Central Bank of Nigeria

Reaction to IMF Press Release on Nigerian Monetary Policy

The reaction is a full transcription of the live interview the Governor, Central Bank of Nigeria, Mallam Sanusi Lamido Sanusi had with CNBC TV programme – Regional Round-up on Friday, 18th February 2011 at 3:25pm. Read on:-

Lareto: *Firstly, your response to the IMF and the statement they have made that Monetary Policy in Nigeria has conflicting objectives.*

Sanusi: I'd like to first of all start by saying that we appreciate IMF's comments on our economy and the support they have given us so far. However, it is important to state that the days have gone when Central Bank Governors simply accept everything that they have said and conflicting objectives in Central Banking are not unique to Nigeria. The United States Federal Reserve for decades had the objectives of pursuing price stability and full employment. Most Central Banks in developing economies do have policies that support stability that is conducive to growth and development. I think it is extremely dangerous to create the impression that multiple objectives are necessarily mutually exclusive or conflicting. There is nothing that says that pursuit of moderate inflation should blind us to the need for growth and development in a country like Nigeria and this has been a source of debate with IMF. We think that a Central Bank in a developing economy is not an inflation targeter and we have continued to say that we would pursue price stability but we would also continue to take seriously our role as a developmental Bank and contribute to the growth of the real economy and we don't see any necessary conflicts.

Lareto: *Let's focus on the issue of managing high inflation, the sense is that the CBN has reduced its standing on deposit rates at banks and possible going forward, you should be taking bolder moves on MPR rates not raising them by 25 basis points but really making decisive stances so that you manage this inflation problem which you yourself have been outspoken about.*

Sanusi: Yes, but I think it is important to make a distinction between questions of policy and of timing. We all agree on what is a right policy response, but there is also a question of timing. I don't think there is anyone who questions the fact that if you do have inflationary pressure, it is time for tightening. The question is do you tighten money when you have a financial crisis in front of you? It is very bad economics when half of our banks are undercapitalized, when we don't have an asset management corporation bill for us to have tightened money and this was our point with IMF. We could not tighten money when we had a banking crisis. The United States still has quantitative easing because of the financial crisis, in the UK inflation is at 4%, the Bank of England has not tightened. No central bank governor after the great depression and what happened in Japan in the 80s will tighten money without finding solutions to the crisis in banks. Now we have AMCON bill that went through a legislative process during a difficult political period, it was not signed by the President until towards the end of the year; until we had AMCON and the board of AMCON, it was too big a risk for us to start tightening and the moment we had the bill and the board, we took the right steps with signals that we were going to tighten, the issue is not whether we should or should not have raised interest, but whether we should raise interest and tighten money at a time when the banking system was a big risk to the economy. Now that it is no longer a big risk, we have done the right thing and this was our argument with IMF.

Lareto: *What do you see by way of risks to inflation going forward, you mentioned the situation in the banks and the need to introduce the AMCON bill to try to rectify some of those liquidity issues, there is also the whole question of unbridled government spending which has also added to inflationary pressures in Nigeria,* *going forward, do you think we are going to see a situation when things get worse before they become better?*

Sanusi: We have always made it very clear and if you follow our MPC statements from the middle of last year, we have also made it clear that we think the time has come to start fiscal consolidation and retrenchment, we have always made it clear that we should reduce overhead and recurrent expenditure and this has been the position of the Central Bank and our last MPC was very strong and even prior to that, we have anchored our justification for raising rates on the rising specter of fiscal dominance. Having said that, you must remember that the CPI itself was rebased by the National Bureau of Statistics sometime last year. Inflation declined consecutively from 14% at the beginning of 2009 to 10.3% in June last year. 10.3%; that was going down but in July, the new index came out and inflation moved to 13%, so that jump, this 12.1% you are seeing (in January 2011) is partly a reflection of a rebased CPI, with different components and different weights. It is important for us as central bank when we understand the reason behind big numbers not to have knee-jerk reactions. If we just jacked up rates by 200-300 basis points and threw up yields by 500-600 basis points it would be distortionary. We want stability.

