics and usefulness to the target audience. To this end, the publication will be highly beneficial to public policy makers, policy analysts, professionals, students and all who have a desire to understand basic monetary and financial policy concepts. The series complements the efforts of the central bank of Nigeria at promoting economic and financial literacy as well as improving monetary policy communication.

I, therefore, invite everyone to get at least a copy for private and institutional libraries.

Mrs. Sarah O. Alade (PhD)
Deputy Governor, Economic Policy,
Central Bank of Nigeria.

Acknowledgments

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We regret and take responsibility for any errors observed in the book

Moses k. Tule
Director, Monetary Policy
Central Bank of Nigeria
March 2017

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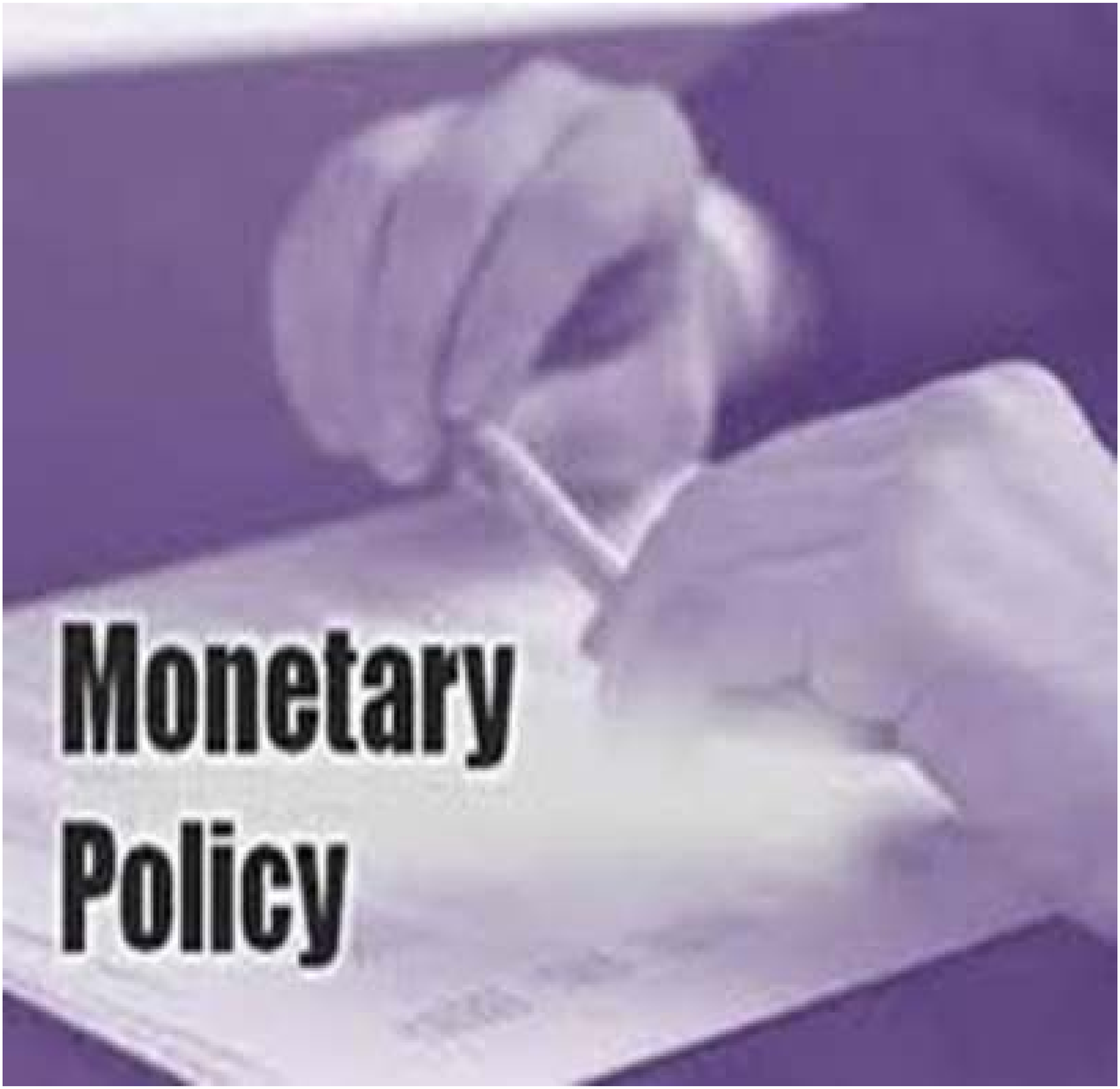
Monetary Policy Concepts in the Series

Concepts

MONETARY POLICY AT A GLANCE

Monetary Policy

This involves the measures through which the central bank manages the supply of money, in order to stabilize prices. Though the primary objective of monetary policy is the attainment of low and stable inflation, the central bank also has the added mandate to promote economic growth and employment. In practice, monetary policy plays a counterbalancing role to address price stability concerns and stabilize the economy. During a period of high inflation, contractionary monetary policy is used to reduce the amount of money in circulation while expansionary monetary policy is used when economic conditions are weak. Depending on the level of financial development of a country, monetary policy is usually implemented through the banking system and financial markets. Implementing monetary policy involves interactions between the monetary authorities and financial intermediaries, using tools of monetary policy including reserve requirements, open market operations, and the policy rate, amongst others. Various frameworks of monetary policy have been used including monetary targeting, exchange rate targeting and inflation targeting, etc. In recent times, unconventional (non-standard) monetary policy has been implemented to address substantial economic meltdown due to adverse global financial conditions.


Monetary
Policy

Mandate of the Central Bank of Nigeria

The primary mandate of the Central Bank of Nigeria (CBN) is promotion of price stability as enshrined in section 2(a) of the CBN Act 2007. Price stability is a major monetary policy objective that enhances predictability of domestic prices, a key requirement for sound consumer decisions. In fulfilling its primary mandate, the Bank has over time used a number of monetary policy frameworks, ranging from exchange rate targeting (at the introduction of the Nigerian currency) to the current monetary targeting framework, which effectively comprises strategies for targeting growth in the monetary aggregates. The basic features of the monetary targeting framework include the ultimate objective that is set for the central bank i.e. low inflation and stable exchange rate; the intermediate policy target; the operating target(s); and the institutional framework for the conduct of monetary policy.

In recent times, however, debates have gained momentum regarding the need to expand the primary mandate of the Bank to include low unemployment. This is against the backdrop of the unabated rise in unemployment, especially amongst the youths as well as successive governments' investment in job creation in response to rising unemployment. To match these fiscal commitments, it is suggested that the monetary authorities should in addition to price stability, also prioritize employment, in order to reduce the national unemployment rate.

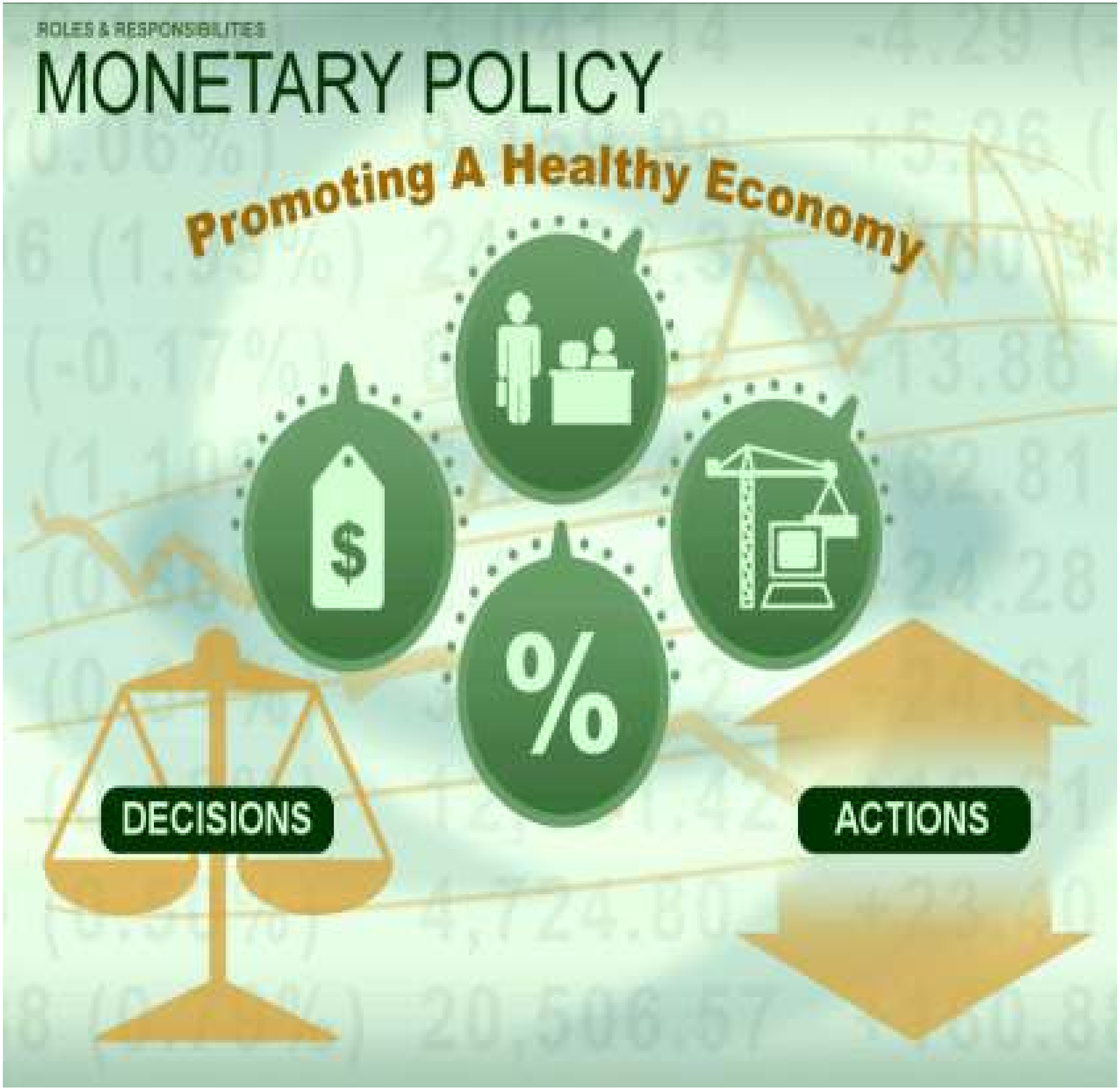
Our Mandate

Monetary Policy Objectives

The CBN Act 1958 and its subsequent amendments which established the Bank also stipulate the Bank's monetary policy objectives. According to the Act, "The principal objects of the Bank shall be to:

- Ensure monetary and price stability;
- Maintain external reserves to safeguard the international value of the legal tender currency;
- Issue legal tender currency in Nigeria;
- Promote a sound financial system in Nigeria; and
- Act as banker and provide economic and financial advice to the Federal Government.

The Bank's monetary, credit, foreign trade and exchange rate policy and the Monetary Policy Committee (MPC) decisions always focus on achieving the monetary policy objectives. Accordingly, the MPC is statutorily charged with responsibility for the conduct of monetary policy in Nigeria. The Committee formulates and monitors implementation of monetary policy to achieve the monetary policy objectives.


ROLES & RESPONSIBILITIES
MONETARY POLICY
Promoting A Healthy Economy
$
%
DECISIONS
ACTIONS

Discretionary Monetary Policy

Discretionary monetary policy are deliberate actions taken by the monetary authority to influence money supply in the system with a view to achieving its mandates. In particular, the central bank adopts measures, including adjusting target interest rates, bank reserve limits and money supply. These actions, are aimed at achieving the monetary authorities' mandates such as ensuring price stability, along with stimulating growth, maintaining international value of local currency, ensuring high employment, to name a few.

Discretionary monetary policy is widely used by independent central banks globally. A key advantage of discretionary monetary policy is the flexibility that it offers to policy makers to provide quick responses to emerging developments. This, however, raises concerns about the direction of monetary policy which can lead to non-credible and ineffective monetary policy as well as macroeconomic uncertainty.

Direct Monetary Policy

Direct Monetary Policy involves the use of quantitative monetary controls such as credit ceilings, credit rationing and statutory liquidity ratios, to control the amount of money in circulation. It also refers to the direct relationship between the monetary policy instrument and the policy objective. The direct monetary policy instruments are used to set or limit prices and/or quantity variables such as interest rates and the sectoral allocation of credit. The use of direct methods has appealed to policy makers for reasons that include

- the perception that they can be relied upon to control both the cost and distribution of credit.
- Second, they may provide relatively easy means of implementing monetary policy. Importantly, such direct monetary controls are quite attractive to governments that seek to channel credit into sectors to fulfill stated economic objectives.

This mode of monetary policy implementation is usually applied in an economy where the financial system is still rudimentary and the transmission mechanism weak, predominantly in developing economies. Indeed, direct monetary controls provide a temporary but only option for such economies until appropriate institutions for use of indirect instruments are established. The major challenge to implementation of direct monetary policy, however, is the risk of inefficiency in resource allocation, with attendant huge costs. Also, it has been posited that direct instruments may lose the capacity to produce significant impact because economic agents usually devise ways to circumvent such instrument. The CBN adopted and implemented direct monetary policy from inception until 1992.

Indirect Monetary Policy

Indirect monetary policy involves the use of market based instruments such as open market operations for the implementation of monetary policy. In other words, it involves influencing the money market conditions by the central bank. The adoption of indirect instruments of monetary control became more wide spread in the late 1970s, when industrialized countries began to migrate towards the introduction of market mechanism for monetary policy implementation. Indeed, the adoption of indirect monetary policy instruments indicates the transition towards an enhanced role for price signals as a major indicator in the economy. In addition, the increasing adoption of indirect instruments in most economies serve to complement the growing wave of current account convertibility amongst countries. Increasing openness and subscription to market principles has made direct instruments increasingly ineffective.


DIRECT
INDIRECT

Ultimate Target

Ultimate target is the foremost objective of the central bank's monetary policy. For most central banks, including the CBN, the ultimate objective is the attainment of price stability and sustainable economic growth. Other underlying objectives are full employment, stable exchange and long term interest rates. For inflation targeting countries, the monetary authority sets an explicit inflation target and makes use of various instruments in the bid to achieve this goal. When the ultimate target of price stability is achieved, monetary policy is deemed to be effective. To this end, monetary authorities adopt certain measures, including adjusting target interest rates, bank reserve limits and money supply. Further, in pursuit of the ultimate objective, the central bank utilizes its operational target (unborrowed reserves), to influence the intermediate target (broad money) which eventually affects the ultimate or policy targets (inflation and output). In setting its targets, the CBN also considers an information set on key economic indicators that have some impact on monetary policy and this is fed into the monetary policy decision process.

Intermediate Target

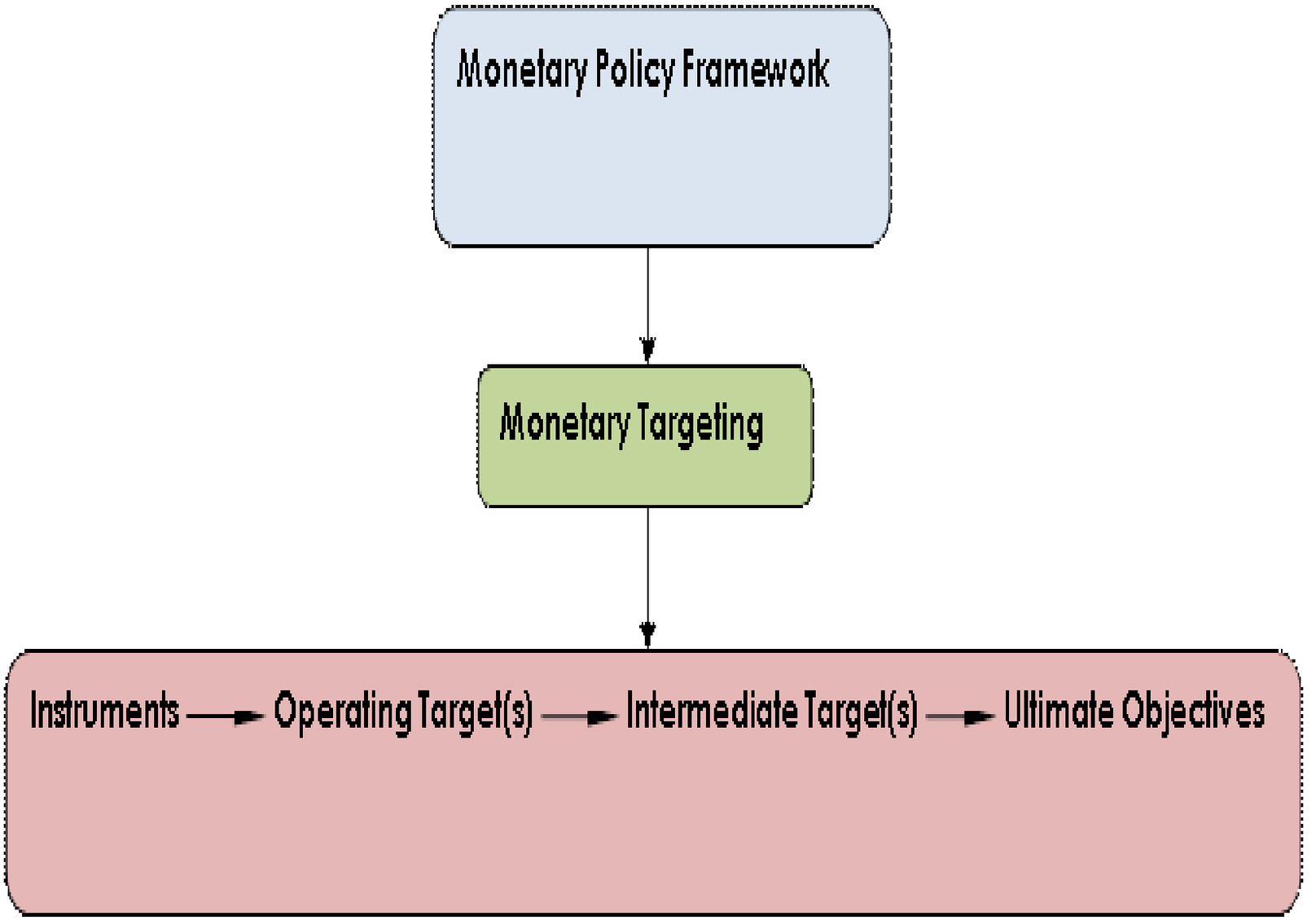
Intermediate Targets are set by central banks as part of their monetary policy goals. Central banks may chose any economic variable that best suits the objective of policy and the specific economic environment. The Central Bank of Nigeria's monetary policy targets are classified as; operational targets, the intermediate targets and the ultimate targets. Instruments used for monetary policy intermediate targets are interest rates, monetary, aggregates, and exchange rates. These targets are expected to be achieved with ease and measured without difficulty. The Bank adjusts the operating target (reserve money) over which it has substantial control to influence the intermediate target (broad money supply, M2) and in turn, the ultimate goal of price, stability, conducive to economic growth .

Monetary Policy Targets

The major objectives of monetary policy in Nigeria include price stability and sustainable economic growth. Other underlying objectives are full employment, stable exchange and long term interest rates. Achieving these objectives necessitates the setting of operating, intermediate and final targets by the CBN under the monetary targeting framework.

The key targets of the monetary targeting framework are: broad money (M2), which is the intermediate target; reserve money, which is the operating target, and final targets; - inflation and output stabilization.

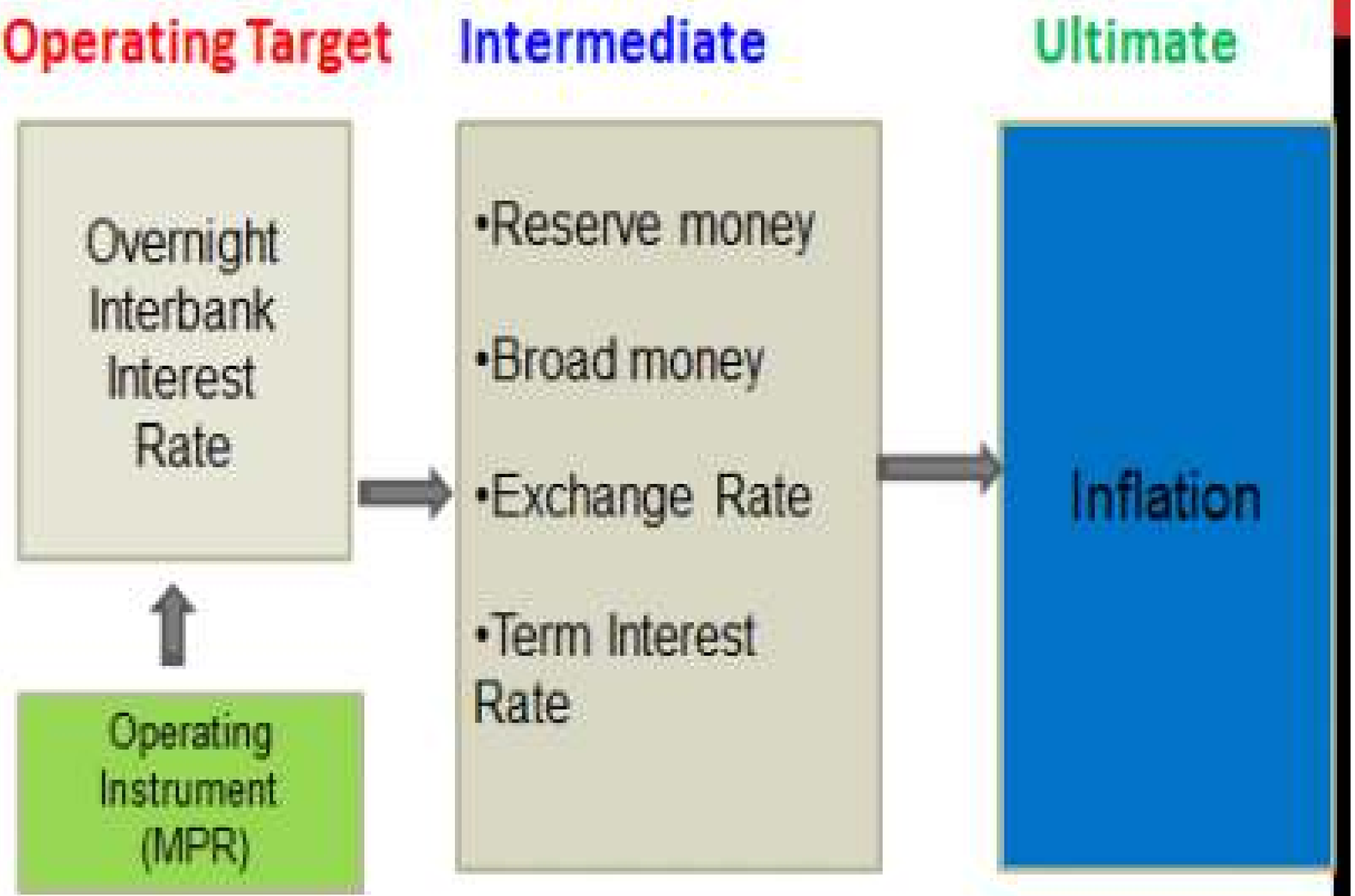
Setting intermediate and operating targets by the CBN requires determining an optimal level of money supply that is consistent with the predetermined ultimate target.


Monetary Policy Framework
Monetary Targeting
Instruments
Operating Target(s)
Intermediate Target(s)
Ultimate Objectives

Operating Target

Operating Target is usually an economic variable that is within the control of the central bank, that is used to influence other variables or monetary aggregates on a daily bases. Decisions of monetary policy meetings of central banks set the current level of the operating target with the view to adjusting monetary operations to maintain the target at the specified level. The operating target, in addition to providing guidance to monetary policy implementation, also provides clear communication of the monetary policy stance, to the public. The use of the operating target usually assumes that the financial market, specifically the money market, operates smoothly in order to guarantee the efficient transmission of policy impulses. This means that the money market should be liquid and robust. Also more importantly, monetary operations should ensure that money market conditions remain in line with the monetary policy stance. This ensures that the operating instrument is both relevant and potent.

