

KEYNOTE ADDRESS BY CHIEF (DR.) J. O. SANUSI, GOVERNOR,
CENTRAL BANK OF NIGERIA AT THE 5TH MONETARY POLICY
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Distinguished Ladies and Gentlemen,

You are all cordially welcome to the fifth edition of the Monetary Policy Forum. The theme *Interest and Exchange Rates in the Context of Economic Growth and Development* has been chosen for the role which these policy variables play in the macroeconomic management of the economy. The Bank has been concerned in the past two years with the twin problems of high interest rates and a depreciating Naira. Although we had focused attention on these issues last year, their persistence has made it imperative for us to revisit the topic.

Although the theme of the seminar had been decided in April, it was fortuitous that when the President of the Federation, Chief Olusegun Obasanjo, met with the Bankers' Committee three weeks ago, he spoke with passion on the same issues. The passion the topic generates arises from the desire of the authorities to achieve the major goals of macroeconomic management, namely to control inflation, promote growth and reduce poverty. Low interest rates are desirable for productive activities but a policy of low interest rates has implications for exchange rates and the domestic price level.

To put the discussion in proper perspective, I will briefly review the causes of high interest rates and exchange rate instability. With regard to interest rate, the causes include: government's fiscal policy regime, especially, the persistent monetary financing of the budget deficits, banks' cost of funds, especially, the oligopolistic structure of the banking industry and the mix of monetary policy measures which have unintended adverse impact on banks' portfolio management. As you are aware, CBN's monetary policy measures are aimed at achieving price stability and the choice of operational tools is dictated by the stance of fiscal policy and

monetary conditions.

You would recall that, in order to address the lingering problem of excess liquidity in the banking system in 2001, the CBN progressively raised its MRR by 650 basis points, from 14.0 per cent in January to 20.5 per cent in September. Similarly, the Cash Reserve Requirement was raised to 12.5 per cent. Through these means, the observed excessive growth in monetary aggregates was curtailed. However, the action brought about some unintended distortions in banks' interest rates structure as their lending rates became generally high while the average savings deposit rates remained low and negative in real terms. Thus, the spread between banks' savings and maximum lending rates remained wide, reflecting the uncompetitiveness and oligopolistic structure of the banking system. As at December 2001, the spread between banks' weighted average deposit and maximum lending rates was 14.7 percentage points, while that between the average savings deposit and maximum lending rates was 26.2 points.

I will not bore you by undertaking a comprehensive review of our exchange rate management. Suffice it to say that the Bank is acutely aware that in addition to economic fundamentals such as inflation, external reserves, output, supply and demand, the Naira has been subjected to speculative attacks. In this connection, the causes of instability in the rate are not far-fetched. Some of the important causes include the inordinate dependence on the oil sector and on imports for production and consumption. Others are evasion and avoidance of import duty payment, high rate of inflation, speculative attacks and unethical behaviour on the part of some banks.

It is important to point out that exchange rate performs a dual role in the economy, both of which are important for maintaining macroeconomic stability. First, the movements of the exchange rate can help achieve and enhance international competitiveness and thus ensure a

viable balance of payments position. Second, exchange rate can serve as an anchor for domestic prices and thus contribute to the establishment and maintenance of internal balance or price stability. While both of these objectives are desirable, it is important to explicitly address the question of what relative weight must be assigned to each of the objectives in order to design and implement an appropriate exchange rate policy.

The optimal management of the exchange rate depends on the economic objectives specified, the source of shocks facing the economy and its structural characteristics. Consequently, neither a permanently fixed or completely flexible exchange rate system is optimal in seeking macroeconomic stability. Admittedly, achieving a low interest rate structure in combination with a strong currency is no simple task and will require the dedication and cooperation of all stakeholders. First, the Government must act to reduce the level of fiscal deficits as well as provide an enabling environment in terms of effective and efficient infrastructure. Similarly, the CBN must continue its efforts at nurturing a more competitive and efficient financial environment through strengthening its surveillance activities and reviewing its policy instruments. The banks should also rededicate themselves to their primary function of financial intermediation. Similarly, manufacturers and other producers in the economy will need to look inwards in order to reduce dependence on imports. If we want the Naira to appreciate we must work for it, we must earn it through increased productivity, by exporting more and importing less. When each stakeholder does what is expected of him, then achieving a strong naira and a low interest rate structure will become feasible.

Ladies and Gentlemen, I hope I have been able to whet your appetite on the current developments with regard to interest and exchange rate issues in Nigeria. I, therefore, wish to challenge you to come up with appropriate and effective measures that could be adopted to ensure efficient interest and exchange rate regimes, which will guarantee macroeconomic

stability and growth in the Nigerian economy.

I thank you for your attention.