Central Bank of Nigeria, Monetary Policy Department

Monetary Policy Series **CBN/MPD/Series/01/2006**

The Series wish to educate stakeholders and the general public on monetary policy issues such as: what is monetary policy, how it is conducted, What it can do and not do and how the monetary policy actions of the Central Bank of Nigeria affects the Nigerians, the economy and the outside world.

WHAT IS MONETARY POLICY?

Monetary Policy refers to the specific actions taken by the Central Bank to regulate the value, supply and cost of money in the economy with a view to achieving Government's macroeconomic objectives. For many countries, the objectives of monetary policy are explicitly stated in the laws establishing the central bank, while for others they are not. The objectives of monetary policy may vary from country to country but there are two main views. The first view calls for monetary policy to achieve price stability, while the second view seeks to achieve price stability and other macroeconomic objectives. The Central Bank of Nigeria, like other central banks in developing countries, achieve the monetary policy goal through the amount of money supplied.

In Nigeria, the Central Bank defines money supply as comprising narrow and broad money. The definition of narrow money (M_1) includes currency in circulation with non-bank public and demand deposits or current accounts in the banks. The broad money (M_2) includes narrow money plus savings and time deposits, as well as foreign denominated deposits. The broad money measures the total volume of money supply in the economy. Thus, excess money supply (or liquidity) may arise in the economy when the amount of broad money is over and above the level of total output in the economy.

The need to regulate money supply is based on the knowledge that there is a stable relationship between the quantity of money supply and economic activity and that if its supply is not limited to what is required to support productive activities; it will result in undesirable effects such as high prices or inflation.

The Central Bank of Nigeria (CBN) derives its mandate from the CBN Act of 1958 and its subsequent amendments. In specific terms, part one, section one of the CBN Decree No. 24 of 1991, stipulates that the principal objects of the Bank shall be to:- Issue legal tender currency in Nigeria; maintain external reserves to safeguard the international value of the legal tender currency; promote monetary stability and a sound financial system in Nigeria, and Act as banker and financial adviser to the Federal Government.

Over the years, the CBN has conducted its monetary policy towards achieving these objectives. More recently, the Bank has refocused on achieving price stability, while at the same time balancing it with other macroeconomic objectives of the Government.

In summary, monetary policy in the Nigerian context refers to the actions of the Central Bank of Nigeria to regulate the money supply, so as to achieve the ultimate macroeconomic objectives of government. Several factors influence the money supply, some of which are within the control of the central bank, while others are outside its control. The specific objective and the focus of monetary policy may change from time to time, depending on the level of economic development and economic fortunes of the country. The choice of instrument to use to achieve what objective would depend on these and other circumstances. These are the issues confronting monetary policy makers.