MONETARY POLICY FRAMEWORK



Intermediate Target

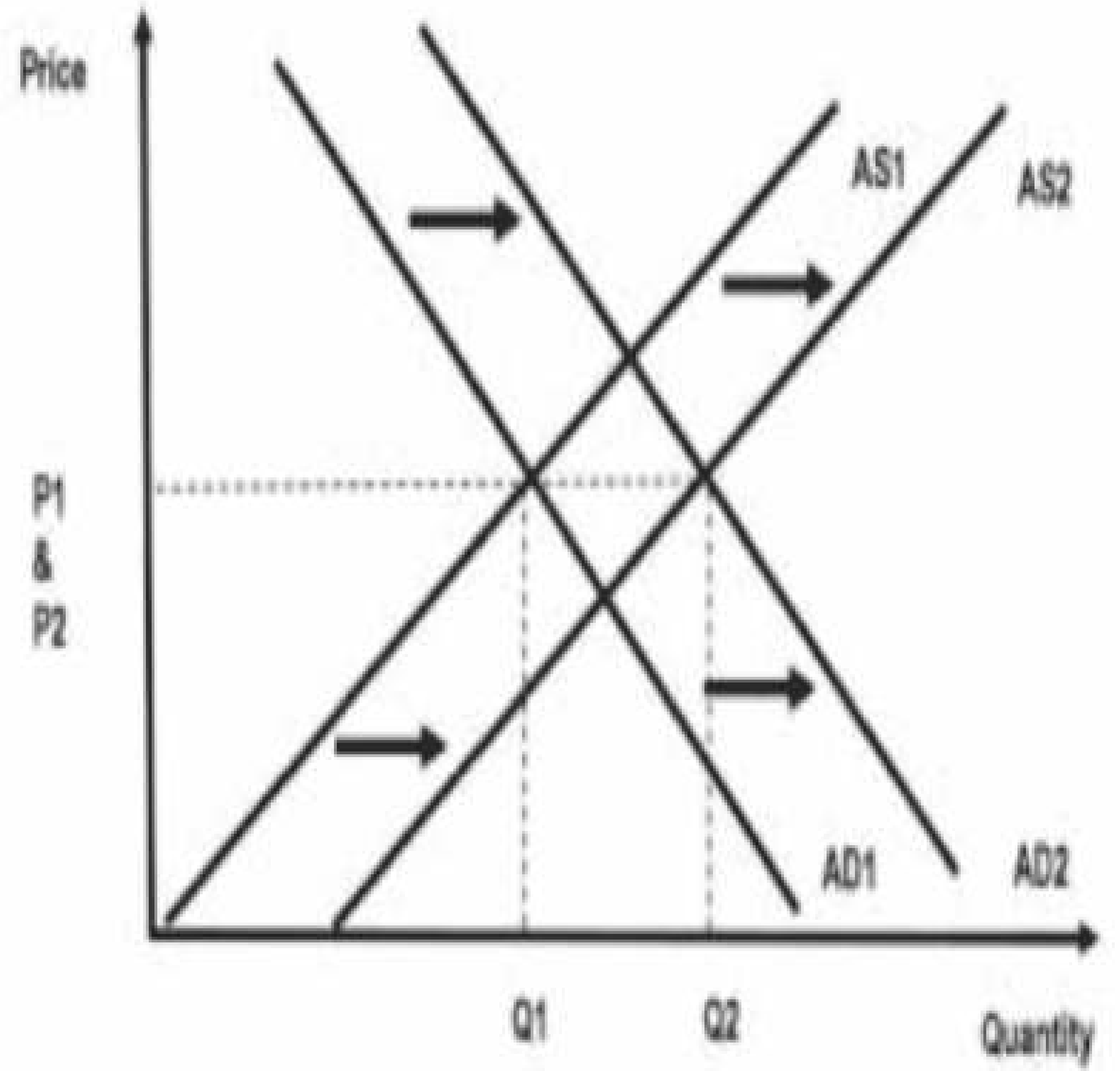
Intermediate Target is an economic variable that may not be under the direct control of the central bank but can be used to influence the monetary aggregates in the implementation framework. An intermediate target(s) is usually expected to be predictable to the monetary authority and adjusts easily to policy impulses. It is also expected to have a predictable relationship with the goals of monetary policy. It, is therefore, an important intermediary between the tools used for the implementation of monetary policy and the anticipated goals of price stability and economic growth. A notable example of an intermediate target is money supply, which various monetary operations are applied to produce the desired impact on inflation. A basic rule in the use of intermediate targets is that quantity and price variables cannot be used simultaneously. Rather, one is used to influence the other – money supply may be used to influence the interest rate or vice versa. However, the intermediate target is typically a monetary aggregate. The use of Intermediate targets has decreased in recent times but are considered to hold quite valuable information for monetary policy implementation by a central bank.

Price Stability

Price stability in an economy means that the general price level does not change much over time. In other words, prices neither goes up or down; there is no significant degree of inflation or deflation. Stable prices influence all other segments of the economy. When prices are stable, investor confidence is sustained, arbitrary distribution of wealth is curtailed, purchasing power of the currency is sustained among others. It is a desirable economic condition and fosters the effectiveness of other economic policies. Achieving stable prices, which is a primary objective of most central banks, involves a resolute commitment by the monetary authority to conduct monetary policy in a systematic manner that ensures inflation remains low and stable. To this end, the monetary authority takes decisions on interest rates and the supply of money in an economy which is intended to control the level of liquidity in the system.

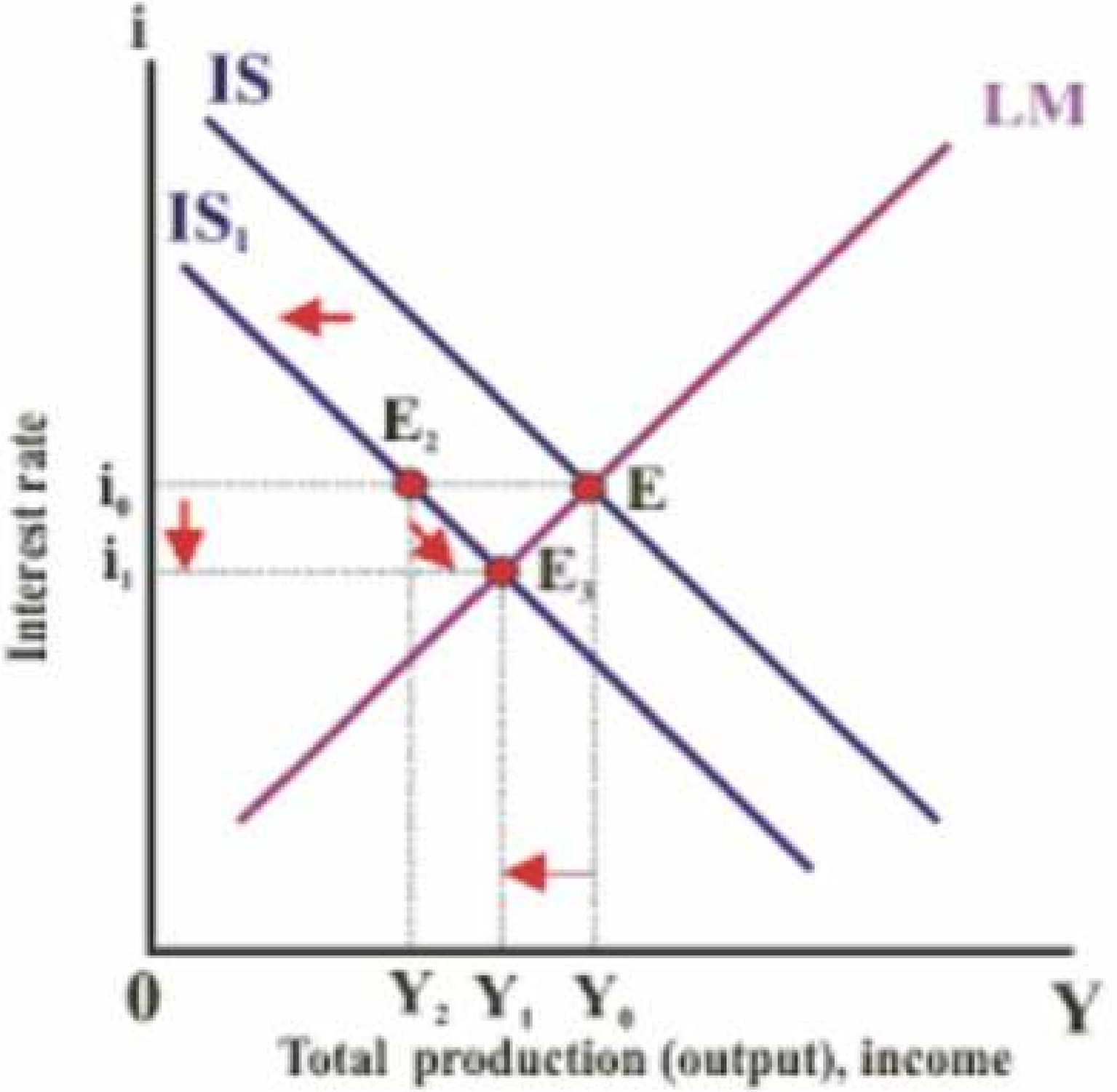
Expansionary Monetary Policy

This involves monetary decisions and actions taken by a central bank to increase the level of money supply in order to boost aggregate demand and support economic activities. Also termed 'loose' monetary policy, it is implemented by either a reduction in the policy rate or by a reduction in statutory reserves and/or open market purchases of eligible securities from counterparties (usually deposit money banks). The impact of an expansionary monetary policy works through various channels; lower interest rate precipitates increased money supply leading to increases in bonds' prices and reduction in bonds' interest rate, etc. The use of any of these tools is expected to boost GDP growth. It is especially used to mitigate adverse impact of an economic slump or recession. For a forward looking monetary policy, forecast of recession or decline in economic growth can trigger the implementation of an expansionary monetary policy stance by the central bank, to ward off the anticipated decline.


Price
AS1
AS2
P1
&
P2
AD1
AD2
Q1
Q2
Quantity

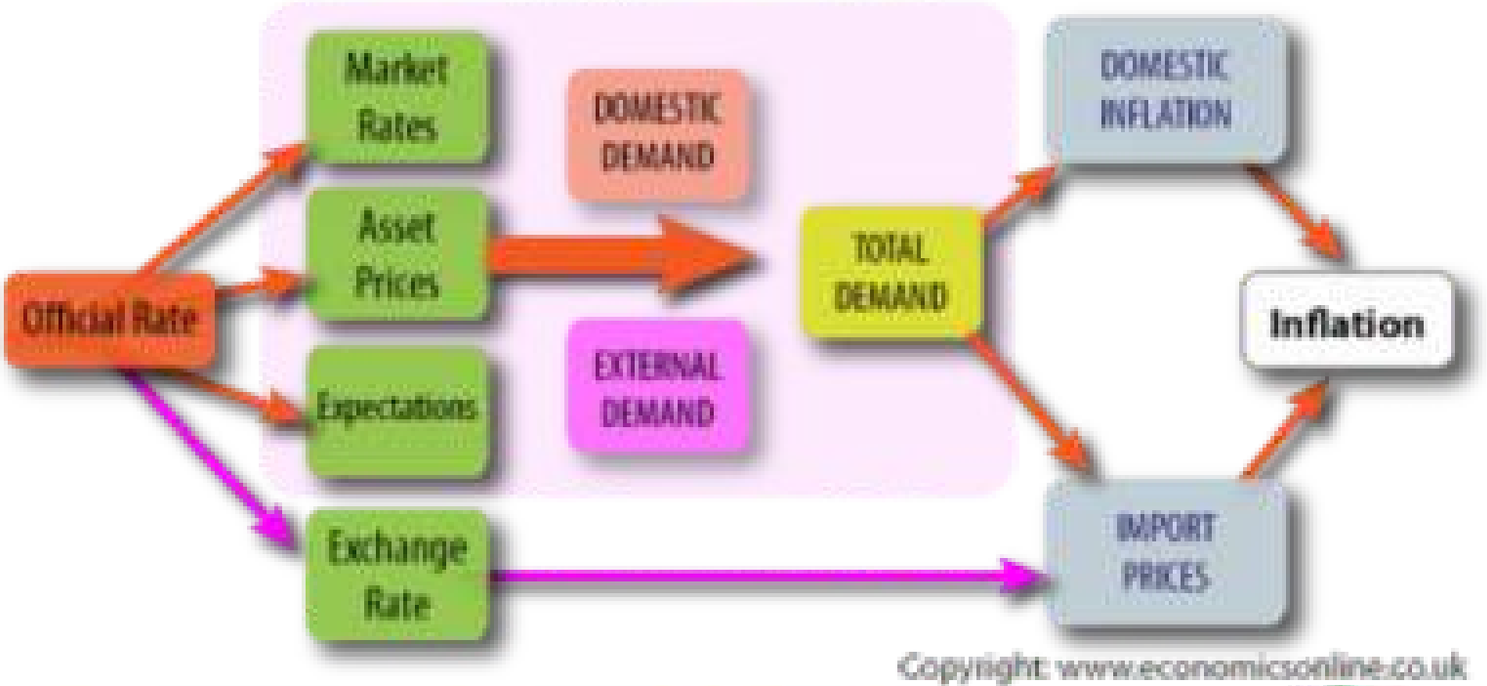
Contractionary Monetary Policy

This is deployed by a central bank to reduce the supply of money in an economy, by raising interest rates to curtail inflationary pressures. The implementation of contractionary monetary policy is usually intended to slow down an overheating economy and reduce inflationary pressures. It is always important for the monetary authority to ensure that the economy does not slide into recession in the process of implementing its policy measures. Contractionary monetary policy is implemented by either an increase in the policy rate (usually the first course of action that also signals the stance of monetary policy), or by an increase in statutory reserves and/or open market sale of eligible securities to counterparties (usually deposit money banks).


i
IS
LM
IS1
E2
E
E1
i0
i1
Interest rate
0
Y2 Y1 Y0
Y
Total production (output), income

Transmission Mechanism of Monetary Policy

This is a set of channels through which monetary policy influences the real economy, particularly output and inflation. In other words, it is a process through which changes in money supply or other monetary aggregates pass through some intermediate variables to affect prices (interest, exchange and inflation rates), output/employment and external balance. Traditionally it can be viewed as the linkage between monetary policy and aggregate demand. When the central bank makes changes to the interest rate, there are channels through which the change transmits to the real sector of the economy. Understanding the transmission mechanism provides great insight into the conduct of monetary policy.



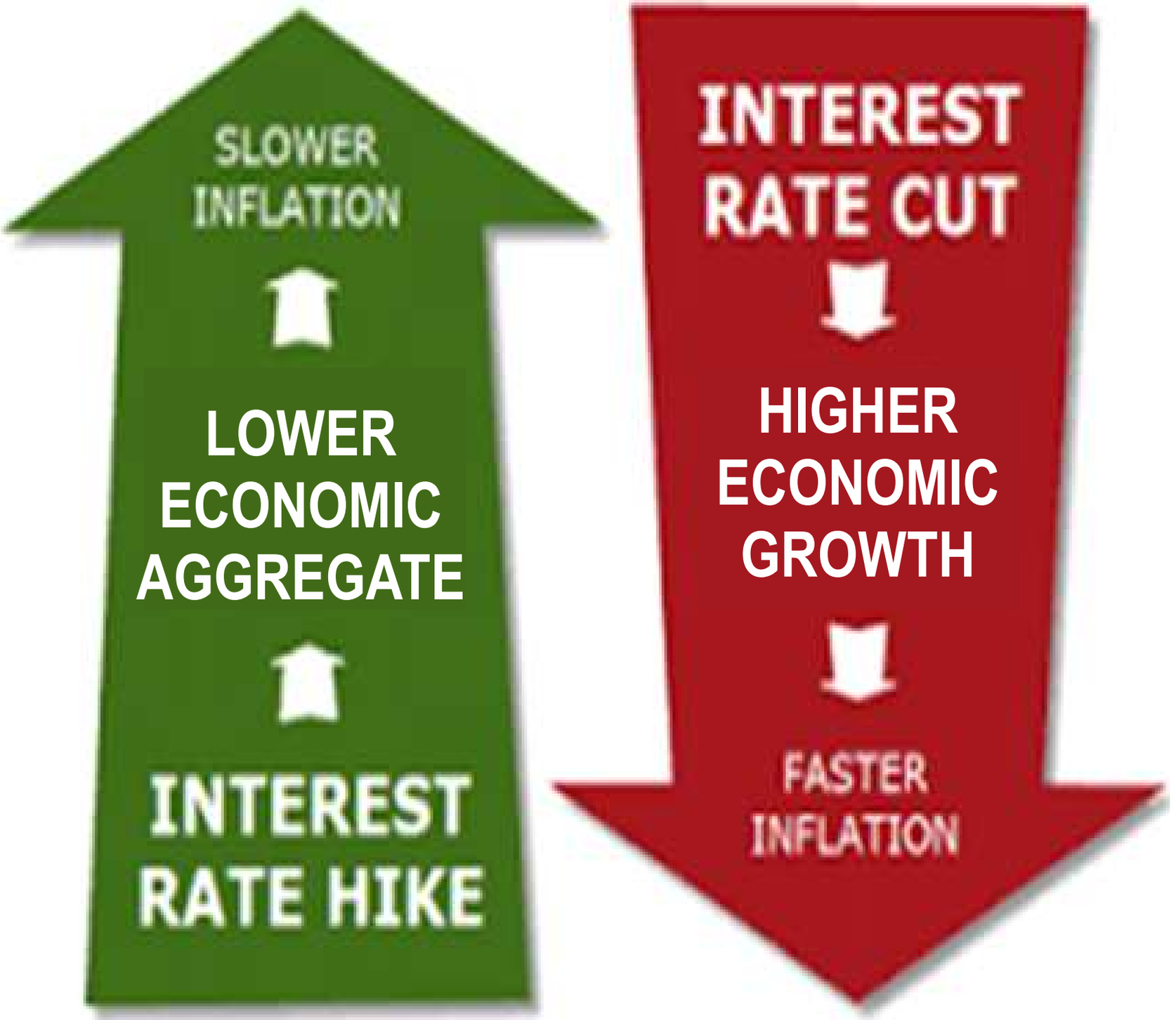
The Transmission Mechanism of Monetary Policy

Exchange rate Channel

The Exchange Rate Channel arises when the exchange rate become the intermediate policy variable for transmission of monetary policy impulses. In Nigeria, the exchange rate channel has received heightened prominence in the implementation of monetary policy, largely due to enormous dependence on the external sector for trade and capital. In this sense, policy actions that lead to either an appreciation or depreciation of the exchange rate feed directly into domestic prices, through trade.

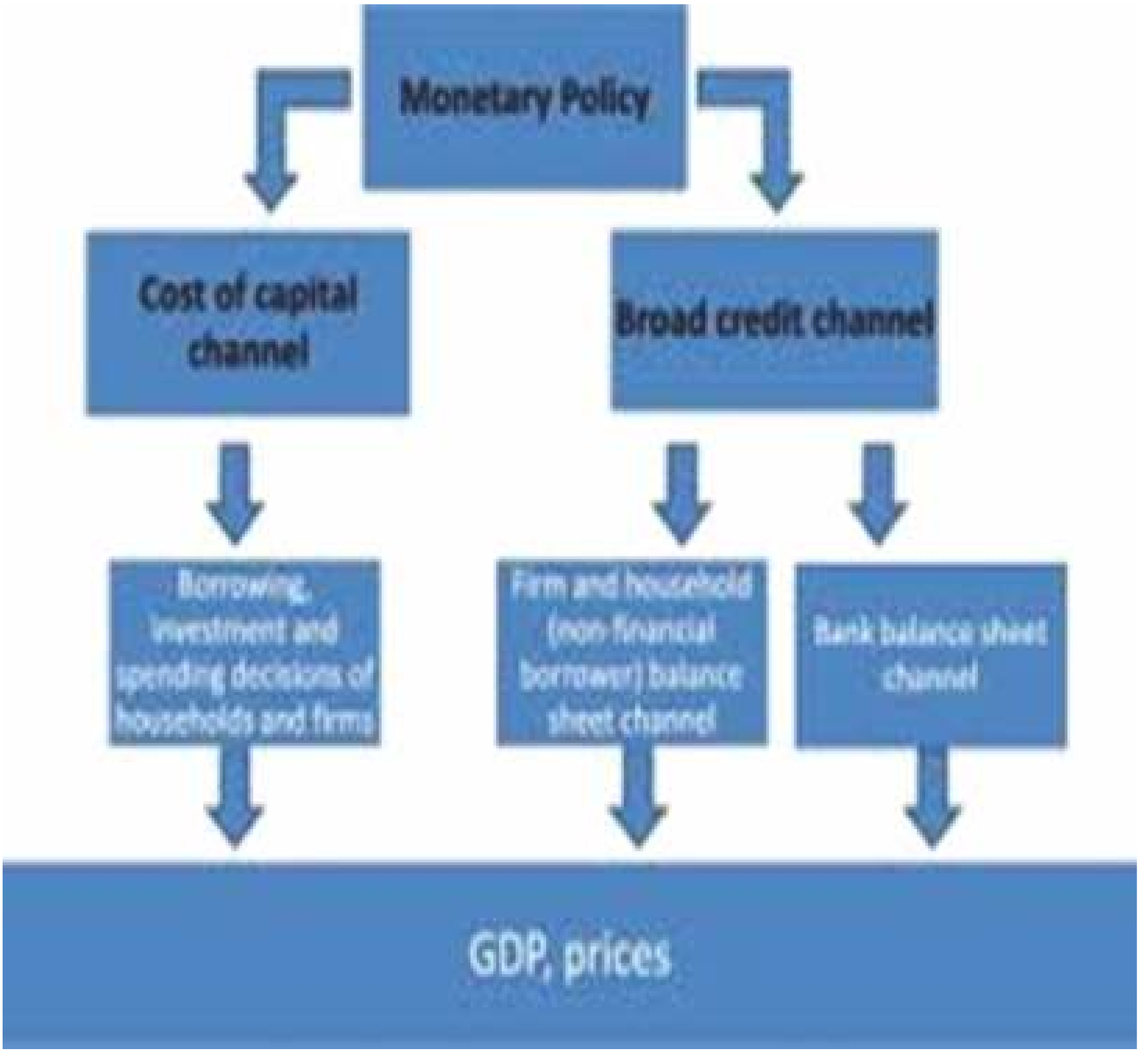
Interest Rate Channel

The Interest Rate Channel is a monetary policy transmission mechanism channel where by changes to the policy are propagated through interest rates to inflation. A brief narration of the mechanics of the interest rate channel shows that the overall impact on the economy is reflected in long-term interest rates that commercial banks charge their customers while the stimulus emanates from the controls of a central bank over short-term nominal interest rates. Simply put, an increase in the nominal short term interest rate produces an increase in the nominal longer term rate. It is, essentially, an outlet that reflects the reactions of investors to monetary policy decisions, with respect to the short and long term interest rates. It is a direct link of impact for monetary policy in bank-based economies, like Nigeria. The interest rate channel is adduced to produce quick changes on commercial rates but possess lags on such changes to expenditure and savings decision of consumers, and ultimately on overall output.


SLOWER INFLATION
LOWER ECONOMIC AGGREGATE
INTEREST RATE HIKE
INTEREST RATE CUT
HIGHER ECONOMIC GROWTH
FASTER INFLATION

Credit Channel

The Credit Channel describes the transmission of changes in the nominal policy rate that affects the amount of credit made available to end users by banks and the subsequent impact on the economy. the credit channel is based on the premise that bank loans are a primary source of funding for productive economic activities, and that there is no perfect substitute for this kind of credit. It also posits that the central bank is in a position to constrain bank's ability to lend, and there exists bank dependent businesses that are unable to substitute credit from other financing sources.


Monetary Policy
Cost of capital channel
Broad credit channel
Borrowing, investment and spending decisions of households and firms
Firm and household (non financial borrower) balance sheet channel
Bank balance sheet channel
GDP, prices

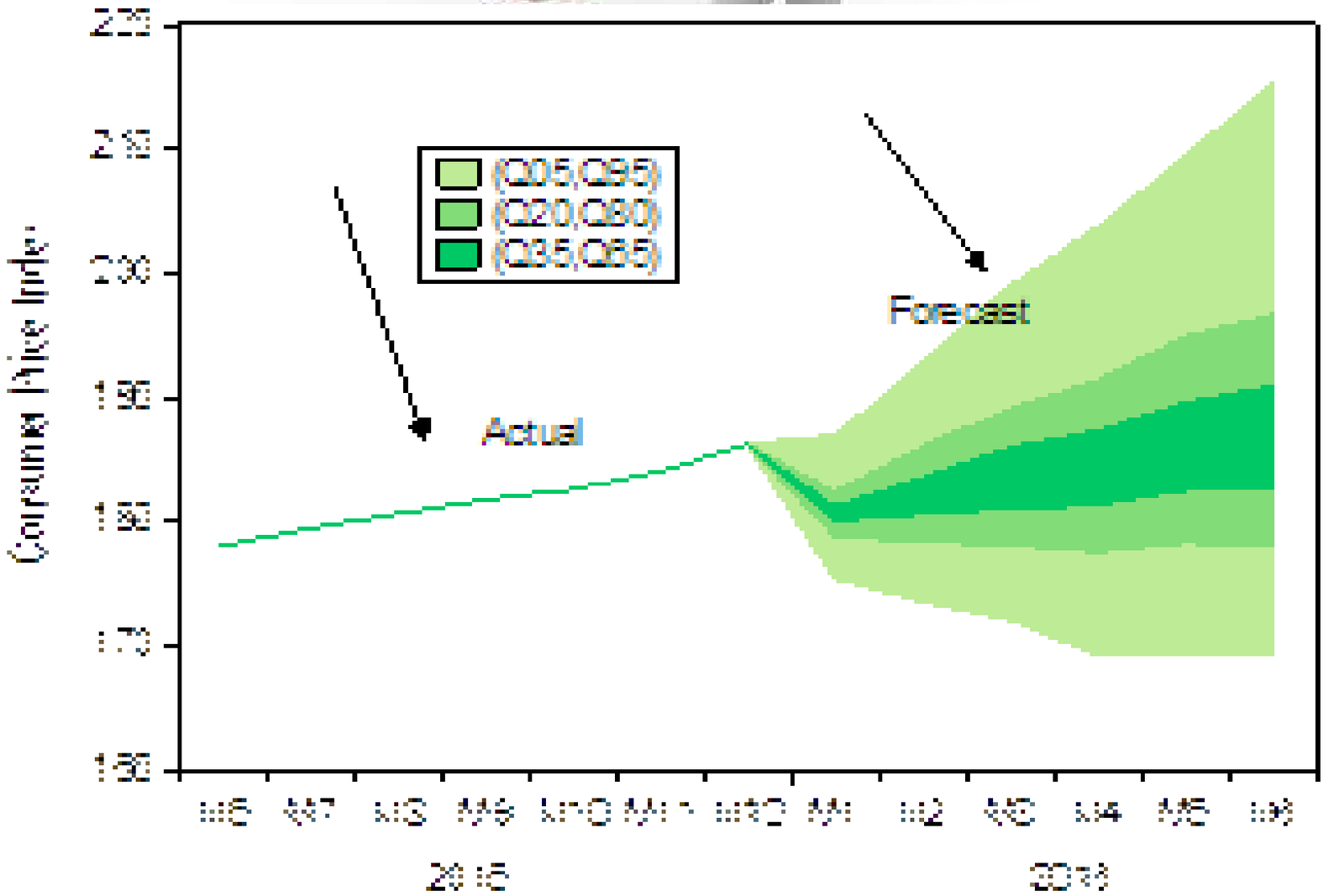
Asset Price Channel

The Asset Price Channel is a line of the monetary transmission mechanism which reflects the reactions of financial market participants to monetary policy decisions, by switching among asset classes such as stock, currency and real estate. It is the channel for the distribution of the effects induced by monetary policy decisions of the central bank. Even though influencing asset prices are usually not the goal of monetary policy, they possess a significant channel that inevitably transmit policy impulses even to unanticipated quarters. The asset price channel is, however, playing a prominent role in economies that have a high percentage of the population that invest in assets. In this scenario, the impact of monetary policy is felt on the pass through from interest rate to the valuation of assets (equities). the importance of this channel in the conduct of monetary policy is reflected in the premise that price stability also ensures asset price stability, as it reduces risks and consequent expectations, thereby lessening speculation. This makes the attainment of price and financial stability to be mutually supportive.


