

Price Stability and Economic Growth in Nigeria: Evaluating the Role of the Central Bank of Nigeria

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Abstract

Price stability is vital to economies because price levels determine inflation and deflation. This can be determined in an economy through the state instrument, which is the Central Bank. A key role of central banks is to conduct monetary policy to achieve price stability (low and stable inflation) and to help manage economic fluctuations. The aim of this study is to examine the role of the Central Bank of Nigeria in enhancing the price state and economic growth in Nigeria. The study adopts a descriptive research design. Data is obtained mainly from secondary sources and CBN Bulletin to examine the issues under discussion. Content analysis was used in discussing literature within the framework of specific objectives the study seeks to address. From the analysis of data, the study concludes the Nigerian state has not been able to achieve this objective due to certain fundamental challenges. It further suggests that, CBN can surmount the challenges and achieve this economic goal through efficient liquidity management strategies, improved coordination between the fiscal and monetary authorities, and strengthening of the banking system towards achieving price stability, among other factors.

Keywords: *Price stability, Economic growth, Inflation, Deflation, Monetary policy*

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Background to the Study

The economy of the world is changing positively and negatively. The negative impact of the economic downturn affects all sectors and at the micro level, all the households. Bernanke (2014) observed that “in the emerging economic market, everyone has had the experience of going to the store and spending more than you did last time, despite purchasing the same things. These unstable prices, uncertainty, and inflation are caused by unstable microeconomic policies in the country. In an open market, the prices of goods and services are driven by supply and demand—as supply and demand rise and fall, so do consumer prices”. Feldstein (1997) earlier stated that “when severe fluctuations occur in general price levels, an economy's financial stability is at risk. That's why governments and banks work to maintain price stability”. He added that “Price stability is achieved when the general level of prices in the economy avoids significant fluctuations, meaning they don't rise or fall drastically in indexes of prices like the Consumer Price Index (CPI) or the Harmonized Index of Consumer Prices (HICP)” (Feldstein, 1977).

According to Ajayi (2012), price stability is the general level of prices in the economy. It is a situation where prices in an economy change slowly or do not change at all. It also connotes avoiding prolonged inflation or deflation. Price stability helps in achieving a high level of economic activity and employment”. Furthermore, he stressed, “It means that prices on average are stable over time. The positive change in the price level can be referred to as inflation. Inflation is the rate at which the general price of goods and services is rising over a period of time, which may eventually lead to a reduction in individual purchasing power and also a decline in the value of money. Inflation and deflation are key monetary/financial occurrences that have costs on the economy of any nation across the globe” (Ajayi, 2012).

In Nigeria, Ajayi (2012) reiterated that “monetary and price stability is the central objective of the Central Bank of Nigeria. This function is executed through monetary policy. Monetary policy is simply defined as the use of various instruments to control the supply of money in the economy”. The importance of controlling the money supply is because its increase may raise the level of inflation, while its reduction can bring down the level of inflation in the economy. Inflation is considered an enemy to some economic agents because of some obvious reasons;

1. High inflation undermines the capacity of the economy to generate gains in output, incomes, and employment;
2. For those with fixed income, it wears away the value of their investment's income and social well-being;
3. It encourages high speculative deeds in the financial markets relative to the investments that boost production activities and enables firms to compete both domestically and internationally (Ajayi, 2012).

In recent years, the Nigerian economy has suffered from volatile and unpredictable inflation. The situation got aggravated by the experiences of COVID-19. This has resulted in high-interest rates on loans and deposits and a high level of dollarization. This has led to an unstable economic environment that has hampered economic growth. Experts admit that the situation

has also led to a fixed exchange rate policy that has resulted in the accumulation of macroeconomic imbalances. As earlier stated by Ajayi (2012), the Central Bank has the responsibility of ensuring monetary and price stability in the country. This study, therefore, examines this role, emerging challenges, and prospects for price stability and economic growth in Nigeria.

Methodology

The study adopts a descriptive research design. Data is obtained mainly from secondary sources and CBN Bulletin to examine the issues under discussion. Content analysis was used in discussing literature within the framework of specific objectives the study seeks to address.

