# HOW DOES THE CENTRAL BANK DECIDE THE APPROPRIATE SETTING FOR ITS MONETARY POLICY INSTRUMENTS?

Monetary policy affects all aspects of our economic and financial decisions-whether to by a car, build a house, start up a business or to expand the existing one, whether to send one's child to school or to make the child learn a trade. Monetary policy tries to influence the performance of the economy as reflected in key macroeconomic indicators like inflation, GDP and employment. It works by affecting aggregate demand across the economy, i.e. individuals' and firms' willingness and ability to spend on goods and services.

In doing this, monetary policy has two fundamental goals: to promote maximum sustainable output and employment, and to maintain stable price level in the economy. This job of stabilizing output in the short-run and promoting price stability in the long-run involves several steps. First, the Central Bank tries to estimate how the economy is doing now and how it is likely to do in the medium-term. Then it compares this estimate to its goals for the output and the price level. If there is a gap, between the estimates and the goals, the CBN has to decide on how forcefully and swiftly to act to close the gap.

Estimates of the current economic conditions are not easy as even the most up-to-date data on key variables like employment, growth, productivity etc, largely reflect conditions in the past. So to get a reasonable estimate of the current and medium term economic conditions, the Central Bank tries to find out what the most relevant economic developments are such as government spending, economic conditions abroad, financial conditions at home and abroad, and the use of new technologies that boost productivity. These developments are then incorporated in an economic model to see how the economy is likely to evolve over time. In doing this, the Central Bank is confronted with some unexpected developments such as the Niger Delta crises that distort oil production and revenues to the government. They therefore have to build uncertainties into their model.

Uncertainty seems to be a problem at every stage. It indeed pervades every part of the monetary policy process. There is yet no set of policy and procedures that policy makers can use to deal with all situations that may arise. Instead, policy makers must decide how to proceed by a case analysis. The issue is far from being settled. Indeed, the Central Bank spends a great deal of time and effort in researching into the various ways to deal with different kinds of situations. Since these issues are not likely to be resolved very soon, the Central Bank is likely to continue to look at every thing.