DXY
Prev 94.150
Lo 94.117
Compare
Actions
Edit
Line Chart
Last Price
2015
2016

Forward Looking Monetary Policy

Forward-looking monetary policy refers to the monetary policy that is characteristically focused on the future while considering the current policy environment. Most central banks depending on the peculiar nature of their economies and concomitant challenges of their economies, adopt forward-looking monetary policy frameworks in order to stabilize their economies. An example of a forward-looking monetary framework is the inflation targeting framework which explicitly combines an inflation target with an obligation to use inflation forecasts. However, these forward-looking monetary policy frameworks cannot succeed without legal backing, to ensure the independence of the central bank.


Consumer Price Index
(Q05,Q95)
(Q20,Q80)
(Q35,Q65)
Actual
Forecast

Monetary Policy Transparency

Literally speaking, transparency means honesty and openness in the conduct of a business. Therefore, in the context of conducting monetary policy, this refers to the commitment of monetary authorities to be open and honest in the conduct of monetary policy. Hence, indicators that provide the basis for monetary policy actions must be properly communicated to the market and the general public as this is key to engendering public trust. It can also aid private sector players to plan and minimize uncertainty about central banks' preferences. Since monetary policy is forward looking, monetary policy communications should cover both the current and the future path. This may take the form of policy circulars, speeches, website communication, and media briefings etc. A transparent monetary policy in which the monetary authorities clearly communicates what they are doing, why they are doing it and how they are doing it helps to eliminate distortions.


Guardian TV
NIGERIA MPC
CBN GOVERNOR GODWIN EMEFIELE SET TO ANNOUNCE MPC DECISIONS
NIGERIA
MPC


Monetary Policy
96
97
98
99

Rule-based Monetary Policy

This is a principle that specifies how a central bank should respond to changes in variables of interest such as inflation. The rationale behind applying rules to monetary policy is that it allows the central bank to focus on other functions while providing direction for the economy. It also means that the rule is followed irrespective and independent of economic conditions. It is widely expected that such rule based monetary policy will provide great improvements to the transparency and predictability of monetary actions. For instance, the Taylor rule is widely regarded in central banking quarters as the primary specification rule to which monetary policy should adhere. Its basic reasoning is that a central bank can, at best, support economic growth by lowering interest rates or, in a worst case, generate excessive growth and demand with consequent inflationary pressures and unemployment. It further stipulates an increase in the central bank policy rate when inflation breaches the stated target or economic activities become unsustainably intense. Conversely, it is expected that there will be a reduction in the policy rate when inflation falls below the target rate or range, or when the economy's productivity is less than desired.

Taylor Rule

The Taylor Rule is a simple guideline developed by Taylor to suggest how central banks should adjust their policy rate in response to changes in macroeconomic conditions that impact on monetary variables. By design, adjustments to the policy rate are expected to produce short term economic stability while maintaining growth in the longer run. Development of the Taylor rule was largely in reaction to the widely held assumption that central bank policy actions are closely tied to decisions of economic agents based on their current information, experiences and what they expect the future path of the economy to be. The Taylor rule was developed to replace demise of this assumption which was considered not to be in tune with experience. Empirically, the Taylor rule is stated as $i = r^* + pi + 0.5(pi-pi^*) + 0.5(y-y^*)$ which essentially denotes that inflation is the difference between real and nominal interest rates. While the real interest rates factors in the inflation rate, the nominal rate does not. The rule, therefore, recommends that the real interest rate should be 1.5 times the inflation rate in order to guarantee stability in financial markets.

Monetary Targeting

This is a monetary policy framework where a central bank adjusts the monetary aggregates in order to achieve low and stable inflation. Under this framework, the central bank uses a simple rule in order to achieve the desired goal of price stability, with selected monetary aggregates as the intermediate and/or operating goal. The mode of central bank intervention under monetary targeting is usually through the money market while the inflation rate is usually not explicitly stated. Rather, the programmed growth rate of monetary aggregate(s) is announced, that is used as the banchmark to achieve a specified value or range of price increase. The intervention essentially involves controlling the monetary aggregates by adjusting/setting the policy rate in response to ensuing monetary developments. Monetary targeting is built on the quantity theory of money which posits that there is a direct proportional relationship between money supply and the general price level in an economy. This clearly establishes the link between changes to money supply and prices, while assuming that velocity of money and aggregate output are constant. And this clear relationship provides the basis for which the monetary targeting framework is implemented.

Inflation Targeting

This is a monetary policy framework in which a central bank announces a target rate or range for inflation that it seeks to achieve within a specified medium term period. The rationale for the implementation of an inflation targeting regime is based on the simple assumption that a central bank is only suitably positioned to ensure short-term price stability as its contribution towards supporting growth in the economy over the longer term. In the operationalization, the central bank will necessarily raise or decrease the policy rate in response to a rise or fall in inflation, respectively. Proponents of inflation targeting posit that the framework ensures a transparent process and outcome for monetary policy formulation and implementation. This framework also enables monetary policy have appropriate considerations for domestic factors in response to shocks. It enhances central bank communication and accountability by providing unambiguous direction to economic agents.


2-3%

Exchange rate targeting

Exchange rate targeting is a monetary policy framework where the central bank sets an exchange rate target to be achieved within the short-term and makes considerable efforts not to deviate from the target. The CBN adopted exchange rate targeting as a monetary policy framework between 1959 and 1973. During this period, monetary policy was anchored on a fixed exchange rate regime where the exchange rate of the Nigerian pound was fixed to that of the British pound. The parity between the Nigerian and British pound was maintained until the civil war when the Nigeria pound was devalued to accommodate increased consumption occasioned by the war. In order to forestall inflationary pressures arising from increased import prices and reduced exports, the Nigerian pound was then pegged to the US dollar.

Conventional Monetary Policy

Conventional monetary policy involves the use of traditional instruments such as short-term interest rates by central banks to control money supply, and achieve the primary mandate of price stability. When a country's price level increases to undesirable levels, the central bank may implement restrictive monetary policy by raising interest rates to tighten money supply. Raising the target rate increases borrowing costs, and reduces demand for money and other cash instruments. The central bank can also increase the level of reserves that commercial banks must keep thereby limiting their ability to lend. These actions reduce the amount of money in circulation, and limit the volume of credit created. The central bank can also sell government securities in the open market to reduce the level of liquidity in the banking system. On the contrary, when an economy is in a recession, the monetary authority may lower interest rates, lower reserve limits, and purchase securities in the open market to inject more liquidity into the economy, to stimulate growth and stem unemployment


The Usual Things

Unconventional Monetary Policy

Unconventional Monetary Policy (UMP) entails the use of non-traditional monetary policy instruments to correct macroeconomic instability in an economy, where conventional tools are deemed ineffective. This form of monetary policy approach became more popular following the financial crisis of 2008 which led to deep economic recession in the US and other parts of the world. The crisis and its aftermath challenged the erstwhile stable model. At that time, interests rates were at the zero lower bound and a further reduction in interest rate would elicit no further reaction from the market. Conventional monetary policy tools therefore were no longer effective. The Federal Reserve had to rely on unconventional tools like quantitative easing, targeted asset purchase and forward guidance. This episode changed the dynamics of monetary policy


THINK
OUTSIDE
THE BOX

Quantitative Easing

Quantitative easing is an unconventional monetary policy tool which involves central banks' purchase of financial assets such as government bonds or other securities from the market. Thus, it helps to lower interest rates and increase the supply of money. Quantitative easing is essentially an injection of liquidity into the financial system, aimed at boosting banks' lending to the real sector, increasing private spending as well as, correcting inflation to central bank target. Quantitative easing (QE) is considered a veritable option when short-term interest rates have reached or are near the zero lower bound. At such point, conventional monetary policy which involves manipulating interest rates would no longer be effective due to illiquidity and confidence problem in the market. Quantitative easing is expected to stimulate economic growth since the liquidity injected into the system increases spending. This can trickle down to consumers and businesses, resulting in increased demand and growth

Direct Credit Easing/Targeted Asset Purchase

Credit easing otherwise known as Targeted Asset Purchase (TAP) is another UMP tool, which was used to address liquidity shortages, especially in times of acute bank distress. It involved the purchase of riskier instruments such as corporate bonds, asset-backed securities and commercial paper by the monetary authority. The effectiveness of this tool depends to a large extent on its ability to finance households and firm level expenditure. There are two main points to note about credit easing. First, the purchase of privately issued instruments and the purchase of government bonds have similar effect on money supply. Second, the central bank interacts with the private sector directly through the purchase of private securities; hence, the risks are higher.

Forward Guidance

Forward guidance is an unconventional tool concerned mainly with the central banks' effective communication to the public regarding the future path of its monetary policy. This tool involves methods ranging from a simple forecast about the economy to a strong statement on the trajectory of future interest rates. With forward guidance, the scale and mix of the central bank's balance sheet is not affected at the time of the announcement. Of the three main UMP tools, forward guidance appears to be more related to conventional tools. It has been employed by central banks for several years even when interest rates were not at the zero bound level.

Signaling

This is an idea that is used in the field of finance where one counterparty in an agreement provides credible information about itself and anticipated activities, to the other with the aim of dispelling uncertainties about their future interactions. Signaling is a very useful tool to align the actions and expectations of counterparties and has become a useful adaptation for monetary policy. It stems from the growing evidence that monetary policy actions disseminate information about the state of the economy to the public that may not possess adequate understanding about such actions. This has also led to the growing recognition that the central bank should pay increasing attention to signaling as a channel to achieve optimal policy outcomes. It, thus, entails that central banks should provide relevant information about economic fundamentals and the future path of monetary policy, to economic agents. Signaling is essentially a way to communicate relevant information that guide expectations and influence decisions that may precipitate economic fluctuations. It creates a link between the interest rate decisions of monetary policy and expectations about inflation, thereby improving possible outcomes in the task of maintaining low inflation.

Central Bank of Nigeria Interventions

The CBN interventions are deliberate actions or injections of resources to target sectors of the economy to boost investment or achieve desired short-term goal. The funds are mainly intended to catalyze the real sectors of the economy such as agriculture, power, aviation, SMEs among others. The interventions funds are mainly designed to (i) facilitate improved access to credit by the private sector, especially in the manufacturing sector (ii) Strengthen the liquidity position of the Deposit Money Banks; and (iii) stimulate economic growth which should generate employment, improve foreign exchange earnings, make available inputs to the production process and diversify the revenue base.

The Anchor borrowers programme is one of the most successful of the interventions. (See www.cenbank.org for details)


SMALL
BUSINES

Monetary Policy Implementation Committee

This is the Committees charged with the responsibility for implementing the monetary decisions of the central bank.

At the Central Bank of Nigeria, the Committee meets weekly on Tuesdays and is saddled with the responsibility of advising the Central Bank Governor on the optimal way ensuring that the set target on broad money supply is achieved. Specifically, the Committee is mandated to:

- Determine the daily injection/withdrawal of liquidity through the CBN; Proposed a plan that will minimized the liquidity gap as well as identify the specific instrument that will be used.

CENTRAL BANK OF NIGERIA

Monetary Policy Communication

Monetary policy communication is defined as the process of providing information about the monetary policy framework, and decisions to stakeholders or economic agents and the markets using appropriate economic indicators. It is necessary for central banks to continually communicate its price stability objective as well as lay down plans towards achieving the objective to its stakeholders and markets. Without a constant and effective monetary policy communication, economic agents are forced to make deductions concerning the motive behind monetary policy actions, the levels and directions of economic variables and the monetary policy path. Well-coordinated and effectively communicated monetary policy actions have the tendency to narrow information asymmetry between economic agents and the central bank.


yGist.com

Monetary/Fiscal Policy Coordination

Monetary/fiscal policy coordination involves the activities that are undertaken between the Central Bank and fiscal authorities to establish mutually agreed targets and ensure that monetary and fiscal policies are consistent, supportive and sustainable. This is necessary in order to achieve broad macroeconomic objectives of sustained economic growth, external balance and price stability. It becomes imperative to ensure that there is close coordination between both policies which are under the control of the same national government. What is vital is usually to obtain an optimal mix of both policies that ensures consistency and provides better scope to achieve desired targets. Fiscal and monetary coordination aids the avoidance of fiscal surprises, while moderating the time inconsistency problem of monetary policy. Monetary or fiscal policy alone cannot achieve macroeconomic stability. The major challenge, however, with regards to the interaction of both authorities, is the financing of an expansionary fiscal policy which could be inflationary and hence impede the achievement of the primary goal of monetary policy. This problem can be moderated through joint setting of economic targets.

COORDINATION

Fiscal Liquidity Assessment Committee

The Fiscal Liquidity Assessment Committee (FLAC) is a platform within the Central Bank of Nigeria (CBN) that provides a forum for interaction between the monetary and fiscal authorities. This aids the CBN to regularly obtain credible data on the revenue and expenditure operations of the Federal Government. It is further expected to provide CBN with useful information on the impact that government liquidity operations have on economy-wide liquidity and implications for monetary management. As an inter-agency forum, it brings together representatives from the Federal Ministry of Finance, Office of the Accountant General, Debt Management Office, Budget Office of the Federation and key CBN stakeholder departments. FLAC also hosts annual retreats and extends participation to a broader segment of the economy from the organized private sector and academia, including state governments.

Liquidity Assessment Group

The Liquidity Assessment Group (LAG) is an in-house platform of the Central Bank of Nigeria (CBN) that serves as a complement to the Fiscal Liquidity Assessment Committee (FLAC). The major activity of the Group is to assess daily liquidity conditions and determine the most appropriate policy action required to correct deviations from pre-specified liquidity targets. The LAG secretariat is located in the Financial Markets Department of the CBN.

FLAC Membership

The acronym FLAC means Fiscal Liquidity Assessment Committee. Its members are drawn from both the fiscal(Federal Ministry of Finance, Budget Office, Customs & Excise, FIRS, NNPC, DPR and OAGF) and monetary authorities (Monetary Policy, Banking and Payment system, Trade & Exchange, Research, and Financial policy regulation). The Committee members meet weekly and are mandated to collect and update data in respect of liquidity, supply information that has liquidity implications, conduct fiscal liquidity forecast and determine the net fiscal liquidity in the system. The terms of reference of the Committee include: (a) providing information on the operations of the Treasury to the Liquidity Assessment Group (LAG) of the Bank for forecasting the level of liquidity in the economy; (b) providing policy advice on fiscal issues to the Management of the Bank; and (c) generating a robust database on the operations of the Treasury that have implications on domestic liquidity. The Committee is chaired by MPD and is part of the collaboration efforts between the monetary and fiscal authorities.

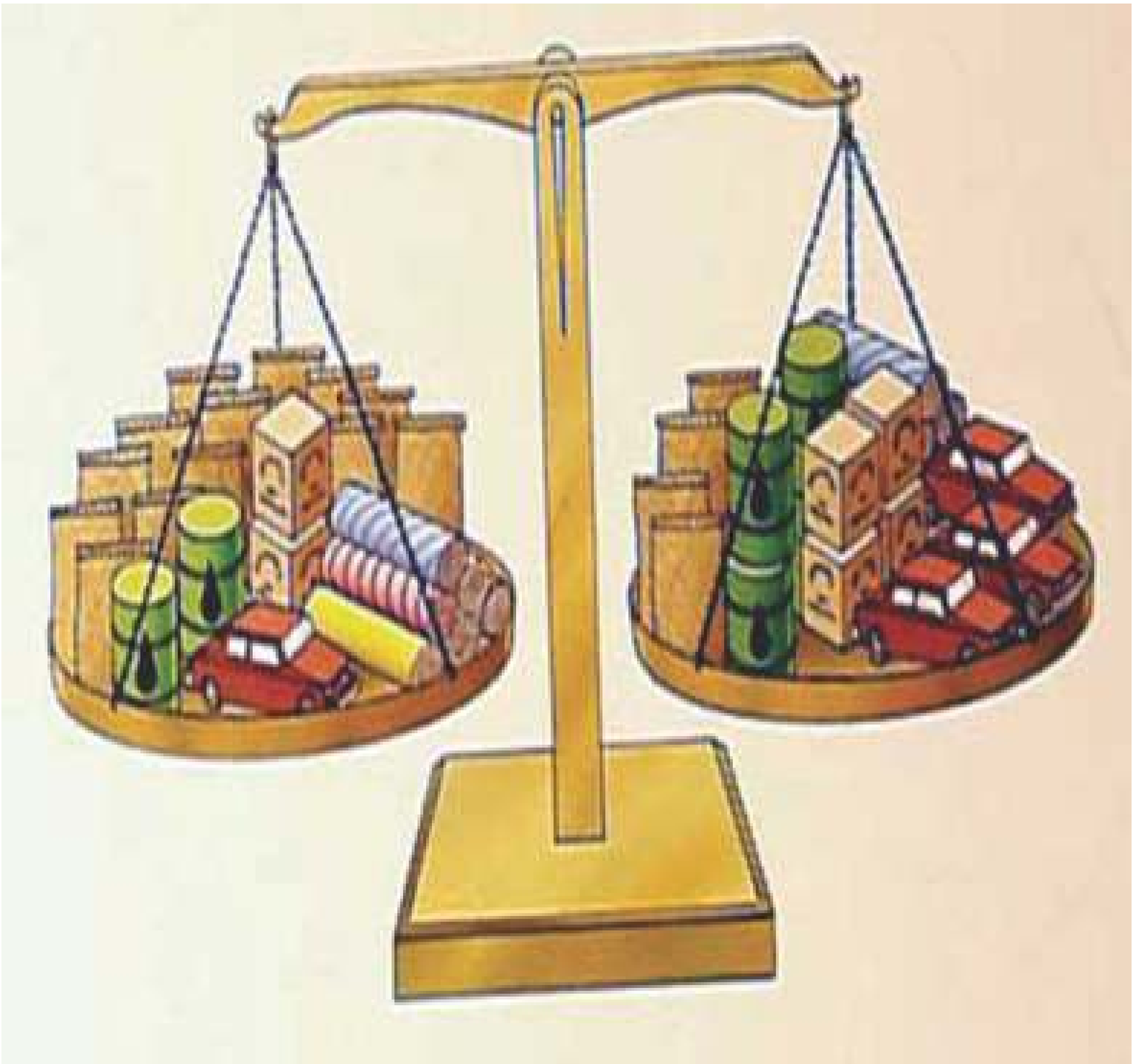
Remittances

Remittances refer to the transfer of money by citizens in diaspora to their home countries either for settlement of obligations, savings or transfer payments. Remittances to the home country involves several parties. The key ones are, the sender, the recipient, official and unofficial intermediaries in the sending and recipient countries, as well as the payment interface. There are formal and informal channels of remittances. The formal channels include the use of mobile payment systems, electronic payment instruments, money transfer operators, etc. Informal channels are non-conventional and un-regulated channels of transmitting funds from overseas to the home country. These funds are economically important to countries that receive them as it usually plays a significant role in economic growth and development. Remittances could also be a channel for helping poorer households to operate bank accounts which could in turn help the nation in promoting economic growth and development.


OVERSEAS
TRANSACTION
COMPLETED

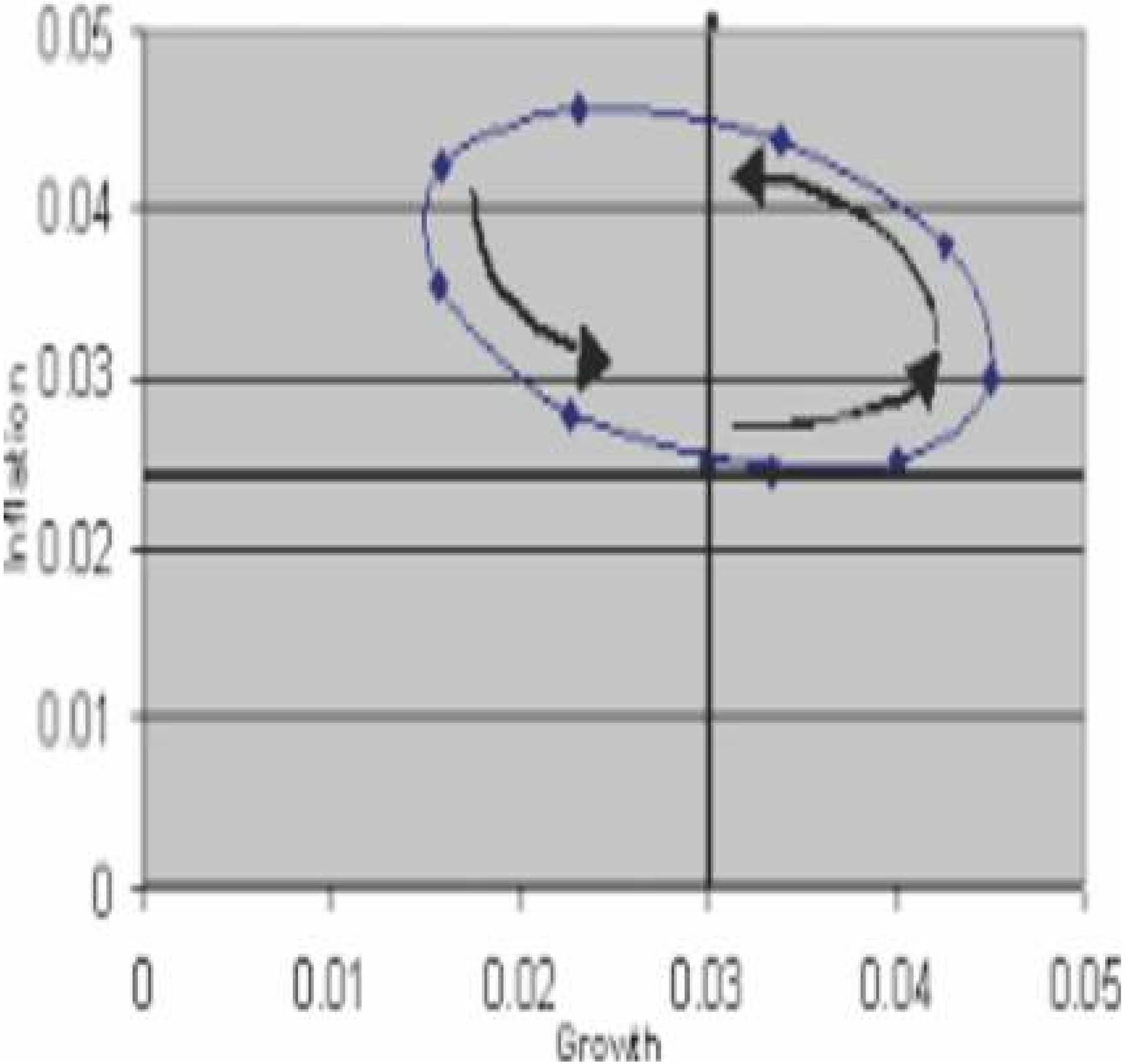
Balance of Payments

A summary of all legal economic transactions that exist between residents (individuals, firms or governments) of a country and the rest of the world in a particular period of time. This can be done quarterly or in most cases over a one year period. The transactions include goods and services, financial claims and income transfers. The balance of payments consists of three accounts namely: a) Current account b) Capital/financial account and c) Official reserves account (balancing account). Theoretically, the BOP should always balance, meaning that assets (inflows) and liabilities (outflows) should balance, but this is hardly the situation in practice. The BOP of a country are usually either in deficit or surplus.



Monetary Policy Reaction Function

The monetary policy reaction function (MPRF) is a simple rule that relates interest rates to inflation and the output gap. It is referred to as an upward-sloping relationship that exists between unemployment and the inflation rate of any economy. During inflationary periods, central banks wishing to fight inflation will raise interest rates and trade off output and employment. However, during deflationary periods, central banks wishing to fight deflation will reduce interest rates so as to stimulate growth in output and create employment opportunities.


0.05
0.04
0.03
0.02
0.01
0
Inflation
0
0.01
0.02
0.03
0.04
0.05
Growth

Foreign Capital Flows

Foreign capital flows refer to the inflows and outflows of financial resources between nations for the purpose of trade, investment or business. It could take the form of either foreign portfolio or foreign direct investment. It is usually used to bridge the resource gap of the receiving economy and generally depends on a myriad of factors within the economic environment of both nations. These may include the population size, educational development, political stability, level of transparency and corporate governance, macroeconomic and policy environment, and tax laws among others. A number of factors determine the flow of capital in a particular direction. When interest rates are high relative to other jurisdictions, capital inflow is encouraged. The reverse is the case when interest rates are low. Other determinants include economic growth, stable exchange rate and a stable macroeconomic environment.


THE MONEY
ARRIVES NIGERIA

The Money Market

The money market is a financial market in which only highly liquid short-term debt securities are traded. The maturity period for money market instruments is usually one year or less. Given their short term to maturity, the price of the instruments traded in the money market are less prone to fluctuations, implying that the instruments are, a less risky investment window.

Some money market instruments include the Nigerian Treasury Bills, Negotiable bank certificates of deposits, Commercial paper, Banker's acceptances, Repurchases agreement, Federal funds.

One of the most common types of money market instrument is the certificate of deposit (CD), which is a debt instrument sold by banks to depositors that pay annual interest of a given amount and at maturity pays back the original purchase price. Commercial paper is a short term instrument, in most cases less than 270, unsecured debt instrument issued mainly by large corporations and banks; while bankers acceptance is a bank draft in form of a promissory note to pay at a future date. This is usually guaranteed for a fee by the bank that stamps it as being accepted.

Inter-bank rate

In order to accommodate the obligations of liquidity of withdrawal and payments made by the banking public, banks with insufficient liquidity at any material time, borrow from other banks with excess liquidity to cover their shortfalls. Inter-bank interest rate are therefore, the rate of interest charged on inter-bank loans.

Interbank rate is also a strategic medium through which the Central bank influences the level of liquidity in the economy through the Standing Lending and Deposit facilities. The Standing Facilities which constitute a vital aspect of the current monetary policy implementation framework, aims at achieving interbank interest rate stability by influencing the short-term money market rates. The interbank rate can be collateralized (open-buy-back) or uncollateralized (call rate).

Open Buy-Back (OBB) Rate

The open buy back (OBB) is part of the interbank money market transactions for raising short term capital, backed by government collateral. Operationally, OBB is an open-ended (both parties can liquidate it without prior notice) money market instrument used to raise short term capital, in the case of Nigeria using Government securities as collateral.