Conceptual literature

Price Stability

According to Potters (2021), Price stability is a goal of a monetary and fiscal policy aiming to support sustainable rates of economic activity. The policy is set to maintain a very low rate of inflation or deflation". The European Central Bank (ECB) describes price stability as a year-on-year increase in the Harmonised Index of Consumer Prices (HICP) for the Euro area of below 2%. However, by referring to "an increase in the HICP of below 2%" the ECB makes clear that not only persistent inflation above 2% but also deflation (i.e., a persistent decrease of the general price level) is inconsistent with the goal of price stability (European Central Bank, 2017). ECB (2017) added that price stability is vital to economies because price levels determine inflation and deflation—inflation is defined as an increase in prices and a decrease in the value of money, while deflation is a decrease in prices and an increase in the value of money. In other words, when prices increase (usually measured over the course of a year), it is called inflation, and when prices decrease, it's called deflation.

According to the National Bank of Ukraine (NBU) (2021), "Price stability is the condition in which the domestic currency retains its purchasing power by maintaining low and stable inflation as measured by the Consumer Price Index over the medium term (from 3 to 5 years)". Price stability does not imply that prices do not change; it means that prices grow at a moderate pace. Ajayi (2012) maintained that "High inflation reduces the incomes and savings of businesses, households, and the state, and drives an increase in production costs, the cost of credit, and interest rates as a result of uncertainty over future prices. Large inflation fluctuations create an unfavorable environment for long-term investment in the economy, as investors focus on short-term transactions. Thus, high and unstable inflation affects economic growth" (Ajayi, 2012).

Taking that into account, creating an environment with low and stable inflation is the NBU's main contribution to sustainable economic growth. This type of environment implies that:

1. Inflation is no longer a concern for households and businesses
2. Trust in the domestic currency grows and the currency becomes more widely used
3. The real value of household incomes and savings is maintained
4. Economic agents do not use foreign currency as the medium of exchange, store of value, and unit of account

5. Low nominal interest rates support investment activity and economic growth
6. Households and businesses adequately assess FX risks and are prepared for potential large fluctuations of the exchange rate, which cause a change in the value of savings and liabilities in foreign currency (NBU, 2021).

Reference to the NBU bulletin discloses that “The NBU's task is to gradually shift the public's focus away from exchange rate fluctuations, to focus on inflation. The only way to achieve that is to conduct a consistent and transparent monetary policy aimed at delivering price stability. The NBU's focus on price stability requires a commitment to a floating exchange rate, which makes exchange rate fluctuations the main buffer against external shocks to Ukraine's economy” (NBU, 2021). The report added, “In the event of negative external shocks (e.g., a decline in demand for Ukrainian exports or a deterioration in the terms of trade), a moderate depreciation of the hryvnia would maintain the competitiveness of Ukrainian exports and mitigate the adverse effect on output and employment”. This experience is similar in Nigeria.

Price stability has a significant impact on the economy. In Nigeria and elsewhere, the experience is positive. A bulletin report by European Central Bank highlighted the benefits of price stability including,

1. **Improves price transparency.** With stable prices, consumers can recognize relative price changes without being confused by overall price changes (for instance, consumers will notice when the price of apple increases compared to oranges). This means informed decision-making when they consume and invest.

2. **Avoids arbitrary redistribution of wealth.** When unexpected inflation occurs, wealth is redistributed randomly, rather than based on merit or need: for instance, different goods' prices increase at different rates, which punishes certain businesses more than others, and creditors receive less in loan payments than they would have with low inflation, while debtors benefit from inflation. With price stability, this arbitrary redistribution of wealth is avoided.

3. **Lowers risk premia.** A risk premium is the lowest return on investment a consumer needs in order to hold a risky asset rather than a risk-free one. If risk premia are high, it means consumers are unwilling to make risky investments, and economic activity slows. If risk premia are low, real interest rates are lower and consumers feel more comfortable with investment decisions, which lead to economic growth (ECB, 2017).