Lareto: *Let's talk about the other mechanisms at your disposal, I mean some of the other concerns raised are structural issues which we know about in the Nigerian economy. The fact that the country relies heavily on oil revenue to finance consumption, issues around productivity in the economy, things you know of, I think there have been questions raised as to the interventions taken by selling of reserves to buffer the naira instead of raising interest rates, what other options are available to you, do you think?*

Sanusi: Options available to a Central Bank tend to be quite limited. We do have control over interest rates and obviously, we can use the supply of the dollar at WDAS to mop up liquidity. We have chosen to go for exchange rate stability. It is not a fixed rate; I have made it very clear that we are not there to defend the Naira at that level at all cost, but we do not have any fundamental reason for reducing the value of the Naira. I have had this debate with the IMF, the recommendations they made are internally inconsistent. If we devalue the currency or we depreciate the currency, it adds to inflation. If we have a volatile exchange rate, it affects inflationary expectations. The question is can we sustain this rate? And in a time of rising oil prices, stable revenues, we think we can. In fact, the depletion of reserves has ended. We have had gradual accretion in the last three months. So we made a distinction between a temporary depletion in reserves and what is permanent and sustainable, and our trajectory and our view was that we had run down reserves because we had special power projects, we had run down reserves because we had to invest money to replace oil wells that had been bombed and production centres that had been attacked during the Niger Delta crisis and get to production, and we had run down reserves to support the naira at the time when it had speculative attack. Now, that has gone, if you look at the demand profile, if you look at the exchange rate, we've been at ₦150, we have always been ₦150 ± 3%, and stability in the exchange rate is central to our price stability objective and we totally disagree that the Central Bank should just devalue based on these short term shocks which are a reflection of a global crisis especially since it was driven by liquidity, and we know that, that liquidity was necessary for the banking system.

Lareto: *Let's talk about the naira just a little bit further. You have just said that you accept and you understand that you cannot defend the naira at all cost, and we've seen proposals for instance that Forward contracts in terms of forex sales. Is this a move towards leaving the naira to the devices of the market?*

Sanusi: No, we do think that we will continue to maintain a stable currency and in fact, we do think that today we are in a much better position to defend the Naira at this level than we were a few months ago. Oil prices are up; output is up, the demand for reconstruction and rehabilitation of structures is not where it was, the power reforms are going on, so we do not see any fundamental reason at this point in time for an oil producing economy when oil prices and output are going up, for us to depreciate or devalue. What we did with Forwards was basically to address the fears of those who have doubts about our willingness and commitment to defend the Naira. We have done this transparently. We have said this is what we are doing. If we think that there is a reason to change that and go to a Crawling Peg and move down 2-3%, we will announce it to the market. Everybody will understand that this is our own view of the long term position. But the reserves position in Nigeria today covers more than 12 months imported goods, it covers about 7 months imported goods and services. We are not in any way in a desperate situation and when people say that the Naira is overvalued, I ask them in relation to what? Nobody has given me an answer to that.

Lareto: *Final question to you Governor, some of the recommendations is that in pursuit of price stability, the CBN should eventually move towards inflation targeting, how open are you to that suggestion?*

Sanusi: All talk of inflation targeting in the Central Bank of Nigeria is prohibited so long as I am Governor. I don't think that a developing country like Nigeria can pursue that. There are a lot of structural problems. First of all there is a question of the serious limitation of monetary policy. A lot of the components of inflation in Nigeria are structural. We are an import dependent economy, we import inflation through imports of food and energy. We do have a large component of our CPI being in agriculture which is affected by the weather; and I think an excessive, exaggerated belief in the power of the Central Bank to control inflation leads to policies that get to high rates of interest, sometimes it creates unemployment and creates bad loans for the banks. We will continue to pursue implicitly a target of single digit inflation but we will do this along with efforts to promote growth and development.

The End

For more on this issue and other related matters, you are invited to watch a live CNBC T.V interview with the Governor on Monday, 21st February 2011 at 11:25am.

M.M Abdullahi
Head, Corporate Communications
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