WDAS

means

Wholesale Dutch Auction System

by allacronyms.com

Treasury Bill (TB)

Treasury Bill (TB) is an IOU (promissory note) money market debt instrument, usually less than one year (example 91, 182 and 364 days), issued by the government for raising funds for its fiscal operations through the open market. The Central Bank also use TBs in the open market operations to regulate money supply in the economy.

The Central Bank of Nigeria in conjunction with the Treasury, which coordinates the financial needs of the Government from time to time issue TBs as a way of closing Government financing gap. For example, when there is a budget shortfall (deficit), the CBN, on request by the FG, finances this shortfalls by raising TBs. However, besides raising money to finance the fiscal deficit, the monetary authorities rely on the economic importance of TB to control liquidity in the economy. A tight monetary policy will require selling TBs, while a loose policy entails buying it.

One attraction of TBs is that, apart from being the most liquid money market security, it has low risk, safe, and moreover backed by the guarantee of the Federal Government.

FEDERAL GOVERNMENT OF NIGERIA

No. No.

TREASURY BILL

(TREASURY BILLS ORDINANCE, 1959)

Due

£1,000

LAGOS, 19 .

This Treasury Bill entitles

SPECIMEN

or Order

to Payment of One Thousand Pounds at the

Central Bank of Nigeria, Lagos

on the day of 19 .

GENERAL MANAGER SECRETARY

CENTRAL BANK OF NIGERIA

* IF THIS BLANK BE NOT FILLED IN, THE BILL WILL BE PAID TO BEARER.

Monetary Operations

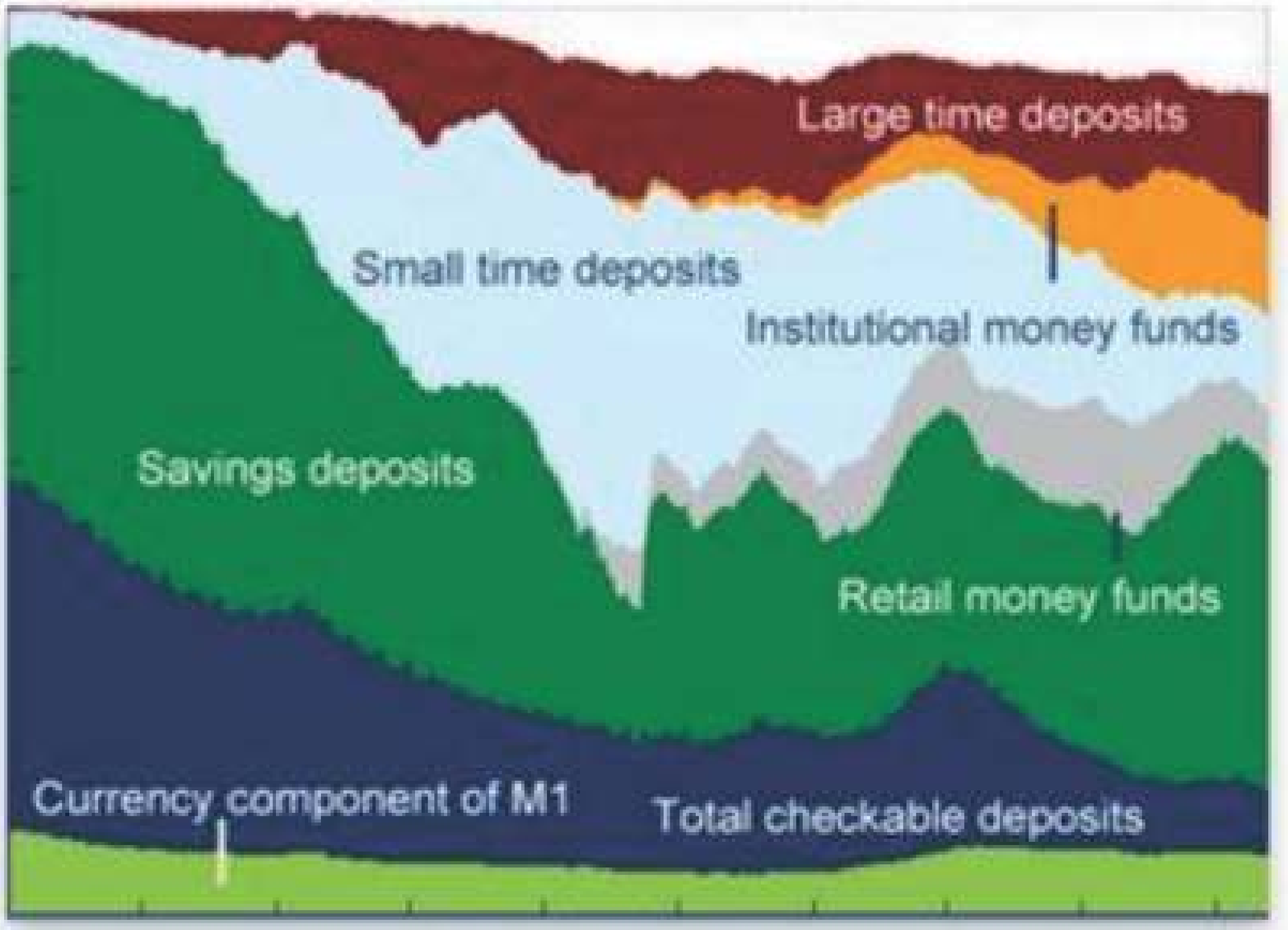
Central banks conduct monetary operations to implement monetary policy, and ensure that policy decisions have the intended effects on financial markets and on the wider economy. Monetary operations are also carried out to more generally manage liquidity in the economy to prevent volatility in market liquidity, thereby fulfilling the Bank's mandate of price stability. For all practical purposes, the target of monetary operations is to achieve appropriate levels of liquidity that would stabilize the exchange rate and domestic prices. The central bank adopts various instruments in the conduct of monetary operations. The instruments include open market operations (OMO), conducted through treasury bills and bonds transactions, complemented by REPO, Reverse REPO, Standing facilities as well as other instruments.

In addition, the repayment of matured government securities as well as Ways and Means advances increase liquidity in the banking system. The use of standing facility is initiated by the commercial banks while the central bank initiate the use of OMOs. The principal institutions through which the Bank implements its monetary operations include Deposit Money Banks (DMBs) and discount houses.


ATM
ATM

The Monetary Aggregates

The Monetary aggregates refer to the different measures of the amount of money in circulation. Also referred to as money stock series or money supply, they represent the amount of money circulating in an economy, and are usually presented as end-of-month currency stock series for the economy. Central Banks usually compile monetary aggregates on the basis of surveys carried out by monetary and financial institutions. Different jurisdictions and their central banks define the aggregates slightly differently. The key monetary aggregates are Narrow money (M1), Broad money (M2) and Reserve money (RM). M1 covers currency (i.e. banknotes and coins), as well as balances which are immediately convertible to currency or used for cashless payments. M2 comprises narrow money (M1) plus, time deposits as well as savings deposits.


Large time deposits
Small time deposits
Institutional money funds
Savings deposits
Retail money funds
Currency component of M1
Total checkable deposits

Monetary Policy Outcomes

Monetary policy causes a number of macroeconomic outcomes, because it is formulated and implemented to achieve set economic objectives. The performance of monetary policy can be measured by its impact, in the short term, on a number of macroeconomic indicators. The major indicators include economic growth, inflation, market Interest rates (prime and maximum lending rates), exchange rate, import prices, export prices, external reserve, foreign capital flows and unemployment. In general, monetary policy is expected to achieve stable domestic prices (exchange rate, interest rates and inflation) that support economic activity and employment. It should also ensure a stable macroeconomic environment that builds business and consumer confidence, encourages the inflow of foreign capital, enhances accretion to external reserves and strengthen the value of the domestic currency.


GDP
Gross
Domestic
Product
inventory
Investment
approach
expenditure
output
goods
Real
country
increase
Government
Nominal
Consumption
Exports
expenditures
calculates
borders
Calculating
services
growth
price
nation's
Approaches
Sales
important
value
calculated
number
deflator
final
GNP
known
component
purchasing
power
citizens
dividing

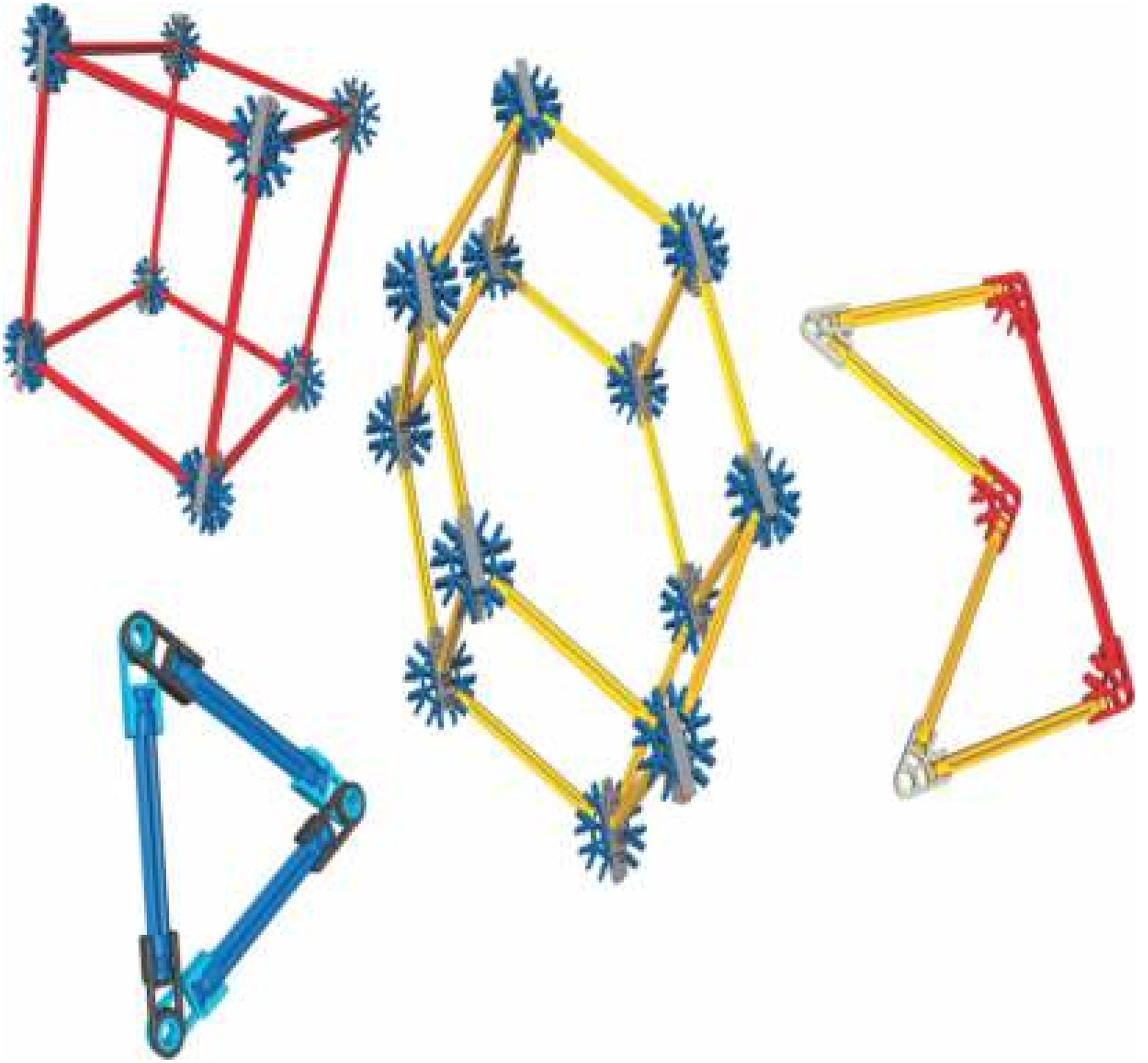
Monetary Policy Implementation Framework

The Monetary Policy Implementation Framework (MPIF) consists of a set of procedures for the implementation of monetary policy. MPIF, consists of three key elements, namely 'policy signal' to officially express the policy stance of the monetary authorities e.g. MPR; the choice of an operational target to ensure that the monetary policy stance is being achieved, e.g. a short-term money market rate being a popular choice (e.g. interbank or OBB rate); and the selected 'instruments' to achieve the operational target.

In Nigeria the key monetary policy, instruments include OMO, which is the primary tool of monetary policy, complemented by standing facilities, reserve requirements, discount window operations and foreign exchange market intervention. The framework relies on an operational target for the overnight interbank rate, particularly the open buy-back (OBB) rate. The target is implemented through an interest rate corridor, currently asymmetric, and the use of open market operations in combination with standing facilities, to ensure efficiency of the money market. The purpose of MPIF is to ensure smooth and rapid transmission of the policy rate (MPR) to other money market rates and, eventually, the wider economy.

More on the Monetary Policy Implementation Framework

This is the structure, processes and practices that a central bank puts in place for the conduct of monetary policy in order to achieve price stability. It essentially specifies the institutions and instruments that are within the central bank's control and are used for necessary actions to control money supply. A monetary policy implementation framework should necessarily possess standard elements including the central bank's target rate as well as the tools that are used to adjust money supply in the direction that will guarantee non-inflationary growth. These are specifically the facilities offered by the central bank and the monetary operations carried out. It also includes a specification of the counterparties that are eligible to participate in central bank monetary operations. An underlying practice in monetary policy implementation is that it relies on the scarcity of reserves. The central bank will reduce the demand for reserves among participating financial institutions and supply such reserves to meet demand and yield the desired level for money market interest rates. Another practice is the use of arbitrage, whereby the central bank fixes its deposit facility rate at or below the policy rate and becomes the floor for the target rate (inflation or interbank). This also provides a framework for mitigating the impact of large fluctuations in reserves, ensuring that the target rate(s) remains within a pre-determined range.



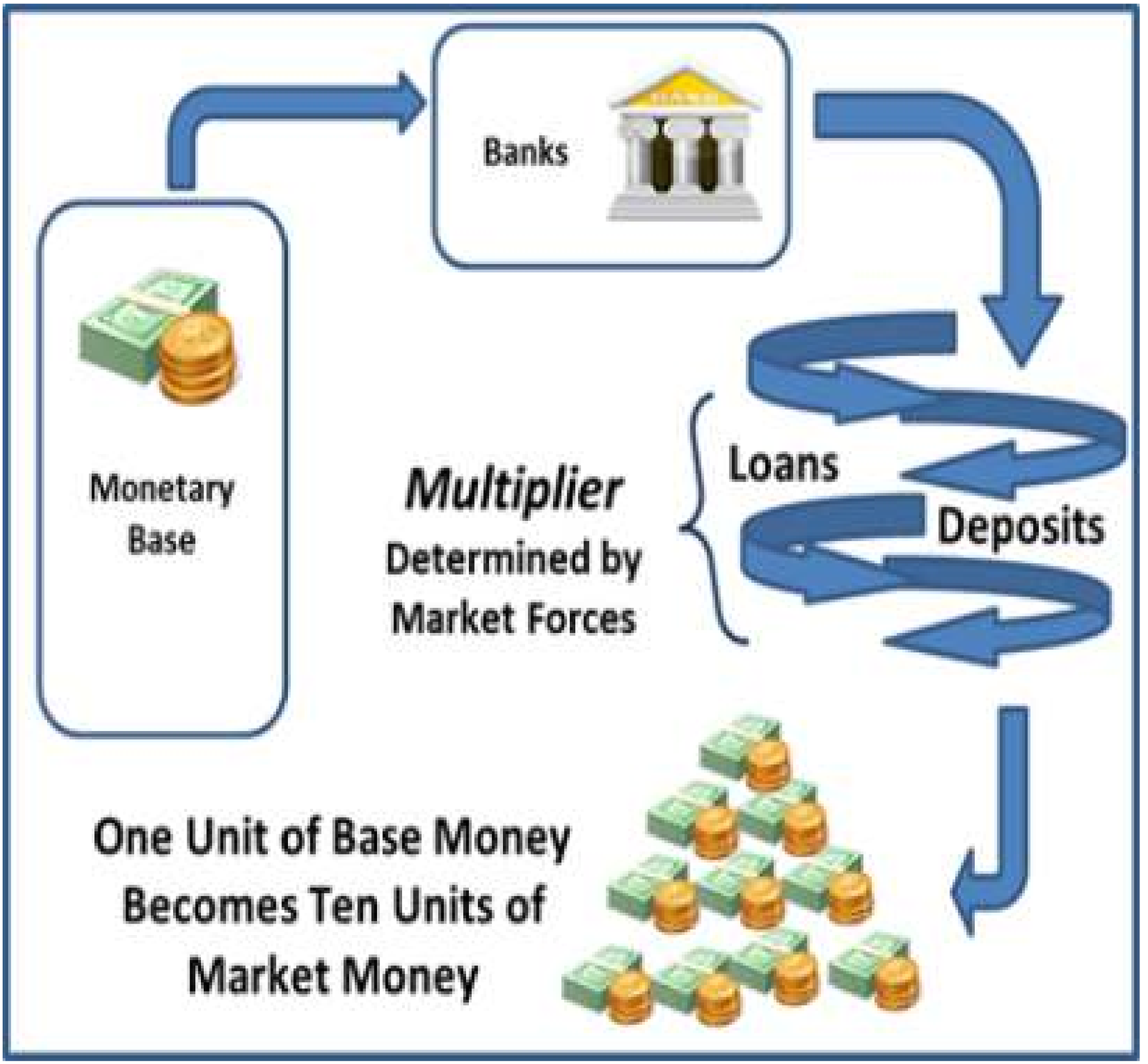
The Money Multiplier

The Money multiplier is the rate of creation of money within the financial system, and a fundamental requirement of fractional reserve banking. It is the amount of money that banks generate with each unit of reserves while reserve is the amount of deposits that the central bank requires commercial banks to hold and not lend out of their deposits. Thus, the multiplier refers to the expansion of a country's money supply due to banks' lending activities. The size of the multiplier reflects the percentage of deposits that banks are required to keep as reserves. It is computed by dividing total bank deposits by the reserve requirement. Therefore, it measures the maximum amount of DMBs' money that can be created for given amount of the central bank reserve, and the reciprocal of the reserve ratio.


multiple
derived
percentage
reciprocal
expressed
publicly
commercial
borrow
creation
summation
empirical
measures
insured
quantity
form
observed
crisis
negating
Money multiplier
broad
theoretical
stage
lend
sum
predictions
series
government
multiplier
geometric
superior
normalized
advanced
amount
supply
drain
fraction
precedent
currency
endogenous
money
change
reserve

More on the Money Multiplier

The money multiplier is a very critical concept in the design and implementation of monetary policy, and relates the central bank and commercial bank money. It is an adaptation of a macroeconomic concept that measures the quantum of change in aggregate money supply as a result of ta change to the monetary base. This largely emerges from the fractional reserve system where money is created by commercial banks through the simultaneous provision of loans to customers and crediting of accounts of such customers with the amount. Thus, the loan disbursed does not actually leave the bank but is reflected as a deposit in the account of the recipient customer and money supply therefore increases by that amount. Thus, money supply increases by a multiple of the amount of reserves that the central bank stipulates. In other words, the extent to which the money creation process expands money supply is limited by central bank (base) money. The concern of monetary policy with the money multiplier is, thus, the predicted impact that a change in central bank money will have on the expansion or contraction of money and, consequently, the inflation rate.


Banks
Monetary Base
Multiplier
Determined by Market Forces
Loans
Deposits
One Unit of Base Money Becomes Ten Units of Market Money

Time Inconsistency of Monetary policy

Time-inconsistency refers to situations where policies that were determined to be appropriate in the past are no longer deemed optimal today and are thereby not implemented. Time inconsistency of monetary policy is, therefore, a situation where a monetary policy-maker's preferences change over time to such a degree that a preferred decision today can become inconsistent at another point in future. This concept is the main explanation put forward to explain the "great inflation" of the 1970s. Given time-inconsistency, the same mechanisms that can cause higher average inflation also can inhibit policymakers' efforts to stabilize inflation. Time-inconsistency influences how the monetary authorities respond to shocks and how resources are allocated over time.


SEC.
24

Exchange Rate Revaluation

The use of government administrative fiat or decree to increase the value of a domestic currency vis-à-vis other foreign currencies under a fixed exchange rate system. The decision to alter the official value of a country's currency depends on the country's government agency such as the central bank in a fixed exchange rate regime. A revaluation is mostly an upward adjustment of the official exchange rate to a country's chosen baseline. Often, the baseline comes from the wage rate in the domestic currency to the price of gold of a foreign currency. Revaluation is conducted by policy makers, commonly driven by market pressure. Example of revaluation, assuming Nigerian government had set the value of Naira N305 to 1$USD, to revalue the Nigeria currency, government would have to value the Naira to N300 per 1$USD. Based on this revaluation, the Naira would be more expensive for people buying it with dollar than the previous rate and the united state dollars would slightly cost less to the people buying it with Naira.


Supply
Demand

Fixed Exchange Rate

This refers to a pegged or rigid exchange rate in which the value of the country's currency is determined through government administrative fiat or government decree. It is tied to gold and always associated with the period of the gold standard. Variation in fixed exchange rate is described by the concepts of devaluation and revaluation. A system in which the exchange rate of a country relative to some other countries is determined by government administrative fiat and not by market forces. It implies that the exchange rate of the country's currency vis a vis some selected currencies is allowed to remain constant or fluctuate minimally around a constant par value. A country that plans to maintain a fixed exchange rate is expected to hold a substantial level of foreign exchange reserves that would be sufficient to absorb minor variations in the value of its currency.

Flexible Exchange Rate

A flexible exchange rate is operated under the flexible exchange system. It is a type of exchange rate regime whereby a currency's value is allowed to fluctuate in response to the dynamics of the foreign exchange market. The forces of demand and supply are allowed to determine the exchange rate. In a pure or clean flexible exchange rate regime, the determination of the exchange rate is left to market forces without government or central bank's intervention in the market. A flexible exchange rate regime also refers to as floating or fluctuating exchange rate. In recent times, countries around the world allow their currencies to float; examples of such currencies include the British pounds, the American dollar, the Australian dollar, the euro, the Japanese yen, the Indian rupee and the Norwegian krone. Nevertheless, some central banks frequently intervene in the foreign exchange markets in attempt to influence the exchange rate. The Canadian dollar is a pure example of a floating currency as the Canadian central bank has not interfered in the market since 1998.


FLEXIBLE

Purchasing Power Parity (PPP)

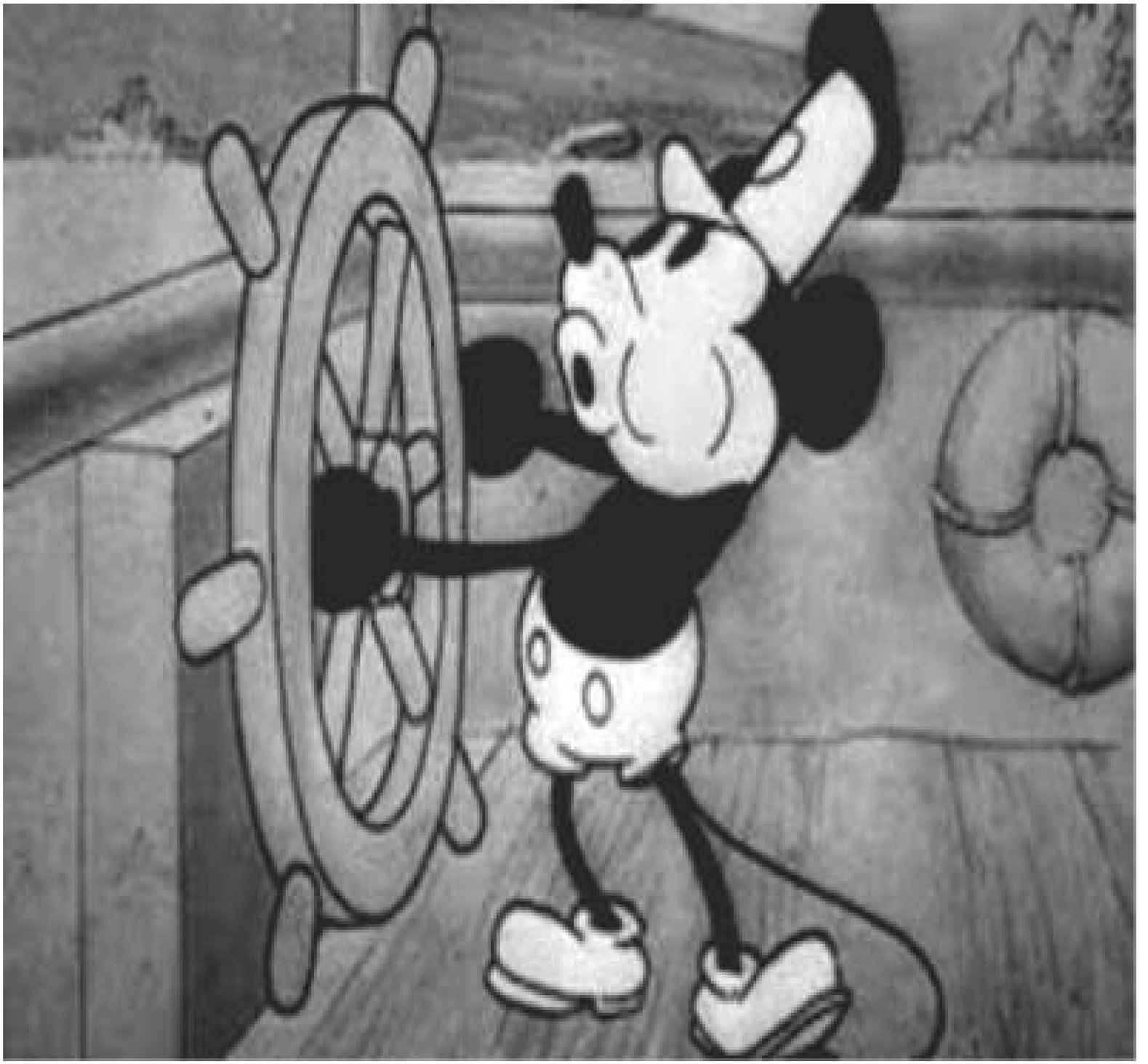
This is an element of economic theory that measures the relative value of different currencies. PPP estimates the amount of adjustments required for two currencies to have an exchange rate equivalent to the purchasing power of the currencies in both countries. In order words, the concept of PPP allows estimation of the exchange rate between two currencies that will equate the purchasing power of the two countries' currencies.