Evaluating the Nigerian experience before the current level of instability, experts (Fischer, 1986, Bernanke, 2004, Ajayi, 2012) admit that price stability,

1. Contributes to a more stable financial system. When prices are stable, everyone is better off: price stability supports economic growth and employment, and allows people to make more reliable plans when taking decisions about borrowing, saving, and expanding businesses.
2. Reduces inefficiency costs arising from the presence of nominal rigidities
3. Reduces the inefficiency costs created by inflation being a tax on money balances.

4. Avoids the adverse redistributive effects of inflation. The adverse effect of inflation on income and wealth differs across different cohorts of society, with higher inflation especially detrimental for low-income households with limited investment options.
5. Avoids adverse interactions of inflation with taxation. The presence of inflation creates distortions because taxes are levied in nominal terms and there is no full indexation.
6. Reduces unexpected changes in inflation, which create distortions. For example, if there is an unanticipated increase in inflation, the value of savings goes down and the value of debt goes down, which transfers wealth from savers to borrowers.
7. Decreases the volatility of inflation, which in turn lowers uncertainty and market interest rates and this motivates people to invest.

The Concept of Economic Growth

The concept of economic growth is defined in the Oxford Dictionary as “the increase in the production of goods and services per head of population over a stated period of time”. In the Cambridge Dictionary, it is seen as “an increase in the economy of a country or an area, especially of the value of goods and services the country or area produces.” Simply, economic growth is an increase in the quantity and quality of the economic goods and services that a society produces. In its broad sense, economic growth describes the process of increasing a country's real gross domestic product (GDP). The growth can be measured as an expansion of real GDP or gross national product (GNP) over a given period (Bernanke, 2004).

According to Potters (2021), “economic growth is an increase in the production of economic goods and services, compared from one period of time to another. It can be measured in nominal or real (adjusted for inflation) terms”. Traditionally, aggregate economic growth is measured in terms of gross national product (GNP) or gross domestic product (GDP), although alternative metrics are sometimes used. He added that “economic growth refers to an increase in aggregate production in an economy. Often, but not necessarily, aggregate gains in production correlate with increased average marginal productivity. That leads to an increase in incomes, inspiring consumers to open up their wallets and buy more, which means a higher material quality of life or standard of living”. He maintained that, in economics, “growth is commonly modeled as a function of physical capital, human capital, labor force, and technology”. Simply put, he said, “increasing the quantity or quality of the working age population, the tools that they have to work with, and the recipes that they have available to combine labor, capital, and raw materials, will lead to increased economic output” (Potters, 2021).

Economic growth and the expansion of production capacity come from technological change and capital accumulation. If a country puts all its resources to produce goods and services and none of its resources to accumulate capital, its production capacity will not change. Potters added that there is essentially a tradeoff between more production now or economic growth in the future. For a country to achieve increased future consumption, it must decrease the production of goods and services. The forgone current consumption is the opportunity cost of economic growth (Potters, 2021).

Potters (2021) elaborated on the ways to generate economic growth in an economy through state policies and price stability.

1. Increasing the number of physical capital goods in the economy. Adding capital to the economy tends to increase the productivity of labor. Newer, better, and more tools mean that workers can produce more output per time period
2. Advancement in technology. Technological improvement is one of the key factors that promote economic growth in an economy. This involves innovating and finding more efficient ways of production. Like capital growth, the rate of technological growth is highly dependent on the rate of savings and investment, since savings and investment are necessary to engage in research and development.
3. Growing the labor force. An increase in the productive workforce significantly affects more economic goods and services. Also, just like additions to capital, it is important for the right type of workers to flow to the right jobs in the right places in combination with the right types of complementary capital goods in order to realize their productive potential.
4. Increases in human capital. This means laborers become more skilled at their crafts, raising their productivity through skills training. Savings, investment, and specialization are the most consistent and easily controlled methods. Human capital in this context can also refer to social and institutional capital; behavioral tendencies toward higher social trust and reciprocity and political or economic innovations like improved protections for property rights are in effect types of human capital that can increase the productivity of the economy.