For instance, what is the amount of money required to purchase a given basket of goods in country A and when converted to country B's currency can purchase the same basket of goods. In the absence of transport costs and tariffs if the price of tradable goods were lower in one country than another, a trader could gain by buying goods in the cheaper country and selling them in the dearer: relative price level thus determine the equilibrium exchange rate.


PURCHASING
POWER
PARITY
DOMESTICALLY
NATIONAL
EXPENSIVE
EXCHANGE
POORER
DISTORTING
DOMESTIC
OVERVALUED
REAL
COMPARATIVE
CONSUMPTION
SHIFTS
MARKET
WEAKENED
ARTIFICIALLY
RICHER
CONVERTED
TRADED
DEMAND
QUALITY
TRADABLE
TALL
OFFICIAL
LOCAL
ESTIMATES
UNDERLIE
GREATER
COMPARE
LAW
PRODUCED
BILATERAL
BENCHMARK
THEORY
OVEREMPHASISE
DIFFERENTIATION
SERVICE
COMPARISON
TEND
STATISTICAL
IMPERFECTLY
LABOR
BASE
METHODOLOGICAL
PRODUCTIVITY
UNDERVALUED
MICROCHIPS
FACTORIES
EQUAL
MULTILATERAL
NOMINAL
DATA
NONFOOD
YUAN
PURPOSES
NUMBER
CAPITA
TABLE
POVERTY
INCOME
COMMODITY
COST
DOLLAR
TRADE
SECTORALMATRICES
EQUIVALENT
CHEAPER
RELATIVE
LABORER
PURCHASE
ISSUES
BARRIERS
BASKET
ADJUSTMENT
DIFFERENTIATION

Retail Dutch Auction System

The rDAS (retail Dutch Auction System) is one of the three segments of the foreign exchange market. It involves direct sale of foreign exchange (forex) through authorized dealers to end users for valid trade transactions. Unlike the WDAS, the RDAS is matched to actual demand for foreign exchange. Authorized dealers (Banks) are required to submit fully documented customer request to the monetary authorities. The rDAS was introduced in Nigeria in April 1987. During the period of rDAS, the Central Bank of Nigeria supplies dollars to the authorized dealers, as the system allows the end users to bid for forex through authorized dealers and received the required amount based on the bid rate quoted by the end user



Whole sale Dutch Auction System

Wholesale Dutch Auction system (WDAS) was designed to consolidate the achievement of the rDAS and to further liberalize the foreign exchange market. It is a type of Dutch Auction System where authorized dealers (DMBs) buy foreign exchange from the central bank on their own accounts and sell in bits to their customers (end users). This was introduced on February 20, 2006 based on the Nigeria's healthy external reserves and favourable macroeconomic condition in 2005, but was suspended in January 2009, re-introduced in July 2009 and suspended since 2013 to reduce capital outflow and drawdown on external reserves.

MPC Decision Making Process

The Monetary Policy Committee (MPC) is the highest monetary policy making authority of the Central Bank of Nigeria. The Committee meets bimonthly to take decisions that have far reaching implications on the wider economy. The decision making process begins with the preparation of the monetary programme by the Monetary Policy Department of the CBN, using a set of macroeconomic targets in the government annual budget. The programme contains benchmarks and projections for major macroeconomic indicators (e.g. inflation, exchange rate, economic growth, etc.) and monetary aggregates, including reserve money, monetary base, net foreign assets, M1 and M2, etc.

Based on the projections in the monetary programme and reports from other relevant departments of the Bank, the Monetary Policy Department prepares an economy-wide Report, which is presented to the MPC during the bimonthly meeting. The Committee considers the draft economic report and assessment made by staff of the Bank. The MPC members deliberate, and subsequently take decisions based on majority votes. As part of the final decision, the MPC chooses appropriate monetary policy instruments which are then applied by the operational departments of the CBN. The CBN has instrument independence, implying that, the Banks' monetary policy decisions are not required to be approved by a higher authority.

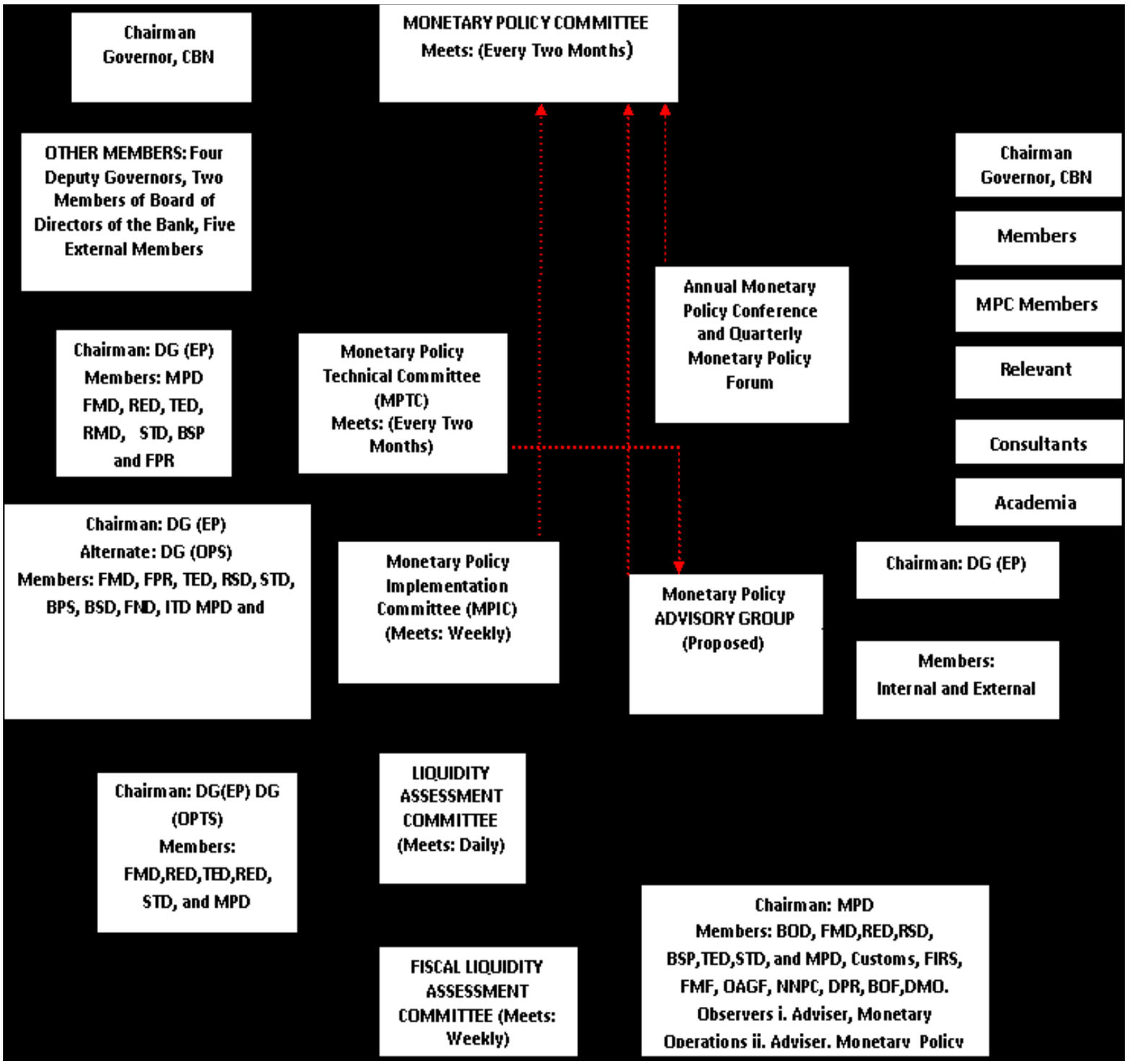
Monetary Policy Institutional Framework

Monetary policy formulation and implementation requires a strong institutional framework, which strengthens the monetary policy process and its effectiveness. The monetary policy committee (MPC) is the highest decision-making organ of the country's monetary authorities, and comprises the Governor and four (4) Deputy Governors, the Permanent Secretary, two (2) external Board members, Ministry of Finance and a secretary, usually the Head of Monetary Policy Department. The CBN Act 2007 led to an expansion of the membership of the Committee to include some appointees of the President and the Governor of the CBN. At the CBN, there are other supporting institutional arrangements.

The Monetary Policy Technical Committee (MPTC) monitors the conditions in the financial and economic environment on a monthly basis, and prepares technical reports, summarizing major developments for the MPC meeting. The Monetary Policy Implementation Committee (MPIC) meets weekly to monitor the implementation of MPC decisions and ensures that departments comply appropriately with the decisions and directives. The Fiscal Liquidity Assessment Committee (FLAC) meets every week, and critically reviews fiscal data, analyze revenue inflow and outflow and enhance the effective interaction between the monetary and fiscal authorities. The Liquidity Assessment Group (LAG) meets daily to evaluate the liquidity situation and offer policy advice and reports to the MPIC.

Monetary Policy Technical Committee

The Monetary Policy Technical Committee (MPTC) is the technical arm of the CBN's Monetary Policy Committee (MPC). It was established in 2005 and is headed by the Deputy Governor (Economic Policy). The primary function of the committee is to prepare economic analyses for the Monetary Policy Committee, by synthesizing inputs received from member departments. These include Research, Statistics, Banking and Payments System, Banking Supervision, Financial Policy and Regulation, Reserve Management, Financial Markets and Trade & Exchange Departments, with Monetary Policy as the secretariat. The economic report reviews monetary, financial, output, and price developments in the economy as well as developments in the international economy that have impact on the Nigerian economy. The MPTC reviews the economic report for technical soundness of policy recommendations to the MPC and meets before each meeting of the MPC.


Chairman
Governor, CBN
MONETARY POLICY COMMITTEE
Meets: (Every Two Months)
OTHER MEMBERS: Four Deputy Governors, Two Members of Board of Directors of the Bank, Five External Members
Chairman
Governor, CBN
Members
MPC Members
Relevant
Consultants
Academia
Annual Monetary Policy Conference and Quarterly Monetary Policy Forum
Chairman: DG (EP)
Members: MPD FMD, RED, TED, RMD, STD, BSP and FPR
Monetary Policy Technical Committee (MPTC)
Meets: (Every Two Months)
Chairman: DG (EP)
Alternate: DG (OPS)
Members: FMD, FPR, TED, RSD, STD, BPS, BSD, FND, ITD MPD and
Monetary Policy Implementation Committee (MPIC)
(Meets: Weekly)
Monetary Policy ADVISORY GROUP (Proposed)
Chairman: DG (EP)
Members:
Internal and External
Chairman: DG(EP) DG (OPTS)
Members:
FMD,RED,TED,RED, STD, and MPD
LIQUIDITY ASSESSMENT COMMITTEE
(Meets: Daily)
Chairman: MPD
Members: BOD, FMD,RED,RSD, BSP,TED,STD, and MPD, Customs, FIRS, FMF, OAGF, NNPC, DPR, BOF,DMO.
Observers i. Adviser, Monetary Operations ii. Adviser. Monetary Policy
FISCAL LIQUIDITY ASSESSMENT COMMITTEE (Meets: Weekly)

The Monetary Policy Committee

The Monetary Policy Committee (MPC) is a statittory committee of the central bank that is saddled with the responsibility for the formulation of monetary and credit policy of the Bank. To fulfil this mandate, the committee is given the task of determining the appropriate policy rate that is consistent with price stability as defined by the central bank. The MPC sits regularly to review domestic monetary and economic developments, determine implications for price movements and take decisions on the stance and path of monetary policy in order to achieve domestic price stability. The Committee is made up of 12 members including the Governor, Deputy Governors and seven (7) external members. This ensures that there is a full complement of institutional knowledge and external information. It meets statutorily every two (2) months but may convene emergency meetings when the need arises. It's activities are coordinated by the Monetary Policy Department.

Monetary Policy Committee Decisions

These are the decisions made at the end of each bi-monthly meeting of the Monetary Policy Committee, after a review of both domestic and international economic and financial developments. The announcement of MPC decisions are usually highly anticipated as they provide an indication of how the monetary authority seek to direct monetary conditions in line with pre-programmed targets. Decisions of the MPC are guided by rigorous research and analysis usually provided by staff of the central bank but also supplemented by the research of external members (where available). Decisions essentially consist of monetary, exchange rate and financial stability measures that aim to guide monetary policy and expectations of economic agents. The monetary policy committee decisions is conveyed in a live press conference immediately after each MPC meeting, where the central bank Governor provides information about deliberations by members and rationale for their decisions. This is usually followed by the issuance of a communique, while minutes of the meeting is released in some jurisdictions, after a time lag.


COMMITTEE
DECISIONS ON
MONETARY POLICY

Monetary Policy Communique

The Monetary Policy Communique provides details of the deliberations of the monetary policy committee, and is usually released to the press and public after each MPC meeting. The communique is released to the public in line with global practice of ensuring transparency in monetary and financial policies. It ensures the immediate dissemination of relevant information to economic agents, to inform the market in line with the ensuing path of policy as determined during the MPC meeting. In Nigeria, the maiden monetary policy communique was produced by CBN out of the MPC meeting held on June 26, 2001. The Monetary Policy Department of the CBN has produced a compendium of monetary policy communique since 2001 and is available on request.

CENTRAL BANK OF NIGERIA

Web Address: cbn.gov.ng

Communiqué No. 100 of the Monetary Policy Committee Meeting of Monday 23rd and Tuesday 24th March, 2015

The Monetary Policy Committee (MPC) met on 23rd and 24th March, 2015, against the backdrop of harsh external economic environment and significant risks to the domestic economy. All members were present (11), out of the twelve (12) members, including Dr. O. J. Nnanna, who assumed duty as Deputy Governor (Financial System Stability) at the end of January 2015. The Committee analyzed key developments in the global and domestic economic and financial conditions as well as the outlook for the rest of 2015.

International Economic Developments

The Committee noted that the pace of global economic recovery had remained modest and uneven, in particular, the Committee noted that heavy commodity prices were weighing heavily on output growth, especially in the oil-exporting countries. In addition, expectations of rates in US dollar money markets rates continues to fuel capital outflows and currency weaknesses in the emerging markets and developing countries. Against the backdrop of sustained weakness in the Euro zone and softening growth in the emerging markets, global output has remained largely tapered.

During the first quarter of 2015, the United States beg the global impetus to output growth as consumer demand strengthened on the back of falling oil prices, lower US oil imports and accommodative monetary policy. In contrast, in the Euro area, continued output decline, in the face of positive oil price shocks, made the European Central Bank (ECB) to introduce a massive €1.1 trillion asset purchase programme, commencing in March 2015, involving a €60 billion monthly asset purchase. The programme, although open ended, is expected to last at least until September 2016 by which time inflation may have quickened towards its target.

The Committee, however, noted a number of important downside risks to global outlook in 2015 including geopolitical tensions and conflicts, the negative impact of commodity price declines, weak external demand and the possibility of Monetary Policy normalization in the US. Nonetheless, however, noted additional boost of the Euro Area and Japan, in the short to medium term. Growth in the emerging markets may exhibit wide variances with sharp deceleration in most of the large emerging market economies, especially in Latin America and Eastern Europe, due to the headwinds from softening commodity prices and slowdown in external demand from the advanced economies. In addition, country specific risks, such as political crisis, structural factors, adverse weather conditions, exchange swings in currencies may continue to drive aggregate demand in a number of countries.

Global inflation continues to be low due to declining oil prices and weakening stock in global output. Core inflation has continued to vary slow amongst other things to the dampening effect of low oil prices and lack of appreciable wage gains. Average inflation for the developed economies is projected to remain flat at 1.2 per cent in 2015 due to the increasing output gap, weak recovery, and strong regional currencies. This developments appears to be offsetting the risk of imported inflation in the emerging and developing countries, most of which have experienced mandatory to severe depreciation in their local currencies. Developing economies are thus expected to have moderate inflation in the medium term.

The Committee observed that the outlook for global monetary policy suggested a predominantly easy stance. The Euro Area and Japan are expected to remain in the accommodative mode, Even in countries where growth appears to be strengthening like the US, UK and Canada, there are indications of delayed switch to tight monetary policy stance. Owing to growing concerns, however, the Committee further noted that some emerging and developing economies may experience headwinds tightening in the short to medium term, Growth in sub-Saharan Africa is projected to average 4.9 per cent in 2015.

Domestic Economic and Financial Developments Output

The National Bureau of Statistics (NBS) rebased real Gross Domestic Product (GDP) growth rate at 2.98 per cent up 0.8 of 2014 lower than the 6.17 per cent recorded in the corresponding period of 2013 and the 6.23 per cent recorded in Q3 2014. The Committee noted that the slowdown in growth resulted mainly from the non-oil sector, which grew by 5.99 per cent in Q4 ,2014 compared with 6.19 per cent in Q3 2014. Agriculture, industry, construction, trade and services contributed 0.89, 1.10, 1.04, 0.87 and 2.01 percentage points, compared with 1.25, 1.04, 0.26, 1.08 and 1.12 percentage points, respectively, in Q3 2014. The softening non-oil GDP was partly traced to the spill over effects of low oil prices which negatively impacted agricultural output, trade and services.

On GDP on the other hand, grew by 1.19 per cent in Q4, 2014 compared with a decline of 1.68 per cent in the preceding quarter. The growth in oil GDP is predominantly witnessed by because it takes a close look for sector was experiencing minimal negative price shocks.

Prices

Headline inflation remained within the 6.0 – 9.0 per cent band established by the CBN. However, the Committee noted with concern, the gradual increase in the year on year headline inflation during the first two months of the year from 8.0 per cent in December 2014 to 8.2 per cent in January and further to 8.4 per cent in February 2015. The underlying inflationary pressures came largely from food (particularly imported food) and the non-components. Food inflation rose from 9.2 per cent in December 2014 to 9.4 per cent in February 2015 while core inflation increased from 6.7 to 7.0 per cent during the same period. The major risks to inflation, the Committee noted, include elevated aggregate spending in the run-up to the 2015 general elections, the likely higher import prices on the strength of an appreciating dollar and possible food supply shocks linked to insurgency and insecurity in some major agricultural areas of the country.

Monetary, Credit and Financial Markets' Developments

Broad money supply (M3) declined by 1.79 per cent in February 2015 over the level at end December 2014. This translated to an annualized decline of 15.21 per cent compared with the provisional growth benchmark of 11.24 for the at 2015. The decline in M2 primarily reflected the contraction of 16.18 and 8.22 per cent in net foreign assets (NFA) and other assets (net), respectively, during the period. The fall in NFA is attributed to the combined effects of weakening oil prices and lower out of portfolio capital flows. During the period, net domestic credit (NDC) grew by 11.89 per cent in February 2015, annualized to a growth rate of 99.17 per cent, compared with a growth rate of 1.89 per cent recorded in the corresponding period of 2014 and an indicative benchmark of 29.3 per cent for 2015. The credit to government (net) component grew sharply by 14.49 per cent relative to a decline of 21.39 per cent at end December 2014.

The Committee noted that money market interest rates were relatively volatile in the interviewing period but maintained an average during the first two months of 2015, as banking systems liquidity fluctuated. Thus, average inter-bank call (**sic**) (OBB rates, which opened at 10.50 and 10.12 per cent on 5th and 6th January 2015, closed at 11.00 and 9.23 per cent, respectively, on February 27, 2015. Average inter-bank call and OBB rates for the period were 11.29 and 10.30 per cent, respectively.

The Committee observed that the bearish conditions in the capital market continued in the review period. The All Share Index (ASI) decreased by 7.1 per cent from 34,637.70 at end December 2014 to 32,192.01 by February 27, 2015. Market capitalization also moved in the same direction, falling by 7.1 per cent from N11.86 trillion to N10.09 trillion during the period. The Committee noted that the situation, though reflecting current trends globally, needed to be monitored closely.

External Sector Developments

Following the closure of the Retail Dutch Auction System (RDAS) window of the foreign exchange market on 18th February 2015, the foreign exchange market is now unified. Consequently, the naira exchange rate opened at N200.5/$50 and closed at N196.0/$50, with a daily average rate of N198.0/$50. This represented a depreciation of N2.7/$ or 1.38 per cent for the period.

Considerations

The Committee expressed satisfaction with the impact of the decisions taken to harmonize the foreign exchange market. As a consequence of these actions, the interbank exchange rate has stabilized after an initial adjustment. The Committee, however, expressed concerns about the wide divergence between the interbank and the bureau de change exchange rates, which provides an avenue for arbitrage and speculative activities in the market. The Committee noted with concern the phenomenon of currency substitution and partial dollarization in the economy, a development which may have significantly fuelled the high demand for foreign exchange. The Committee, therefore, instructed that the ban remained on cement purchases in the economy and advised the Bank to take all possible measures to address this development. The Committee also expressed concern about the outlook for growth, which had moderated partly due to the effects of low oil prices, naira exchange rate depreciation, and election related concerns. The Committee was however, optimistic that the situations would improve once elections were successfully conducted with the expected improvements in economic conditions.

The Committee took note that while adverse developments in international oil prices had affected government revenues and reserves accretion and imparted negatively on capital flows, the financial system remained stable with key banking stability indicators showing robustness. In the light of this, the Committee directed the Bank to take all necessary measures to improve the resilience of the financial system as well as the overall economic environment and functioning of the financial markets.

The Committee also took note of the administrative measures implemented by the Bank since the last meeting of the MPC to enhance stability in the foreign exchange market. The Bank held on 18th February 2015 where the Bank supply management measures to close the official window of the foreign exchange market in order to create transparency and minimize arbitrage opportunities in the foreign exchange market. Furthermore, to deepen the market and enhance the efficacy of the demand management measures, the Bank gave specific directives on the effective monitoring and repatriation of both oil and non-oil export proceeds. In addition, the utilization of export proceeds has been restricted to eligible transactions only, to minimize leakages. The Committee enjoined the Bank to continue to fine-tune demand management measures as well as implement appropriate supply enhancing strategies to ensure effective demand and utilization of foreign exchange in the country.

Monetary Programme

The Monetary Programme is a comprehensive framework, developed by a central bank, for the determination of the appropriate level of money supply and credit that is conducive to the attainment of price stability. The programme is usually based on the central bank's projections for macroeconomic variables that are relevant for the stated objective of achieving and maintaining price stability. While monetary programmes necessarily focus on the current year, it also provides projections for the near term (8 – 16 months). The programme essentially provides an extensive evaluation of the net financing capacity of the economy and forms a critical element for decision making especially in central banks. The monetary programme is built on the four macroeconomic accounts namely National Accounts, Balance of Payments (BOP) Account, Government Accounts and Monetary Accounts. A key goal in the preparation is usually to ensure consistency between the financial and income sides of the economy.

More on the Monetary Programme

Operationally the framework uses a spreadsheets for generating benchmark monetary aggregates to enable the CBN meet its non-inflationary objectives, while ensuring consistency in the four sectors of the economy.

The purpose is to provide early information to guide monetary policy formulation, by enabling the central bank to determine the level of money supply and credit that would be adequate for the economy under a financial programming and policy Framework.

Liquidity Management

Liquidity Management consists of all decisions and operations of the central bank to control the level of liquidity in the economy, with the goal of maintaining price stability. The Monetary Authorities believe that monetary policy will produce desired effects when it controls the liquidity levels of banks. It essentially requires that the level of liquidity of the banking system and individual banks are fine-tuned to produce desired outcomes. This forms the basis for monetary operations using various instruments such as open market operations, reserve requirements, discount windows, and interest payments on reserves. The conventional practice was for central banks to use adjustment in interest rates for the implementation of monetary policy. The need for active liquidity management by central banks, using balance sheet policy, arose after the global financial crises of 2008, necessitating the use of liquidity management as a strategy to adequately regulate the level and flow of liquidity within the banking system and economy at large.

CENTRAL BANK OF NIGERIA

The Monetary Survey

Monetary survey is a consolidated balance sheet of the assets and liabilities of the deposit money banks (Deposit Money Banks) and the Monetary Authorities. It shows a snap shot of the indicators of the monetary and credit situation over a period of time. The monetary survey contains the monetary assets comprising the foreign assets of the CBN, the DMBs and merchant banks (here refereed to as the banks); and the banking system's domestic credit to the public (Federal, States and Local Government) and the private sector (Non-Financial Public Enterprises inclusive).

The liabilities side shows the total monetary liabilities namely the narrow money also called M1 in the case of Nigeria (the Currency Outside Bank - currency in circulation, vault cash: currency held by commercial banks and merchant banks; Demand Deposits - private sector deposits at CBN , and private sector deposits at commercial banks) Quasi Money (Time, Savings & Foreign Currency Deposits of: commercial banks, merchant banks, and other private sector deposits at merchant banks). Thus, the total monetary liabilities (M2) is arrived at by adding narrow money (M1) and Quasi money.


Balance Sheet
Y2013
Y2012
Y2011
Cash
Account Receivable
Bill of exchange
Inventories
Prepaid expenses
3,294
3,100,386
389,510
712,294
798,387
1,010
47,009
10,609

The Macroeconomic Trilemma

Trilemma or the unholy trinity in macroeconomics is the impossibility of the simultaneous achievement of exchange rate stability, free capital mobility, and independent monetary policy. In particular, it shows how impossible it is for the monetary authorities in an open economy, to have a fix exchange rate, perfect capital mobility, and yet conduct an independent monetary policy. It is a policy trade-off of the monetary authorities.

A typical example is what happened in the Bretton Woods era where the exchange rate was fixed with monetary authorities excising independence and monetary policy discretion. It was however, difficult for central banks to place restrictions on the volume of capital that flows in and out of the country – less capital restrictions.

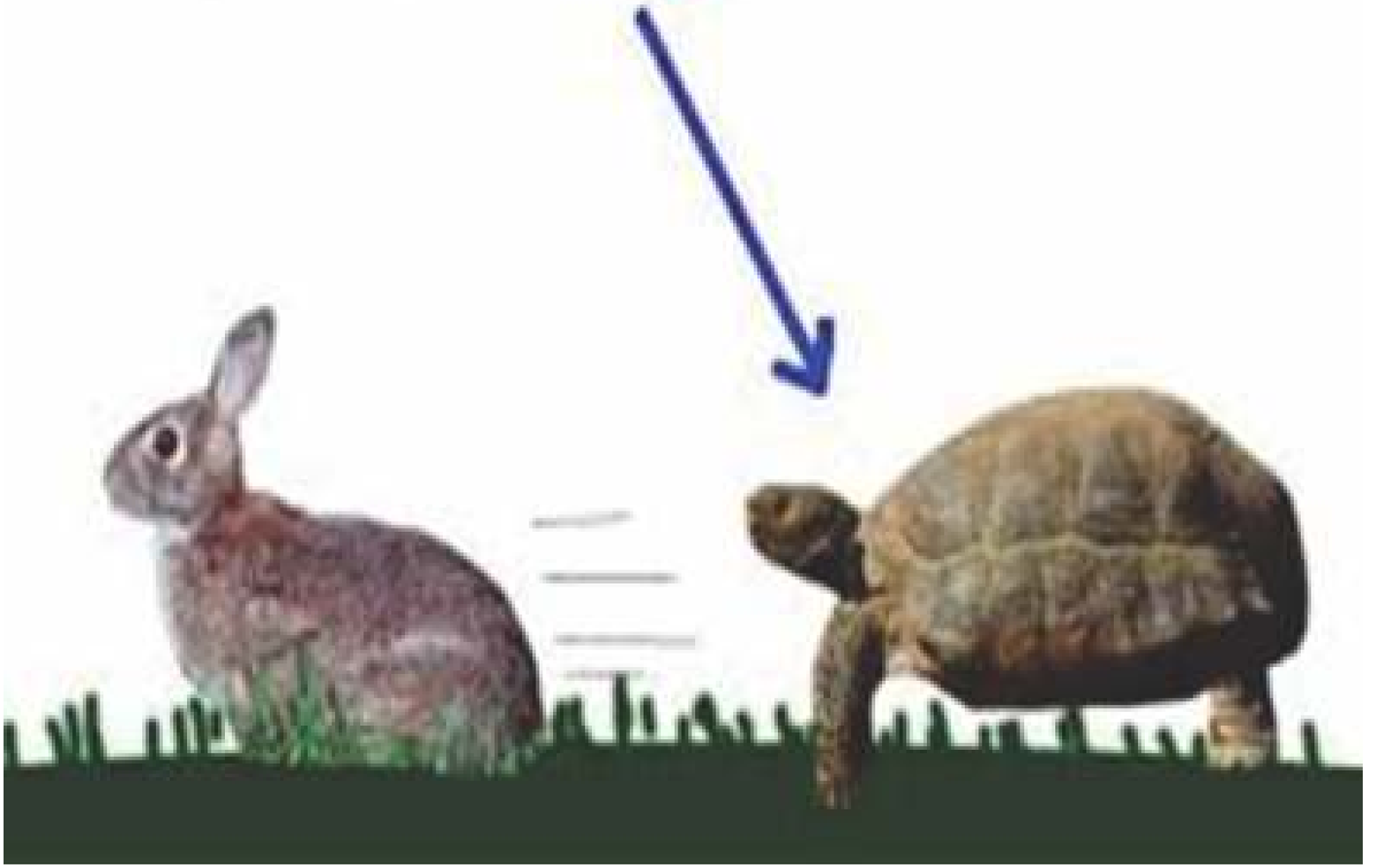
The perfect mobility was not by choice or linked to the authorities policy choices, but shows that in those three scenarios, 'the policy hand' of the central banks is too small to accommodate these three irreconcilable outcomes.

This is the same policy conundrum that the central bank of Nigeria is facing which is not different from what obtains globally. Since it is a global phenomenon, countries consider their domestic macroeconomic objectives to be able to prioritise the trade-off

Policy Lags

Policy lags are the time differential that exist between the identification of an economic problem that requires a monetary policy response, and when the full impact of decisions taken to correct the problem are felt. Essentially, monetary policy lags represent the time that it takes for a policy decision to permeate through relevant transmission channels and produce the desired effect. Monetary policy lags have been variously categorized into Data lag – which is the build up in changes to an economic phenomenon that policy makers may not yet be aware of; Recognition lag – which is the time taken for policy makers to become aware of changes to economic phenomenon of interest. It usually requires that such changes need to be persistent in order to receive relevant attention; legislative lag – which is the time required for the next meeting of a monetary policy committee to convene and discuss the identified change in economic phenomenon, and make policy prescriptions; transmission/Implementation lag – which is the time it takes to reflect the use of policy instruments based on the policy decision; and Impact lag – referring to the space of time that it takes for changes to policy instruments to produce the desired outcome.

lagging ~~behind~~

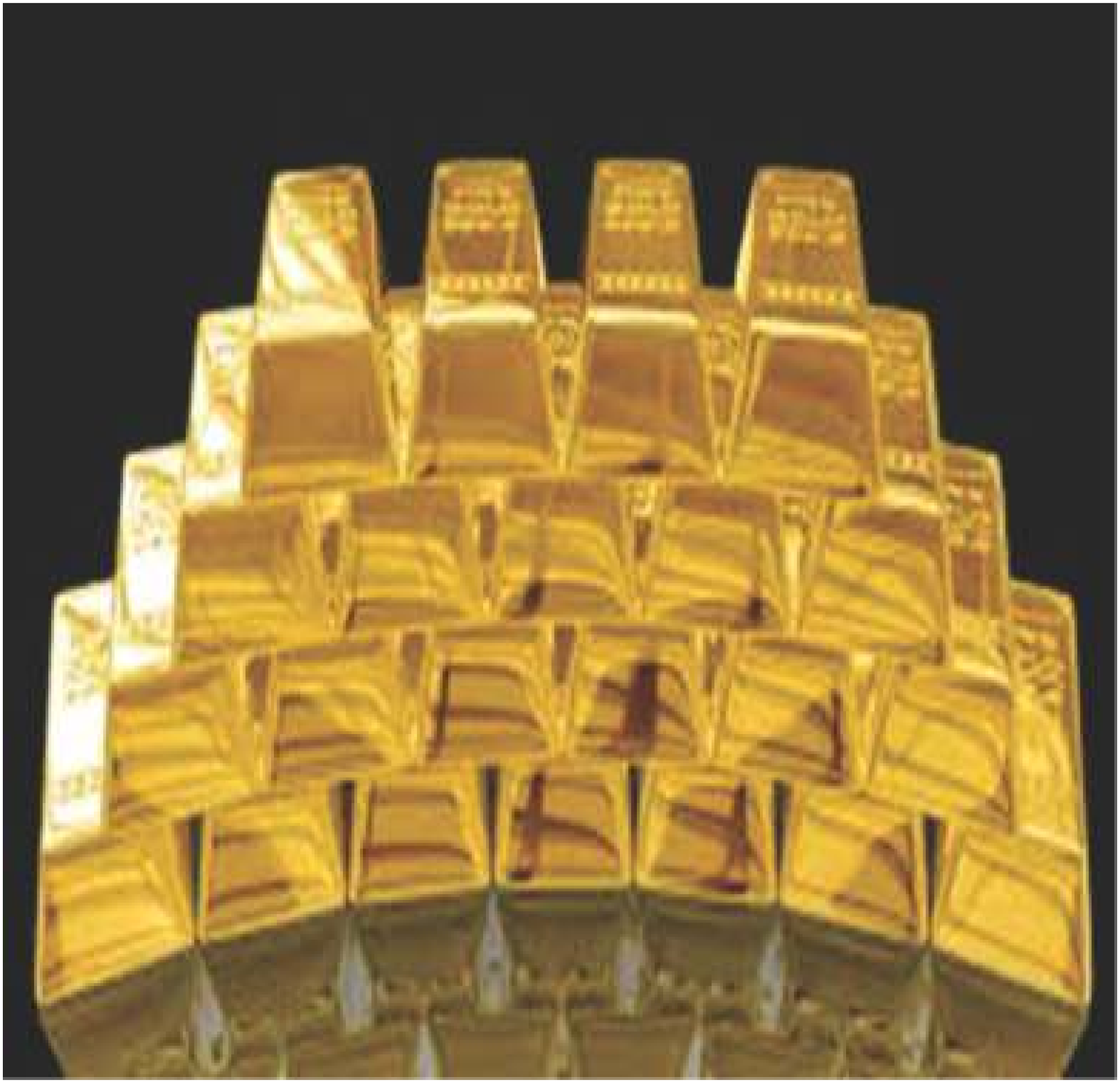


Policy Horizon

The Policy Horizon is a specified timeframe over which the CBN, or any policy agency, is expected to achieve its price stability (or other) target. It represents a specified future timeline during which policy processes are evaluated to determine the outcome vis a vis what was anticipated. It is important to specify appropriate time horizons within different policy space in order to make adequate provisions for policy prescriptions to permeate the system and produce desired outcomes. For monetary policy, a medium-term horizon is usually specified. This ensures that decisions taken and implemented are given sufficient time for policy makers to assess the impact before deciding on another measure in the same direction. CBN adopts the medium term monetary policy horizon which spans over 2 years. This provides the advantage of freeing monetary policy from the problem of time inconsistency, as witnessed under the short-term time horizon (1 year). The time inconsistency problem necessarily see policy makers reacting to each emerging economic challenge without allowing time for outcomes of policy actions to provide clarity on the next line of action.

Monetary Base

The Monetary base is the total amount of a currency in an economy that is either circulating in the hands of the public or held as deposits of commercial banks in the central bank. The monetary base is under the control of the central bank and is used to control the supply of money through the deposit money banks. This is largely dependent on the fulfilment of the assumption that there is a stable relationship between it and the size of deposits that DMBs can create. The monetary base is different from money supply which is made up of the total amount of currency that is in the hands of the general public and non-bank deposits in commercial banks. Open market operations as an instrument of monetary policy is used by central bank for liquidity management, and this impacts mainly on the monetary base. It is also referred to as high-powered money in reference to the larger increase or decrease in money supply when the monetary base is increased or decreased.



Banking System Liquidity

Banking system liquidity is a measure of the ability of banks to meet funding requirements without undue disruptions to their operations. A liquid banking system is, therefore, characterized by the excess of funds' inflows over outflows. Banking system liquidity is largely a function of deposit money banks' (DMB) supply and demand for central bank money which is composed of cash in the hands of the public and DMBs' deposits at the central bank (monetary base). This relationship necessarily reflects the importance of central bank balance sheet as the primary source of liquidity for the entire banking system. Thus, banking system liquidity constitutes the primary focus in central bank liquidity operations.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Excess Liquidity

Excess liquidity describes the quantum of cash and eligible securities held by deposit money banks, which is over and above the ratio that is specified by a central bank. Excess liquidity may also include funds that banks deposit at the standing facility window of the central bank. It essentially arises when the flow of liquidity into the banking system exceeds liquidity withdrawals by the central bank, over an extended period of time. Excess liquidity is known to have potential effects on the conduct of central bank intervention in the money market, central bank balance sheet and transmission of monetary policy. It is a useful indicator of underlying inflationary pressures. The ability of a monetary authority to synchronise its supply and withdrawal of banking system liquidity such that there is no excess, is pointer to the effectiveness of its liquidity management operations. Liquidity management frameworks have developed to create balanced money market liquidity conditions, in jurisdictions that have developed a strong monetary policy orientation. In Nigeria, excess liquidity has remained a major concern during implementation of monetary policy, this is against the background that there are numerous outlets to channel such liquidity but it has remained on the books of DMBs and require costly liquidity management operations by CBN.

Excess Reserves

Excess reserves are the resources of a deposit money bank or financial institution that is kept for future investments but is over and above the limit of specified liquid assets by the central bank. Excess reserves are usually determined with reference to specified liquidity requirements by the monetary authority. Financial institutions that possess excess reserves are considered to possess buffers to absorb adverse shocks especially in the event of significant withdrawal of cash by depositors or loss of substantial loan amounts to defaults. It is, therefore, that the preponderance of excess reserves across the banking system may be said to reflect soundness and safety of the industry, in the event of economic upheavals but may also reflect inefficiency and high risk perception. Such institutions are also known to receive enhanced credit ratings from rating agencies. Excess reserves are, however, known to constitute a threat to price stability through inflationary pressures, unless they are channeled in ways that contribute to boosting economic activities.


EXCESS RESERVE FORMULA
Excess Reserves = Legal Reserves
- Required Reserves
BANK
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Dollarisation

This is a situation where residents of a home country adopt the use of a foreign currency for payments in transaction of goods and services, instead of the domestic currency. On the other hand, dollarisation, also known as currency substitution, can be adopted as a formal policy within an economic jurisdiction after a serious economic crisis. Where it is fully adopted, there is wholescale or total replacement of the domestic currency with a more suitable foreign currency. The official adoption of a foreign currency necessarily implies that the adopting currency has given up control of its domestic monetary policy. Domestic monetary developments are, therefore, largely determined and influenced by decisions taken in the country of the anchor currency. Partial dollarization results when residents choose to store a substantial part of their financial asset holdings in a foreign currency, and is usually in response to growing loss of confidence in the stability of the domestic currency.

Monetary Policy Instruments

These are tools or measures used by a monetary authority to influence the price/cost or quantity of money and credit in desired direction.

Examples of monetary policy instrument include: The policy rate, open market operations: reserve requirements, etc.

The choice of instruments depends on the level of development of the economy, especially the financial sector, and the prevailing financial or monetary conditions. Since 1993, the Bank transited fully from direct instruments to mainly market based ones, including a policy rate (MPR), introduced in 1996, accompanied by standing/lending facilities, open market operations, supported with discount window operations, reserve requirements, among others.

Monetary Policy Tools

- Instruments that initiate monetary policy

- Open Market Operations
- The Discount Rate
- Reserve Ratios

Cash Reserve Requirement

Cash Reserve Requirements is a specified minimum proportion of reserves that a bank is mandated to hold in its vault or with the central bank and cannot be given out as loans or used for investments. Also called cash reserve ratio, It is usually a proportion of the deposit liabilities of commercial banks. Reserve requirements are largely considered to be macro prudential instruments used for financial stability considerations. They are widely used by the monetary authorities but avoided by some central banks in highly liberalized economies, who consider it to be a form of direct monetary control. Indeed, central banks in the advanced economies rarely use reserve requirements due to potential liquidity problems that it may create for financial institutions (mainly banks) that have low excess reserves. They are, however, a very useful tool for the implementation of monetary policy and are used to adjust the quantum of money that is available to banks for the creation of loans.

Liquidity Ratio

Liquidity ratio is a measure of a deposit money bank's ability to offset its short term liabilities when they fall due. In other words, LR represents the sufficiency of cash and near cash assets that a bank has to cover short term borrowings when they mature, and other current liabilities.

The CBN requires Banks to maintain a minimum liquidity requirement by ensuring that the level of cash flow is matched by equivalent receipts to enable them meet their obligations as they fall due. Given the critical role of liquidity in banks' operations, it is essential for banks to provide for both the expected and unexpected fluctuations in their daily transactions as reflected in their balance sheets and to provide funds to grow the economy.

Liquidity Ratios

Definition of liquidity:

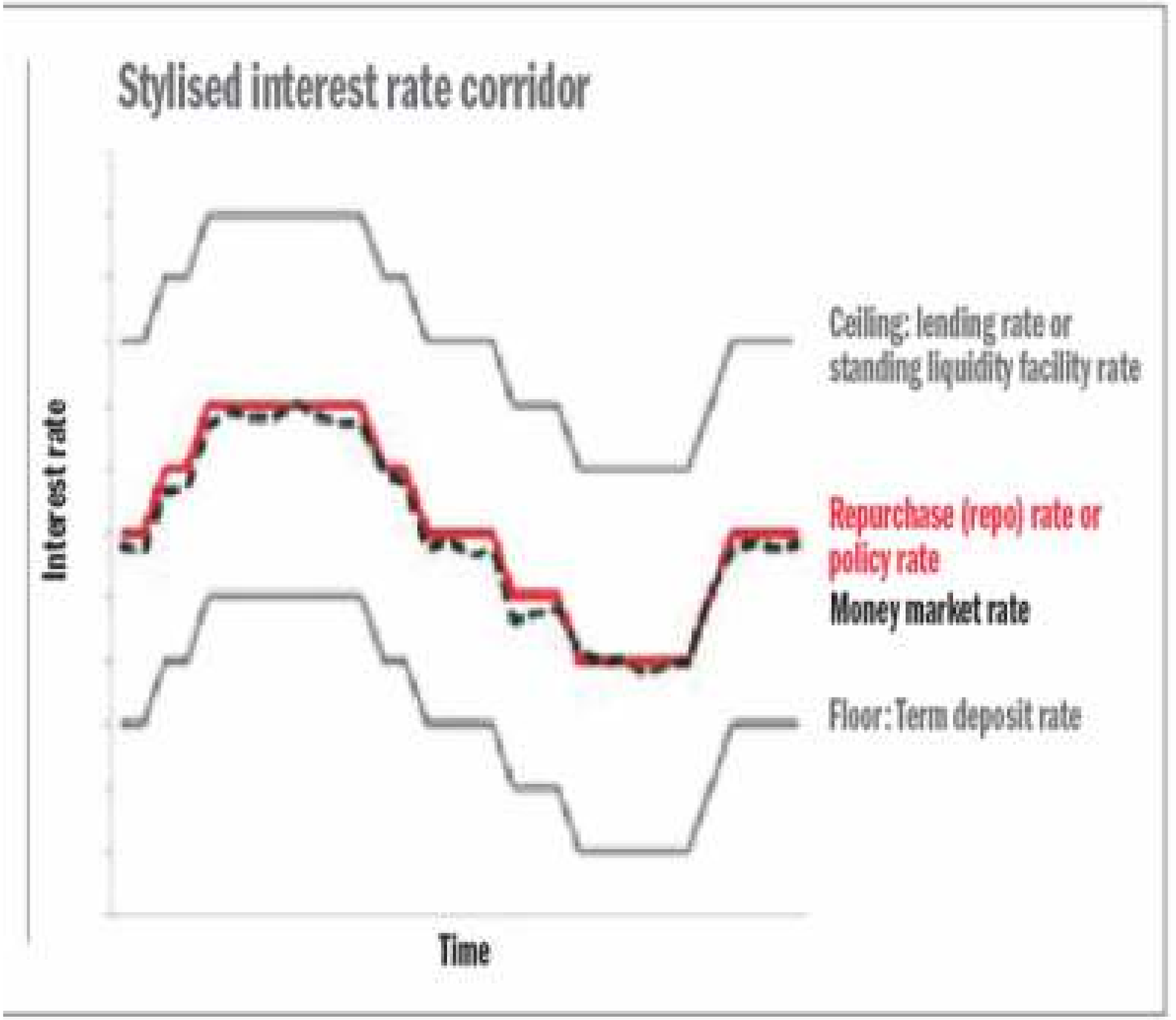
1. **Liquidity ratio** = liquid investments/(UPR + Loss and LAE Reserves)

   liquid investments =

2. **Quick Liquidity ratio** = quick assets/net liabilities
   1. Quick assets =
   2. Net liabilities =
3. **Overall liquidity ratio** = total assets/total liabilities

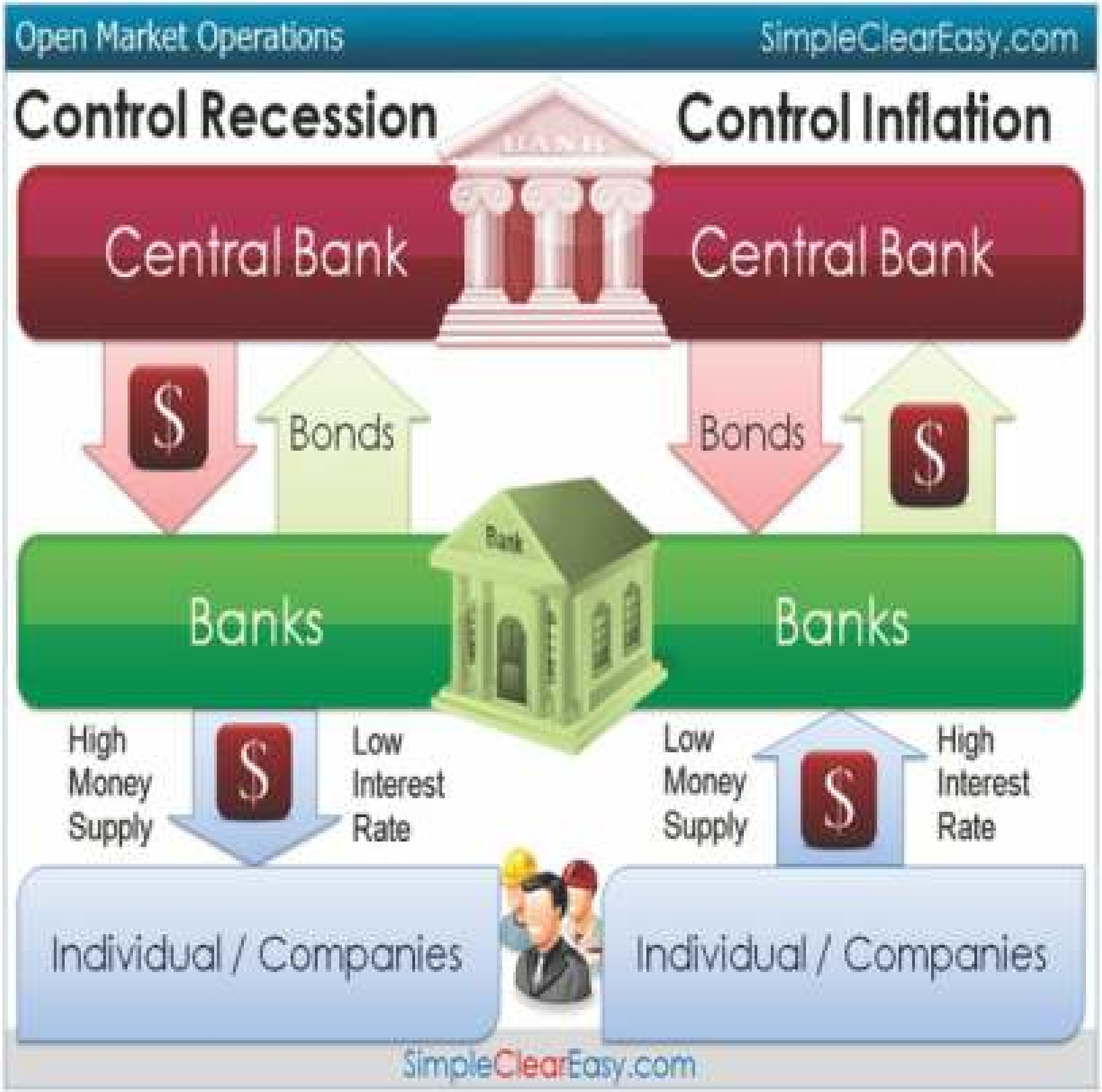
Corridor Operating Framework

A corridor operating framework for monetary policy is devised to provide a band that defines the range for a designated operating target, in the quest to fulfil the ultimate objective of price stability. The use of a corridor framework essentially entails that a daily target for the operating rate is specified and reserves are supplied to the banking system to ensure that the specified target is attained. Such reserves are usually those that the central bank can adjust using open market operations. The use of a corridor for monetary policy is especially useful for attaining a central bank's policy target in jurisdictions where reserve requirements are non-existent or monetary stimulus (quantitative easing) is a major policy instrument. In theory, the corridor approach is expected to minimise volatility in the operating target.


Stylised interest rate corridor
Interest rate
Time
Ceiling: lending rate or standing liquidity facility rate
Repurchase (repo) rate or policy rate
Money market rate
Floor: Term deposit rate

Open Market Operations

The Open Market Operations (OMO) is one of the most important and flexible instrument of monetary policy in use by the Bank. It involves sales and purchases of financial instruments, particularly, government securities, in the open secondary market, in order to control the volume of money in the banking system. Common instruments used in the OMO operations include, Treasury Bills, central bank bills, or prime commercial paper. By purchasing securities, the central banks inject money into the banking system to ease credit conditions in order to stimulate growth. On the other hand, they absorb or sterilize excess liquidity by selling these securities. Thus, if excess liquidity situation is perceived in the domestic economy, the CBN sells government and own securities (FGN treasury bills and CBN bills) to reduce the supply of money. Conversely, when liquidity shortages are experienced, the Bank buys these securities as a way of increasing money supply.


Open Market Operations
SimpleClearEasy.com
Control Recession
Control Inflation
Central Bank
Central Bank
Bonds
Bonds
Banks
Banks
High Money Supply
Low Interest Rate
Low Money Supply
High Interest Rate
Individual / Companies
Individual / Companies
SimpleClearEasy.com

Standing Lending Facility

The Standing Lending Facility (SLF) is a window that the Central Bank of Nigeria established to provide access to overnight funds for deposit money banks (DMBs) that have deficit positions in the interbank market. It is also the upper limit of the monetary policy corridor. This window is anchored on the bank's function as lender of last resort.

In other words, the SLF is a liquidity support tool provided by the CBN. It is a mechanism the CBN uses to lend funds to DMBs and other financial institutions in order to satisfy reserve requirements using the overnight lending facility. Through this platform, the CBN increases liquidity over longer periods. A variety of assets are accepted as collateral from the financial institutions in exchange for the loans.


Borrowing
Lending

Standing Deposit Facility

The **Standing Deposit Facility** (SDF) is a window that the CBN established to accept overnight funds from deposit money banks (DMBs) that have a surplus position in the interbank market. It is also the lower limit of the monetary policy corridor. The window serves the Central Bank's function as banker to the banking system.

The CBN requires Banks to maintain a minimum liquidity level by ensuring that the level of cash flows is matched by receipts to enable them meet their obligations as they fall due. Given the critical role of liquidity in banks' operations, it is essential for banks to provide for both the expected and unexpected fluctuations in their daily transactions as reflected in their balance sheets. Excess reserves are deposited in the SDF window.