Central Bank of Nigeria, Price Stability and Economic Growth in Nigeria

The Central Bank of Nigeria is tasked with ensuring monetary and price stability in Nigeria. This function is executed through the formulation and implementation of monetary policy measures in Nigeria. The Bank has continued to perform this task over the years (CBN, 2012). However, it continues to be confronted with the challenge of effectively anchoring the expectation of economic agents, among others. Over the years, the objectives of monetary policy have remained the attainment of internal and external balance of payments. However, the emphasis on techniques/instruments to achieve those objectives has changed over the years. There have been two major phases in the pursuit of monetary policy, namely, before and after 1986. The first phase placed emphasis on direct monetary controls, while the second relies on market mechanisms (CBN, 2012).

In 2020, the thrust of the Bank's monetary policy continued to signal an accommodative policy stance, reflecting developments in the global and domestic economic and financial environments. These developments included the protracted lockdown of economies across several regions of the world following the outbreak of COVID-19 infections and the absence of effective treatments for the virus, which continued to drag global output recovery. Other factors were persisting decline in global aggregate demand and supply; disruptions in global supply chain and trade; rising sovereign and corporate debts; heightened financial market vulnerabilities; low prices of crude oil and other commodities; and rising unemployment.

Price stability refers to a condition of relatively low change in the general price level over time. In other words, the degree of fluctuation or volatility is relatively low, suggesting the absence of inflation or deflation. Price stability is important to economic agents because inflation, a condition of a general rise in prices, is normally regarded as a “theft of value”. A general rise in price level is undesirable for various reasons.

1. First, it is difficult for economic agents to effectively plan and efficiently deploy their resources to achieve their immediate and future economic goals.
2. Second, high inflation undermines the capacity of the economy to generate gains in output, income, and employment.
3. Third, for those with fixed incomes, it erodes the value of their investment and social well-being, and lastly, it encourages speculative activities in the financial markets relative to investments that boost production. Consequently, concerted efforts must be put in place to address issues relating to inflation if an economy must experience sustainable growth and development. It is against this perspective that maintaining a low and stable price level (Price stability) has been globally considered the core objective of monetary policy (Ajayi, 2012).

Price stability, as an objective of monetary policy, is desirable for several reasons as indicated below:

- i. It facilitates an improved standard of living: In a general context, both inflation and deflation have severe consequences on the standard of living via a reduction in the level of investment. A stable price regime facilitates investment planning, which would translate to a higher level of employment and invariably, a higher standard of living.
- ii. Reduction of uncertainty about future price development: Economic agents are less worried about future development in prices under a regime of price stability. Accordingly, it is easier for firms and individuals to make the right investment and consumer decisions. It also allows people to identify changes in the price of goods and services.
- iii. It reduces the inflation premium risk: Price stability allows creditors to discount or ignore the inflation risk premium as compensation for the risk associated with holding nominal assets for some time. This equally enhances the efficacy of monetary policy transmission because real and nominal variables are closely aligned, thereby strengthening confidence in the economy and invariably attracting investment inflows.
- iv. Reduces or eliminates unnecessary hedging activities: A considerable level of resources is devoted to hedging in an environment of high and rising price levels. This, invariably, represents a shift of resources from productive uses to hedging of inflation. If the price level remains stable, these resources could be put into productive use, leading to a rise in domestic output.
- v. It increases the benefit of holding cash: Generally, inflation brings about high transaction costs and therefore, increases household demand for cash. In a regime of price stability, the frequency of demand for cash is reduced, hence a reduction in the transaction cost associated with the use of cash.

- vi. Prevents arbitrary re-distribution of wealth and income: low and stable inflation prevents substantial and arbitrary redistribution of wealth and income. Economic agents respond to the anticipated changes in price levels through portfolio rebalancing. The immediate challenge of the rebalancing process is that the weak and the vulnerable are excluded from economic activities since they have limited possibilities and are unable to participate in the process. This process from time to time may trigger a social and political upheaval which ultimately leads to further deterioration in economic conditions.
- vii. Enhances financial stability: Price stability enhances financial stability because it helps to avert inflationary shocks. A persistent and general rise in price levels constrains the use of money as a store of value. This implies that economic agents would reduce their level of savings with financial institutions which invariably weakens the intermediation capacity of the financial system (Ajayi, 2012).