Lend
Borrow

Moral Suasion

Moral suasion is a persuasive monetary policy measure used by a monetary authority (i.e. the Central Bank) to influence, but not compel, banks into adhering certain policies and approaches. Strategies employed are meetings with bank directors, increased inspections, appeals to community spirit, and vague threats. The Central Bank issues licenses or operating permits to DMBs and also regulates the operation of the banking system. It can, from this advantage, persuade banks to follow certain paths such as credit restraint or expansion, increased savings mobilization and promotion of exports through financial support, which otherwise they may not do, on the basis of their risk/return assessment. Essentially, it involves regular dialogue and consultations between the CBN, banks and other financial institutions using the Banker's Committee and other channels to enhance efficiency of operations in the financial system.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OK
Cancel

Discount Window

The Discount Window (DW) operation provides an outlet for Deposit Money Banks (DMBs) and Discount Houses (DHs) to borrow reserves against collaterals in the form of government or other acceptable securities. This is particularly useful for DMBs and DHs experiencing unexpected liquidity or funding squeeze to adjust their positions. The CBN through the DW operations lends to financially disstressed DMBs at the repo rate. This rate sets the floor for the interest rate regime in the money market and thereby affects the supply of credit, savings and investment which have implications for the supply of reserves, monetary aggregates and employment and GDP growth. Transactions are conducted mainly in overnight facility collateralized by the borrowing institutions holdings of debt instruments approved by the CBN. The SDF and SLF are deposit and lending arms of the DW introduced in December 2006 to frequently guide market expectations about the monetary policy orientation.

CENTRAL BANK OF NIGERIA

Prudential Guidelines

Prudential guidelines are specifications of a central bank that aim to guide the conduct of banks and financial institutions to ensure accountability and proper conduct in their operations. They may be detailed requirements that guide the recognition and measurement of loan disbursements and allied activities, while making adequate provisions in the event that there are defaults which create financial system stability concerns. In order words, prudential guidelines prescribe the standard practices that operations of banks and financial institutions are expected to adhere to. They are very essential elements of a financial system as it guarantees the efficient functioning of individual institutions, prevents the build up of systemic risks and mitigates the occurrence of crisis episodes. Prudential guidelines are mainly a financial regulation tool. CBN prudential guidelines serve as a basic framework for evaluating banks' loan loss provisioning policies and practices.


FINANCIAL
REGULATION
JURISDICTIONS
TRADING
PROVIDERS
CARTEL
MONITOR
INDUSTRY
LAUNDERING
STABILITY
FINANCIAL
SOLVENCY
CREDIT
FRICTIONLESS
SETUPS
TRANSPOSED
LISTED
CONFIDENCE
GOVERNMENTS
CRIMINAL
UNWELCOME
DOGMATICALLY
ENFORCE
PENSIONS
INSTITUTIONS
SHAREHOLDER
RELIANCE
DEREGULATED
GLOBALIZED
INVESTMENT
SUPERVISION
GOVERNMENT
BANKS
FORWARDS
PARTICIPANTS
PUBLISH
RATING
ACTIVITIES
BANKING
PROTECTION
COMMITTEES
SUPERVISES
NOTIFICATIONS
LEVEL
INTEGRITY
MANAGEMENT
AUTHORITY
STOCK
HOC
AGENCIES
ABDICATED
CASE
REGULATOR
PRIVATE
SERVICES
ENDANGER
REGULATORY
CRIME
EXCHANGES
REQUIREMENTS
EMPOWERS
COMPANIES
FINANCIERS
INSURANCE
LISTING
SECURITIES
EFFICIENT
ACTS
MAINTAIN
STRUCTURE

Monetary Policy Rate

The Monetary Policy Rate (MPR) is the anchor rate that the CBN uses to implement or signal the stance of monetary policy. It is the policy rate that provides an indication of the Bank's stance regarding current monetary conditions as well as its preferred path of action. It is closely tied to the market interest rate faced by banks and end-users of funds. Thus, changes to the policy rate by the CBN is expected to induce corresponding changes in the banking system and financial markets. An increase in the MPR indicates that the CBN considers that there is a build up of inflationary pressures and seeks to pursue a contraction in liquidity conditions. On the other hand, a decrease in the policy rate indicates that the Bank views current liquidity conditions to be non-inflationary and consider it appropriate to expand money supply to support economic growth. Decisions to alter the monetary policy rate are taken at meetings of the Monetary Policy Committee (MPC), after adequate consideration of domestic and global monetary conditions.

Nominal Anchor

A nominal anchor for monetary policy is usually selected to be a variable that a central bank uses to anchor the expectations of economic agents about what it expects the path or level of general prices to be, as well as to signal its anticipated course of action towards maintaining the stated level and path of general prices. A nominal anchor is usually a critical element for the success of a monetary policy regime and serves to impose a constraint on the value of domestic money supply. It creates a unique proposition upon which the price level can be determined and pins down inflation expectations across a broad range of economic sectors. Importantly, the nominal anchor provides a basis to avoid the time inconsistency problem with implementation of monetary policy, where policymakers are prone to adopt short-term decisions that may counteract anticipated longer-term outcomes. It provides a basis to adopt a forward-looking stance that is required for formulation and implementation of monetary policy with a medium-term perspective.

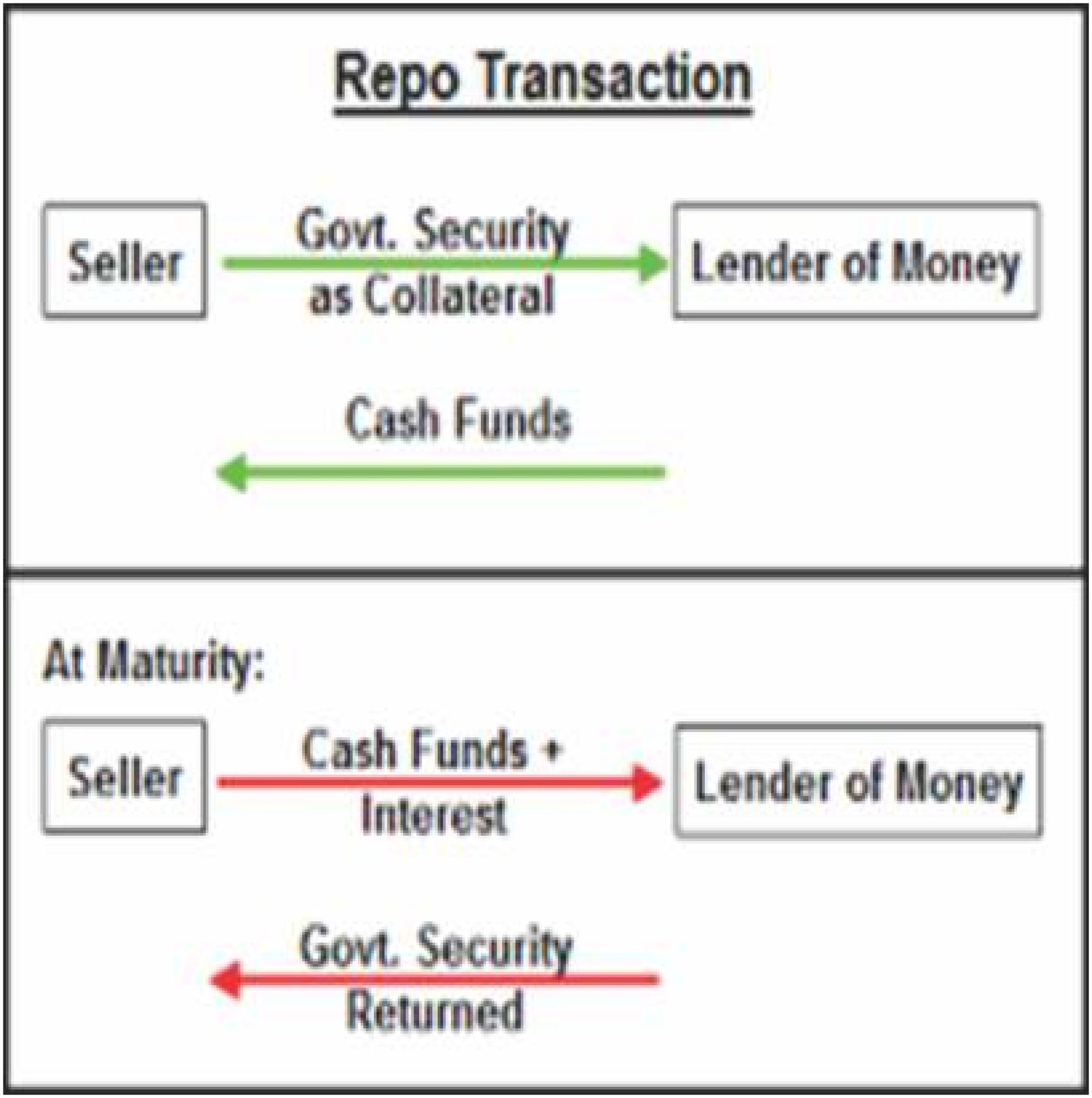
Guarantee of interbank Placement

The Guarantee of Interbank Placement is a measure utilized by the CBN to correct liquidity challenges in the banking system. With effect from July 13, 2009, the CBN decided to guarantee all inter-bank placements and placements with the banks by Pension Funds Administrators which were to mature on or before March 31st, 2010. The strategy involves the guaranteeing of loans at the interbank market and putting a cap of 4.0 per cent on deposit rates at which funds are fixed in banks. The key objective of the measure was to lower lending rates and stimulate economic growth since banks could pass on the benefits of reduced lending costs to their borrowing customers. It was also designed to moderate risks in the interbank market and address the concerns of banks and investors, such that more credit could be advanced to the economy, particularly the real sector.


BANK
BANK

Repurchase Agreement

These are temporary purchases and sales of designated financial market securities by a central bank, to either increase (sale) or decrease (purchase) the supply of money in the banking system. Operations to decrease money supply (purchases of securities) are termed 'reverse repurchase'. Usually, repurchase transactions are consummated with the exchange of cash and collaterals, usually government securities. The mechanism simply entails the exchange of cash based on prescribed collaterals with an agreement to repurchase the collateral at a future date. It is variously referred to a liquidity adjustment facility, in apparent reference to its use by the central bank to alter or adjust the quantum of liquidity available to the financial system. They are useful to the monetary authorities as a monetary policy instrument due to low credit risk and flexibility for use in liquidity management. The central bank of Nigeria (CBN) uses repurchase agreements as one of its major instruments for the implementation of monetary policy.


Repo Transaction
Seller
Govt. Security
as Collateral
Lender of Money
Cash Funds
At Maturity:
Seller
Cash Funds +
Interest
Lender of Money
Govt. Security
Returned

Currency

Currency is any commodity issued by a government and generally accepted as a medium of exchange for goods and services, within an economy. Currency is, therefore, the widely accepted means of paying for goods and services in a country. There is, therefore, a unique currency for each country (except those that have adopted the currency of others - El Salvador uses the US Dollar, or currency blocs where a single currency is used by different countries e.g. the Euro). Modern currencies acquire value from the implicit faith and backing of government, and are referred to as 'Fiat currency'. This innate quality further ensures that it can be controlled by the monetary policy of the central bank. A broader definition of modern currency includes near money assets such as cheques and bank accounts, through which payments can be easily made. Recent developments in information technology have also led to the proliferation of online (crypto) currencies that are not tied to any specific country - a widely known example being the Bitcoin. Advances to the payment system, leveraging on IT, has also brought increasing prominence to digital and virtual currencies.


South Sudan
One
1000
LIRE MILLE
REAL
Cook Islands

Currency Outside Banks

Currency outside banks is currency in circulation (CIC) plus vault cash. It is, therefore, any currency outside the vaults of private banks and of the Treasury, which is held by the public. All banknotes and coins of the national currency held by all economic subjects such as households, businesses and non-residents, are considered as currency outside banks.

Thus, currency outside banks is computed as a difference between the total printed banknotes and coins and cash in the vaults of those involved in cash distribution, namely central bank, commercial banks' vaults, cash in transport and postal services.

The currency outside banks is difficult to estimate for a developing country like Nigeria, where there is a high proportion of informal financial services and low level of financial inclusion.


British
US Dollar
Euro
Japanese
Chinese

Money

The term ***'money'*** means anything that is generally accepted as a medium of exchange and settlement of debts. As noted by Adam Smith in the Wealth of Nations, although money and wealth are used in every day language as synonymous, in Economics, wealth is created in the real economy through the production and exchange of goods and services of the society. Here, money performs two distinct roles: in facilitating the exchange of goods and services and in expressing in a single unit of measurement, the value of the goods and services created by society. In the first instance, we are talking about the distinction between real values and money or nominal values. Thus, although wealth can be expressed in money terms, wealth and money are not synonymous. What then is money? ***Money is anything that is generally accepted as a medium of exchange***


RenMoney

Velocity of Money

This is a concept that describes the rate at which money changes hands among several transactions as well as the frequency that a unit of currency is used during a given period of time. A higher velocity of money implies that in an economy relative to a different time period or another economy, implies that a higher rate of inflation may be produced. The velocity of money concept is a key element of monetary policy, based on the quantity theory of money which forms the basis for monetary policy implementation. The velocity of money can be used to gauge the economy's strength or people's willingness to spend money. It is usually calculated as the ratio of nominal gross domestic product (GDP) to the money supply. When there is a high velocity of money, it implies that the same quantity of money is being used for a greater number of transactions and the economy is likely to expand. Conversely, a lower velocity of money when there are fewer transactions being made in the economy, money velocity decreases and the economy is likely to contract.

Demand Deposits

This is money kept in either a deposit, time, savings or foreign currency account at deposit money banks, that can be withdrawn at any time without notice to the bank using either an over-the-counter cheque, ATM machine and, in recent times, online banking platform. Demand deposits ensure that consumers have unfettered and speedy access to funds for transaction purposes and, in major economies, constitute a significant proportion of money supply. They are recorded as liability items on the central bank balance sheet, to which monetary policy is applied in order to control money supply. When there is heightened withdrawal of demand deposits by bank customers, as witnessed during a financial crisis, money supply increase while banks are faced with precarious liquidity positions. Demand deposits are, thus, a very critical variable for implementation of monetary policy.


Current Account
Saving Account
Demand Deposit

Cash

Cash is money in notes or coins that is issued by a government and used in payment for goods and services as well as to settle debt. It is usually the physical representation of the currency that is approved by the government of a jurisdiction. Historically, cash assumed different forms during several epochs in the development of human civilization. At various times, precious metals and commodities were used as cash in various jurisdictions. In recent times, however, notes and coins have become the dominant forms of cash, with notes being the most recently introduced during the eighteenth century. Other assets that are easily converted to cash include: treasury bills, commercial papers, banker's acceptance, etc., and these have also been used as cash. In the banking industry, outstanding amounts of a line of credit or overdraft that is provided by a bank may also be included as cash. While it is the most widely-used medium in payment for transactions in goods and services, the proliferation of other payment media such as cards and online banking has reduced the demand for cash. In fact, current innovations in payments' systems are leading towards less emphasis on cash payments and more towards cashless transactions.

Currency in Circulation

This is the total amount of notes, coins and demand deposits that is used by businesses and individuals in payment of goods and services. It represents the total amount of money that is readily available to the public both for transaction and precautionary purposes, and also constitutes a significant portion of total money supply in an economy. Currency in circulation is a highly liquid component of money supply and receives keen attention from central banks, in the implementation of monetary policy. This arises largely from the role of CIC as an indication of the quality of banks' reserves and, consequently, the extent to which loans can be disbursed. By definition, currency in circulation includes notes and coins in the vaults of deposit money banks, who are closely regulated by the central bank. This provides the leverage for central bank action to influence monetary conditions through this channel.

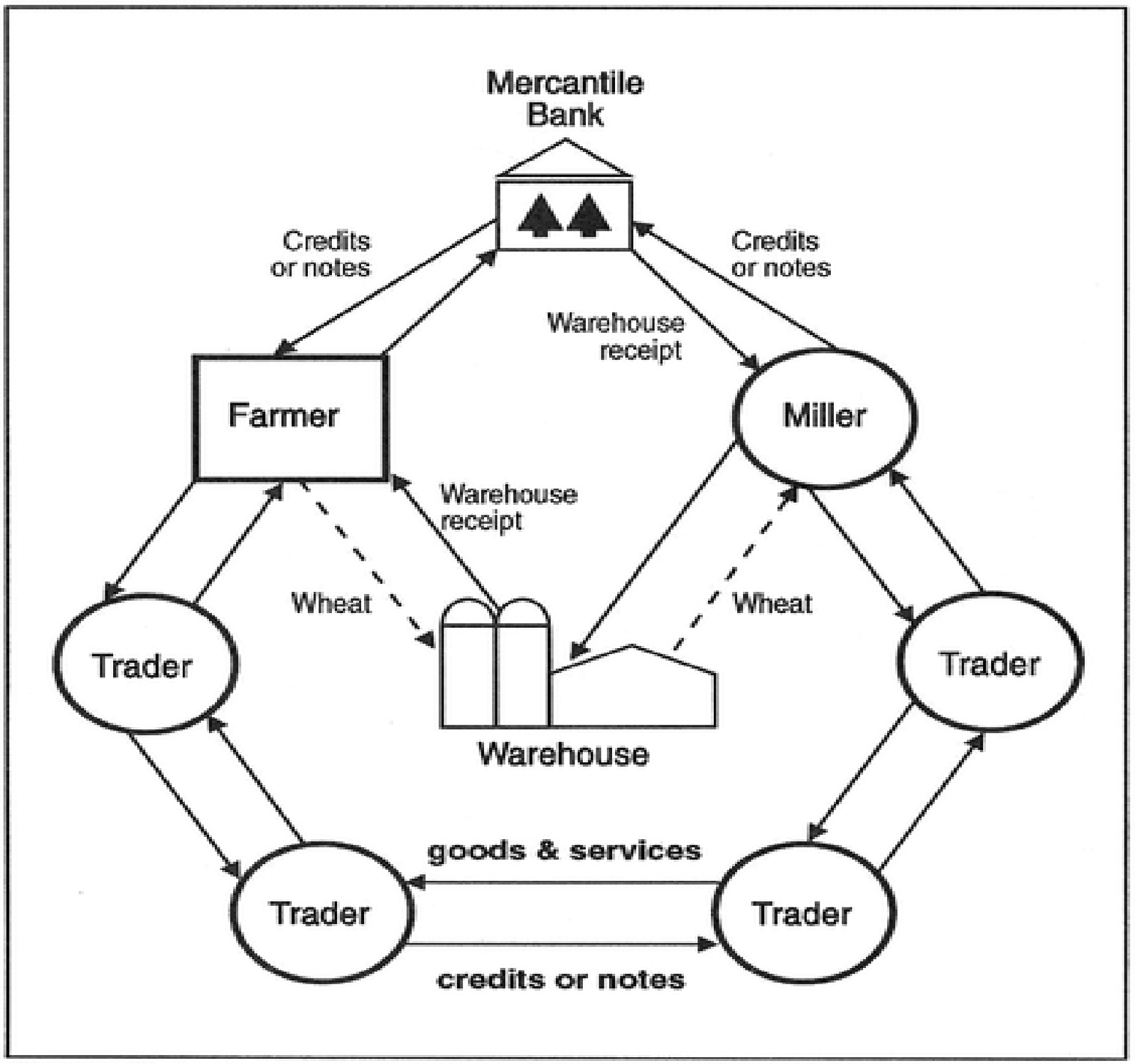


Figure 13.1: A Commodity-based Currency Circuit

Virtual Currency

Virtual or digital currency is a digital (e-money) representation of a unit of account, store of value, and medium of exchange. It is however, different from real money because, it does not have legal tender status. Example of virtual currency is bitcoin, crypto-currencies and Altcoin. While different forms of e-money exist, it was Satoshi Nakamotol, pseudonymous developer, who first introduced Bitcoin, a crypto currency in 2009 to facilitate payments. The amount of currency in the crypto-currency system is controlled at an open rate bounded by a predetermined value and supplied through a mining process, which also depends on the technical capability of participants (or miners). Mining entails validating transactions by using computing resources to find a solution to algorithm problems, which is the only way to create new money in the crypto-currency system. One of the risks associated with virtual currency is that it is neither issued nor guaranteed by any authority.

Currency Swap

A currency swap is sometimes referred to as cross currency swap. This is a contract entered into by two nations to make a currency exchange. It is a foreign exchange derivative that is used between two institutions for the purpose of exchanging the original and/or accrued payments of a loan in one currency for comparable amounts, in net present value terms, in another currency. Originally, currency swap was an arrangement between nations as a way of granting nations access to appreciable amount of foreign currency to make purchases in foreign markets or provide predictable streams of revenue in another currency.

Narrow Money

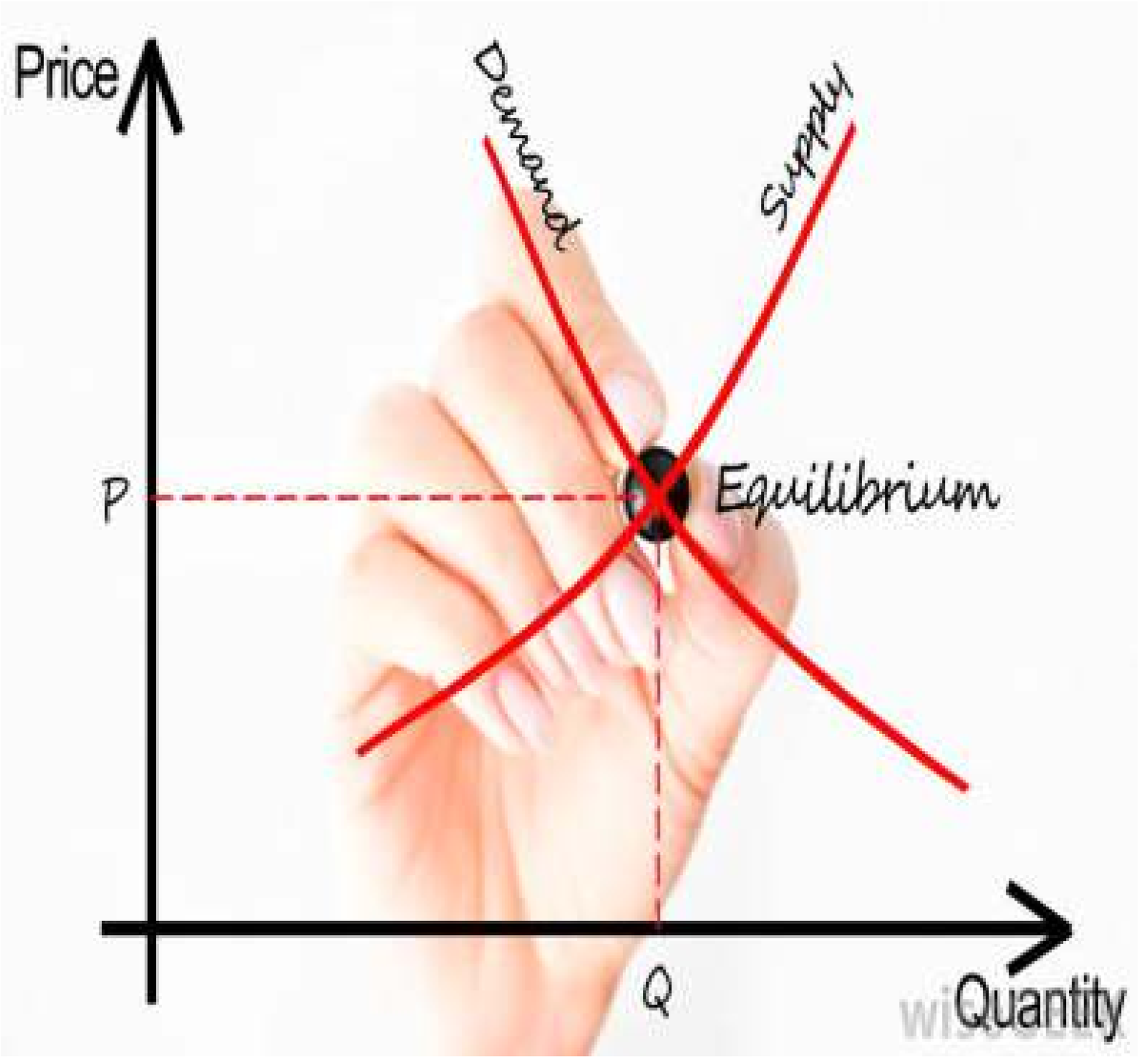
This is the total of notes, coins and some bank balances that are easily converted to cash and used in payment for transactions within an economy. It is essentially all physical forms of domestic money and current deposit accounts that are readily available to economic agents as well as the liquid assets of depository institutions that are kept with the central bank. The term 'Narrow' is used to denote that the elements included in this measure of money supply are restricted to only highly liquid assets thereby excluding longer term deposits. The defining feature of the components of narrow money is that they are readily convertible to cash or are cash in themselves

Broad Money

Broad Money or M2 is composed of narrow money and other forms of money such as short term investments, which are not easily convertible to cash and may not be in physical form. It is regarded as a more inclusive measure of money supply in a given country, and includes more elements of liquidity. Due to it being a wider measurement of money supply, broad money is considered by economists to have a closer relationship to inflation and is used by central banks in the implementation of monetary policy. Movement in broad money is a critical indicator that provides credible signals to central banks on appropriate measures to be taken, particularly for liquidity management purposes. Broad money may, however, be measured in more than one way depending on differences in stages of economic and financial development as well as peculiarities in different economies. This leads to other broad money definitions such as M3, M4 and M5. Due to its broader composition and possibility of frequent changes to its components, broad money appears to be less stable than narrow money

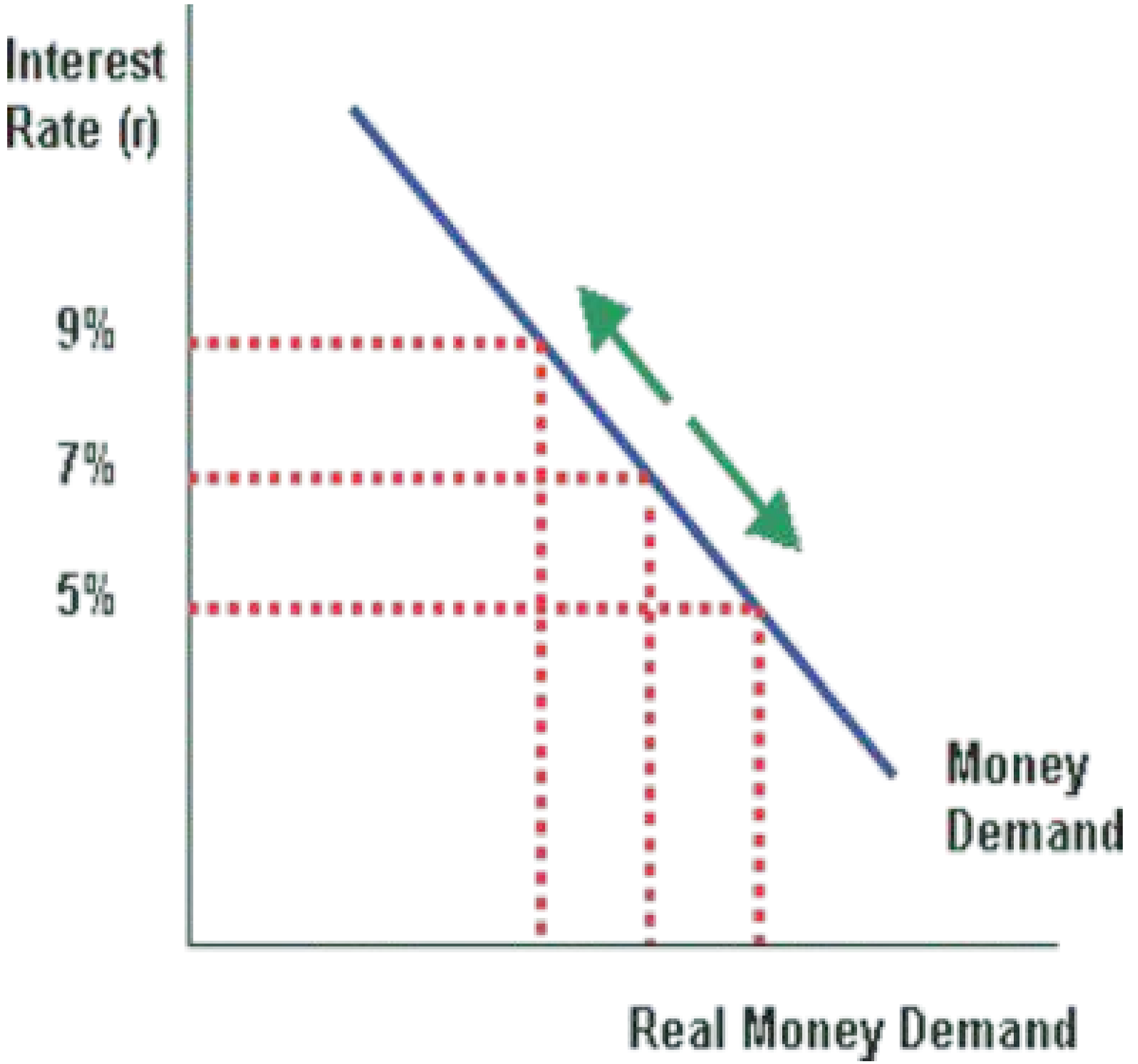
Aggregate Money Supply

This is the entire amount of money that is available to the economy at any point in time. In other words, it is the overall composition of the monetary assets that an economy has at a specific time. It is usually a summation of the various measures of money supply viz MI, M2, M3, M4, etc. in practice, the aggregate money supply is expected to reflect the quantum of economic activities and GDP of a country. Where aggregate money supply grows, it should indicate that economic activities are thriving and vice versa. Like its individual components, aggregate money supply is a major variable that a central bank controls in order to influence economic activities and control price increases – increasing the aggregate to stimulate economic activities (which pushes up inflation) and decreasing supply to slow down an overheating economy (thereby reducing inflation).


Price
Demand
Supply
P
Equilibrium
Q
Quantity

Demand for Money

Demand for money is the amount of cash or bank deposits that an individual is willing to hold as money at any point in time. The demand for money usually arises from the trade-off between money as a store of value and as liquidity. This gives rise to the transaction, speculative and precautionary motives for holding money. Transactions demand emanates from the need to meet regular demand for money by individuals and to facilitate operations by businesses. Speculative demand arises from the need to take advantage of investment opportunities that may arise while precautionary demand arises from the need to hold money to meet exigencies. A basic principle is that increases to nominal output leads to an increase in the demand for money. The demand for money is an important variable for central banks because it largely guides the implementation of monetary policy. Specifically, the stability or otherwise of the money multiplier determines, to a large extent, the potency of the monetary policy rule for stabilizing policies in the economy.


Interest
Rate (r)
9%
7%
5%
Money
Demand
Real Money Demand

Interest Rate

Interest rate is the cost of borrowing money and is expressed as a percentage of the loan amount. In other words, it is the proportion of a loaned amount that the lender charges as interest to the borrower. It may also be the rate that is paid for holding a financial asset as investment or depositing money in a bank. Generally, the level of interest rates in an economy is an indication of the level of liquidity within that economy. High interest rates usually indicate that there is shortage of liquidity while low interest rates reflect loose liquidity conditions. Other factors that may determine interest rate movements include the term to maturity of an investment, central bank's desired level for interest rate to achieve monetary policy and broad macroeconomic goals, etc. It may either be the market or policy rate. Market rates include lending and deposit rates in the banking system or interbank rates while the policy rate is usually controlled by a central bank. The signals from interest rate movements, therefore, makes it a critical variable for central banks to consider in the formulation and implementation of monetary policy.

Exchange Rate

Exchange Rate is the amount that the currency of one country can be exchanged for a unit of another currency. It usually changes to reflect developments in economic factors such as political stability, inflation, trade balance, etc. Determination of the exchange rate is usually based on the foreign exchange regime that is adopted in a country. In a market based (flexible) regime, the rate is determined by the forces of demand and supply while official considerations are used to determine the exchange rate in a managed regime. The exchange rate is said to appreciate when a lesser amount of the domestic currency is required to buy a unit of a foreign/reference currency. On the other hand, a currency depreciates when more units of the domestic currency are required to purchase a unit of the foreign/reference currency. The exchange rate may also be determined in the spot or futures market. In the former, the exchange rate is determined for payment and settlement at the time of contact between transacting parties while price in the futures market are determined for payment and settlement at a future date or date of maturity of the contract.

Real exchange Rate

It is derived when the nominal exchange rate has been adjusted for relative national price level differential. Contrary to other variables, the adjustment for real exchange rate necessitates accounting for price levels in two different countries. The nominal local currency price of international currency multiplied by the international price level and divide by local price level will result to the Real exchange rate. i. e,

$$R=EP^*/P$$

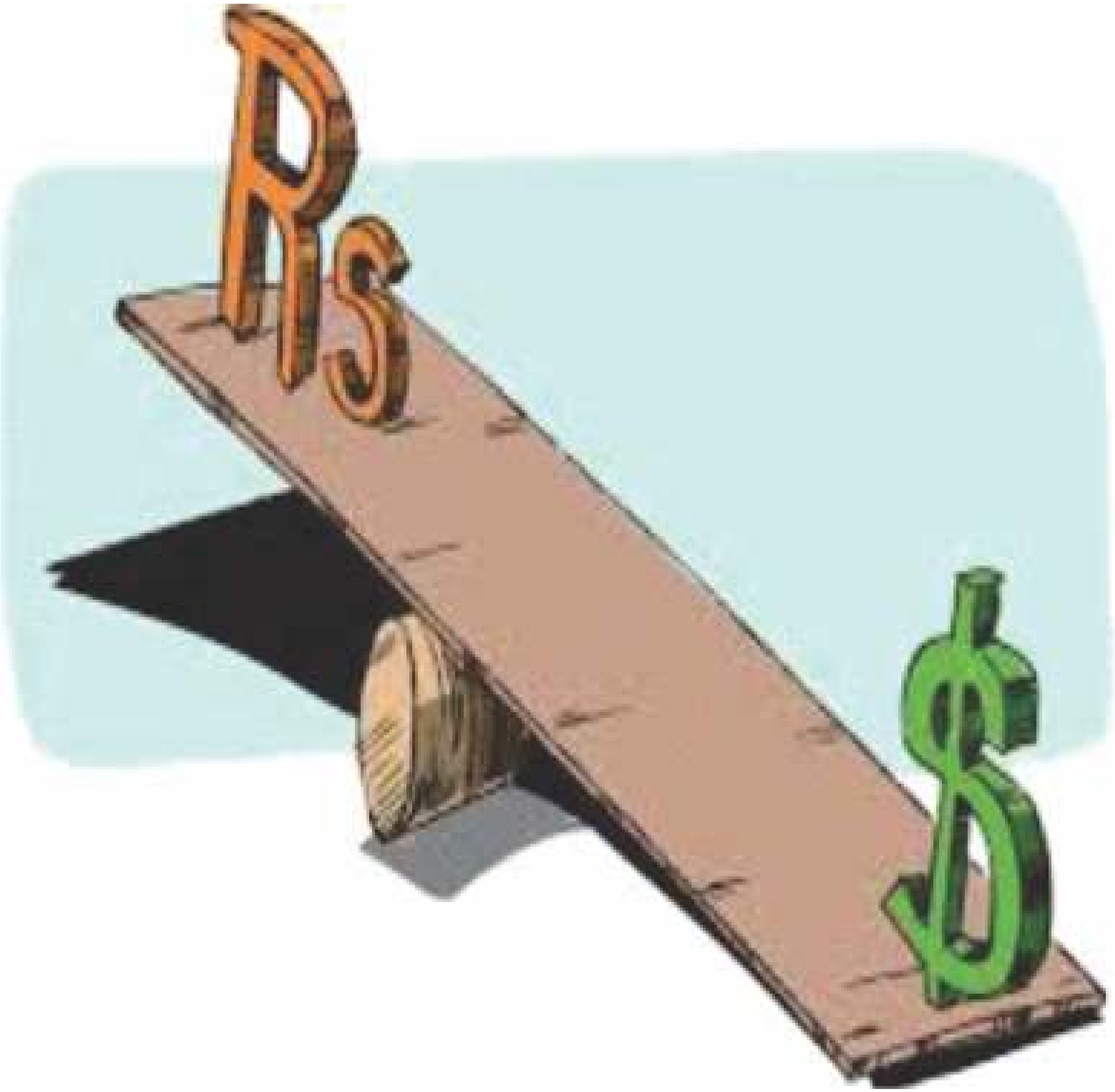
R= Real exchange rate
E= nominal local currency price of international currency
P*= international price level
P= local price level

The Real exchange rate amid two currencies is could be derived from nominal exchange rate (the naira cost of a dollar, for instance) and the fraction of prices between the two countries.


depositphoto

Exchange Rate Depreciation

Exchange Rate Depreciation is the opposite of currency appreciation. It is also common under a floating exchange rate regime. It represents a decrease in value of a home currency when compared to a foreign currency. Depreciation induces a reduction in imports but promotes exports. Example, if the Nigerian Naira depreciates, then the reverse of an appreciation occurs. Assuming that the Nigerian Naira depreciate from N120 = 1$ to N150 = 1$, this will make Nigerian goods and services cheaper abroad and so Nigerian export will increase. Also United States goods and services become more expensive for the Nigerian and so import decreases while export will increase. Most of the reasons for the depreciation in home currency is associated with weak domestic economy, low domestic interest rates compared with overseas and higher inflation that the other trading partners. To calculate exchange rate depreciation, we use the formula: $\{(P2-P1) \div P1\} \times 100$


Rs
$

Exchange Rate Appreciation

Currency appreciation is common under a flexible exchange rate regime. It is an increase in the value of a currency of a country when compared with other currencies. It arises from the interplay of demand for and supply of foreign currency in the market. A currency gains value or appreciates relative to other currencies when you require less of it in exchange for other currencies. Example of currency appreciation is a situation where N150 is exchanged for a USD1$ but later changed to N120 in exchanged for a UDS1$. i.e N150 = 1$ = to N120 = 1$. The home currency is said to appreciate if the domestic economy become stronger, higher domestic interest rate than abroad and the domestic inflation is lower compared with is obtainable around the world. Other available policy which countries could adopt to increase the value of its currency is the selling of foreign exchange assets to buy own currency. Appreciation in the Naira compare to United States dollar will make goods and services cheaper, the Naira will buy more of goods and make travelling abroad cheaper.

To calculate appreciation, we can use this following formula: {(P2-P1) ÷P1}×100

Exchange Rate Devaluation

The act of lowering the price (exchange rate) of a country's currency relative to other currencies by government administrative fiat under a fixed exchange rate system. The primary purpose of devaluation is to enable government to reduce the price of the country's exports and increase the price of foreign imports, thereby resulting in increased domestic production. Mostly, central bank keeps a fixed value of its currency by getting set to purchase or trade foreign currency with its own currency at a specified rate; a devaluation occurs when a change in the specified rate make foreign currency more expensive in terms of the domestic currency. A change in the specified rate making foreign currency less expensive is refers to as revaluation, an opposite of devaluation.

Inflation Rate

This measures the change in the general prices of goods and services in an economy, over a given period of time. As a concept, inflation refers to the sustained increase in the general price level of goods and services in an economy over a specified period of time. This, leads to a reduction in the purchasing power of money (currency) as the currency can only buy fewer amount of goods and services. This, invariably, leads to a higher cost of living and poses serious concerns to economic managers. The inflation rate for a current month can be measured with reference to the same month in the previous year (year-on-year) or month (month-on-month). Also, inflation can be calculated for different groups of commodities such as transportation, education, food, etc. Inflation may either be cost-push, demand-pull or structural to indicate the source of price pressures. The inflation rate is usually measured as a change in the consumer price index (CPI) or any other designated index, and is reported on a monthly basis. This provides regular indications of the movement in economy-wide prices for informed formulation of monetary policy by a central bank.


INFLATION
©PAREL

Inflation Forecast

The rate at which the general price level for goods and services rise is referred to as the inflation rate. In most jurisdictions, the rate of inflation is usually released on a monthly basis. However, sequel to its relevance in the management of the economy, policy makers are always on the lookout for its future path either in the short or long term horizon. This future path of inflation is referred to as inflation forecast. It is alternatively defined as the variation in the consumer price index of a basket of goods and services that would be consumed by households in the future.

Consumer Price Index

The consumer price index (CPI) could be defined as an all-inclusive measure that is used for estimating changes in the price of a representative basket of goods and services that mirrors the consumption expenditure pattern of an economy. It is also seen as a weighted average of the prices of goods and services such as transportation, processed food, medical, education and housing etc. The consumer price index is estimated by averaging the price changes for each item in the predetermined basket of goods and services. There are three types of consumer price index. They include-headline consumer price index, core consumer price index and food consumer price index

Headline Inflation

This is defined as the totality of price inflation in an economy. It is made up of core and food inflation. It takes into consideration changes in the price of food and energy. Because of the usefulness of headline inflation in reflecting the changes in the cost of living within an economy, it is a key macroeconomic indicator. Some of the components of headline inflation include housing, water, electricity, gas and other fuel, education, food and alcoholic beverages, clothing and footwear, transportation services, communication etc.


nbs
NATIONAL BUREAU OF STATISTICS

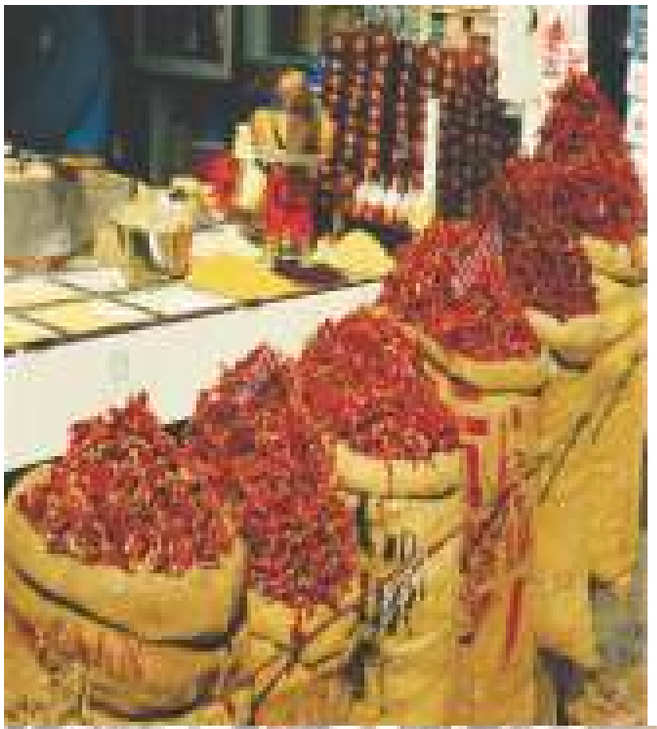
Core Inflation

This is defined as the price change of goods and services excluding items that are subject to volatile price changes such as food and energy. Unlike headline inflation computation that takes into consideration the price of all the goods and services, core inflation considers the prices of all goods and services except commodity prices (like prices of vegetables, fruits etc.) and oil prices which are characterized by extreme volatile price movements. This is particularly necessary since in most cases, the price shocks are transient. In essence, core inflation is the measure of underlying inflation.


INFLATION

Food Inflation

Food inflation could be defined as a steady rise in the price level of all agricultural food items. It involves an increase in the wholesale price index of essential food items (defined as food basket) relative to the general inflation or the consumer price index. In most cases, agricultural prices fluctuate due to the inelastic nature of demand and supply as well as variation in supply that is associated with weather conditions. Food inflation is made up of some of the following components-bread, cereals, fish, meat, yams and other tubers, wine, potato, soft drinks, coffee, tea and cocoa etc



Price Stability

Price Stability is an economic condition whereby changes in the price level are moderate over a given period of time. This means that the upward or downward movement in prices are not significant when measured over a specified period. The objective of price stability, as a mandate for central banks, requires that extended periods of price increases or decreases should be avoided. It is usually characterised by economists and central banks as a specified rate or range of inflation, to be achieved using monetary policy instruments. A key benefit of ensuring price stability is that it improves the ability of people to recognize relative changes as against changes to the general price level. This ensures that consumers are not concerned about a reduction in the value of their disposable income and consumption expenditure is not affected. Thus, a key reflection of stable prices is stability in the inflation rate. In addition, price stability prevents the arbitrary redistribution of wealth while contributing to the attainment of financial stability. In Nigeria, price stability was for a long time regarded as the attainment of a single digit inflation rate.

Market Intelligence

It is primarily a qualitative information gathering process undertaken by Central Banks through direct interaction, and discussions with market participants. Information gathering by way of market intelligence from the financial markets is a vital input into monetary policy formulation and implementation. It is a way of enhancing and extending the Authorities' insight from market data.

There are various reasons for the monetary authorities' market intelligence: (1) market operations and financial market analysis, (2) monetary policy analysis, (3) foreign exchange management, (4) debt management policy (5) domestic portfolio management, (6) fiscal policy, (7) macro prudential policy. In all the survey by the bank for International Settlement shows that the primary purpose for Market Intelligence rests on the monetary authority's market operations and financial market analysis. Market intelligence as a major input into policy formulation, is of particular interest to inflation targeting countries.

Market intelligence is gathered on different economic agents and institutions such as money markets, sovereign rates, agency-related securities, corporate credits, securitised products, equity markets, bank capital and funding markets, and commodities.


MARKETS
PRODUCTS
INDUSTRIES
COMPETITORS
VENDORS
CUSTOMERS

Foreign Direct Investment

Foreign Direct Investment (FDI) is an investment by a national of one country to acquire long-term interest in enterprises in another country. It refers to an incorporated or unincorporated enterprise in which a single foreign investor either owns 10 per cent or more of the ordinary shares or voting power of an enterprise, yet still maintains an effective voice in management. FDI is a catalyst to global economic integration and with the appropriate policy, FDI is capable of providing financial stability, promote growth and development, enhances the socioeconomic wellbeing of the citizens of the recipient country.

Measuring the size of FDI is vital because it helps in understanding the openness of the economy and the resulting mobility of capital across countries. The extent of capital importation into a country is highly dependent on restrictions of capital and sometime fluctuates with economic activities. For primary commodity exporting countries like Nigeria, fluctuations in commodity prices also affects FDI inflow. For example, the National Bureau of Statistics report suggests that the reason why Nigeria has attracted less FDI is related with the concern about whether they will be able to repatriate the earnings from investment, given some recent exchange rate policies, the slowdown in growth and the recession in 2016, which raised concerns about the profitability of investment.


Y'ello Zone
90
Domino's Pizza

Foreign Portfolio Investment (FPI)

Foreign Portfolio Investment is investment made in debt securities (bonds, note, money market instruments, and financial derivatives that are not part of FDI) by nationals of foreign countries in another country in order to make capital gains. The distinguishing characteristics FDI and FPI is that in the later, the investment interest is less than 10 percent and the investor is not required to be affiliated to the enterprises.

Increase in FPI inflow facilitates a substantial increase in the depth and breath of the secondary market, increases earning in the financial market, investment diversification for foreigners, and provides a buffer for financing the balance of payment deficits.

However, high inflow of FPI to what is considered desirable, particularly for a developing country has been put to question. Most developing countries who rely heavily on FPI are said to be highly vulnerable given that FPI is highly volatile. In particular, it is described as friends in good times whose departure in bad times leaves an economy worse than it was prior to the FPI inflow. Consequently most countries trade with caution in the volume of FPIs inflow.

Gross Domestic Product

The Gross Domestic Product measures the market value of all goods and services produced in an economy within one year. It is a major indicator of the health of an economy. An increase in GDP growth suggests the economy is improving while a decline suggests a slump in economic activities. There are mainly three approaches to computing the GDP. The income, expenditure and value added approach. All approaches are expected to yield the same values.

The GDP values in Nigeria are calculated quarterly and annually. It is an indicator of the performance of the economy within the period. A significant change in GDP (either increase or decrease), impacts other indicators such as inflation and employment. Hence, the performance of the economy has some impact on the well-being of everyone in the country. The more the economy grows, the more income grows and vice versa. When there are two consecutive quarters of GDP negative, the economy is said to be in a recession. At such times, the efforts at stimulating the economy through public and private spending are required.


G
D
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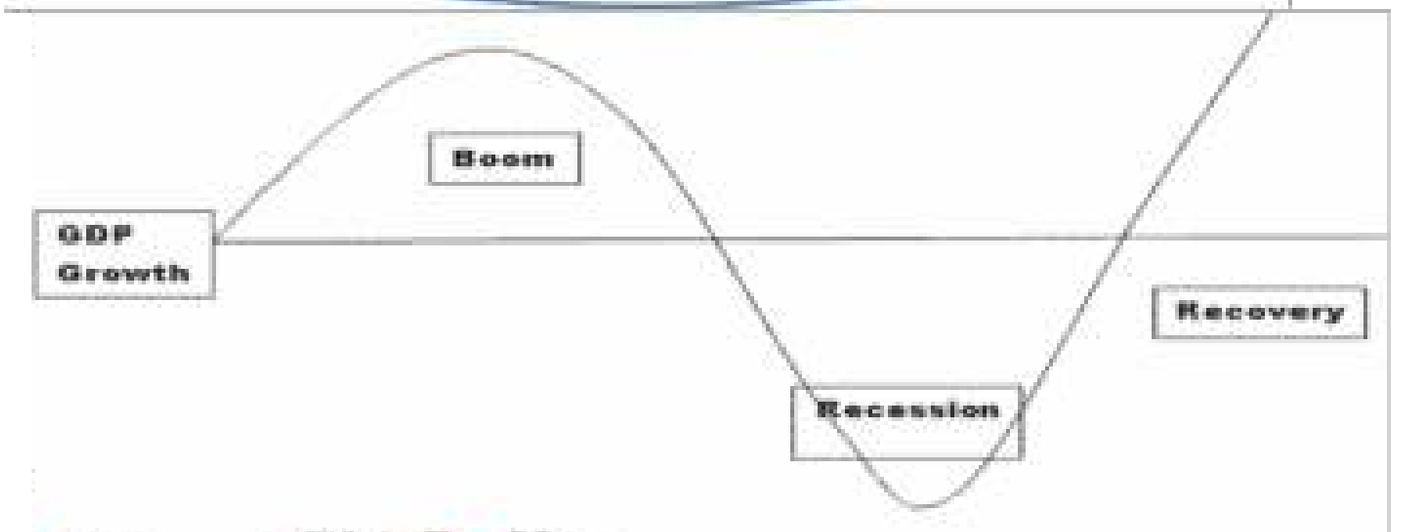
Economic Recession

An economic recession is a period of general slow down in economic activity. It is characterised by two consecutive quarters of negative GDP. During a recession, macroeconomic indicators such as GDP, investment spending, capacity utilization, household income, business profits, and inflation fall, while bankruptcies and unemployment rates rise. It is also regarded as a contraction in the business cycle. Coming out of a recession is usually a costly process because it requires huge fiscal spending to stimulate economic growth. Sometimes, the monetary authority may consider lowering interest rates to increase investment in the real sector. This is a reasonable policy option when inflation is still at tolerable levels.


RECESSION


Boom
GDP
Growth
Recovery
Recession

Economic Depression

Economic depression is an extreme case of economic recession. Although there is no widely-agreed single definition of depression quarters of unlike economic recession, which is two consecutive quarters of negative growth in output, depression describes severe downturn in economic activities that lasts several years. In extreme cases, economic depression could lead to socioeconomic and sociopolitical crises. In a more technical term, it is a situation of prolonged and sustained economic downturn or recession, which is associated with, hunger, job loses, closure of business, and low demand. Example of economic depression, is the great depression which began on black Tuesday of 1929, which lasted ten years. Depression is usually associated with high unemployment, deficient demand, low and negative growth in output, and unwanted inventories. It began after a major crash of the stock market in October 1929.

Stagflation

“Stagflation" is a hybrid of economic stagnation and inflation occurring at the same time. The idea is attributed largely to the British Conservative party politician, Ian Macleod who was the first to coin it in November 1965 when the United Kingdom was experiencing both inflation and unemployment during the same period. Macleod later became the Chancellor of the Exchequer in 1970. The term generally refers to a condition of high inflation rate, slow economic growth, and high unemployment. Stagflation was not limited to the United Kingdom as there is evidence that it has transcended through several other countries especially during the period 1973 to 1982 ,

Algebraically, Inflation + Unemployment + Negative GDP growth=Stagflation

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End Note

We welcome comments and suggestions from our users on how better to serve you.

About the Series

"At a Glance" is part of the Central Bank of Nigeria's literacy series, designed to enlighten users with brief descriptions of basic monetary policy concepts.

The publication presents in a simplified pictorial form, monetary policy concepts in a manner that can be easily understood by users. The pictorial animations make for a more reader friendly presentation. The content will be highly beneficial to all who have a desire to learn the basic concepts of monetary policy, fiscal policy, central banking, financial policy and other related concepts. The book is readily available in libraries across the nation and will be updated as often as required. Enjoy the experience of a well-researched and packaged literacy material.