Central Banks perform this function through the formulation and implementation of monetary policy to influence the cost and level of money supply in an economy. To achieve a stable price level, the monetary policy aims to achieve a condition where the quantity of money demanded equals the quantity of money supplied. The price at which the supply of money equals its demand is the equilibrium price level. Thus, price stability is achieved when economic agents do not hold excess or less money than required to make intended transactions. The task of formulation and implementation of monetary policy in Nigeria is vested in the Central Bank of Nigeria (CBN) through the CBN Act of 2007. The Act provides instrument autonomy to the CBN and recognizes the Monetary Policy Committee as the body responsible for monetary policy in the Bank (Central Bank of Nigeria, 2011).

Ajayi (2012) explained that the monetary policy objective of price stability has several benefits in contrast to the adverse social, economic, and political costs of high inflation. Too much money chasing too few goods is the key reason for upward inflationary pressure in most economies. Other factors that may contribute to upward inflationary pressure include structural issues such as poor power supply, poor transportation networks, and insecurity. In addition, excess liquidity in the banking system and fiscal imbalances continue to pose a challenge to price stability.

Several factors affect the Central Bank of Nigeria's achieving price stability in Nigeria price stability in Nigeria. Ajayi (2012) identified the following:

1. Fiscal Imbalance: This is a situation where government revenues do not match its expenditure. In such a circumstance, the government may resort to central bank financing of its deficit, which could cause structural inflation.
2. Extraordinary Liquidity Crisis. The central bank as a lender of last resort is meant to supply liquidity in times of financial distress in the economy. The central bank intervention would be appropriate to stem the financial crisis, but the level of intervention in question may have long-term consequences on inflation expectations.
3. Unpredictable Medium-Term Fiscal Strategy: Another major challenge of monetary policy is the unpredictability of the medium-term expenditure and revenue of the

three-year frameworks, normally employed by the Government. The estimated revenue from oil determines the size of the budget, and Government may resort to the banking system to meet its financing needs if the expected revenue is affected by an external price shock.

4. **Lack of Clear Understanding of the Concept of Price Stability:** The term price stability is ambiguous in most jurisdictions, making it difficult for economic agents to key into various measures that could moderate rising price levels. It is generally recognized that a certain degree of price increase (inflation) is required to stimulate the production of goods and services.
5. **The credibility of Central Banks:** In an environment where central banks have a pedigree for policy inconsistency, anchoring inflation expectations becomes difficult. This, invariably, would affect inflation expectations, which is a key driver of actual inflation performance.
6. **Structural Issues:** The instruments at the disposal of the monetary authorities are largely for managing the demand side of the economy but it is increasingly being recognized that supply-side issues play a significant role in price development in many economies. The achievement of price stability through measures taken by central banks would largely remain elusive in as much as supply-side issues continue to play a dominant role in price evolution.
7. **Weak Transmission of Monetary Policy:** The transmission mechanism of monetary policy is weak in many climes due to several factors including the inadequacy of monetary policy instruments, the dominant role of the informal sector, oligopolistic financial structure, excess banking system reserve, and poor financial market infrastructure, among others (Ajayi, 2012).

Conclusion and Suggestions for Improvement

In recent years, the Nigerian state has experience price instability and slow economic growth. The Central Bank of Nigeria is identified as an instrument of the state in ensuring price stability in the country. This responsibility is without challenges, as enumerated above. Despite these challenges, the Nigerian state, through the instrument of the Central Bank can achieve price stability through efficient liquidity management strategies, improved coordination between the fiscal and monetary authorities, and strengthening of the banking system towards achieving price stability. Maintaining price stability can come from the government with fiscal policy, or from a Central Bank with monetary policy. Governments must raise or lower taxes and adjust government spending to influence the amount of disposable money in the system.

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