

Monetary and Fiscal Policy Coordination in Nigeria

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Abstract

This paper seeks to examine monetary and fiscal policy coordination in Nigeria. It discussed monetary policy as expansionary or contractionary, showing the various tools of monetary policy instruments in the country. Data are generated from secondary sources and evaluated through content analysis. The study is anchored by the Monetarist theory of inflation. Various literature examined shows that with declining oil prices and production challenges in an oil-dependent economy, achieving the growth projection requires better coordination of fiscal and monetary policies in a way that supports the non-oil sector. The government must develop and strengthen effective monetary and fiscal policy using appropriate instruments and international best practices.

Keywords:

Monetary and fiscal
policy, Policy
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Background to the Study

Monetary policy is a macroeconomic policy laid down by the central bank. It is the process by which the monetary authority of a country, usually the central bank or currency board, controls either the cost of short-term borrowing or the monetary base, often targeting an inflation rate or interest rate to ensure price stability and general trust in the currency (Jahan, 2014). Monetary policy also aims at stabilization of the gross domestic product (GDP), achieving and maintaining low unemployment, and to maintain predictable exchange rates with other currencies. In a recession, monetary policy raises the level of expenditure by increasing the amount of cash and other liquid assets (e.g., short and long-term government securities) at the disposal of the community and by making borrowing conditions easier through lower rates of interest. In an inflationary situation monetary policy seeks to restrict aggregate spending by reducing the total amount of liquid assets with the community and by making borrowing more costly (Amadeo, 2018). This paper seeks to examine monetary and fiscal policy coordination in Nigeria. Data are generated from secondary sources and evaluated through content analysis. The assessment of literature on the key variables provides the framework for conclusion and policy assessment.

Monetary Policy as Expansionary or Contractionary

Monetary policy is referred to as being either expansionary or contractionary. Expansionary policy is when a monetary authority uses its tools to stimulate the economy. An expansionary policy maintains short-term interest rates at a lower than usual rate or increases the total supply of money in the economy more rapidly than usual. It is traditionally used to try to combat unemployment in a recession by lowering interest rates in the hope that less expensive credit will entice businesses into expanding. This increases aggregate demand, which boosts short-term growth as measured by GDP growth. Expansionary monetary policy usually diminishes the value of the currency relative to other currencies (the exchange rate) (Friedman, 2001). The opposite of expansionary monetary policy is contractionary monetary policy, which maintains short-term interest rates higher than usual or which slows the rate of growth in the money supply or even shrinks it. This slows short-term economic growth and lessens inflation. Contractionary monetary policy can lead to increased unemployment and depressed borrowing and spending by consumers and businesses, which can eventually result in an economic recession if implemented too vigorously (Friedman, 2001).

There are several monetary policy instruments. The monetary authority in performing its responsibility includes;

Conventional instrument: The Central Bank influences interest rates by expanding or contracting the monetary base, which consists of currency in circulation and banks' reserves on deposit at the central bank. Central banks have three main tools of monetary policy: open market operations, the discount rate and the reserve requirements.

(a) Open market operations (OMO): An important tool with which a central bank can affect the monetary base is open market operations if its country has a well-developed market for its government bonds. This entails managing the quantity of money in

circulation through the buying and selling of various financial instruments, such as treasury bills, company bonds, or foreign currencies, in exchange for money on deposit at the central bank. Those deposits are convertible to currency, so all of these purchases or sales result in more or less base currency entering or leaving market circulation. For example, if the central bank wishes to lower interest rates (executing expansionary monetary policy), it purchases government debt, thereby increasing the amount of cash in circulation or crediting banks' reserve accounts. Commercial banks then have more money to lend, so they reduce lending rates, making loans less expensive. Cheaper credit card interest rates boost consumer spending. Additionally, when business loans are more affordable, companies can expand to keep up with consumer demand. They ultimately hire more workers, whose incomes rise, which in its turn also increases the demand. This tool is usually enough to stimulate demand and drive economic growth to a healthy rate. Usually, the short-term goal of OMO is to achieve a specific short-term interest rate target. In other instances, monetary policy might instead entail the targeting of a specific exchange rate relative to some foreign currency or else relative to gold.

(b) Discount rates: The central bank can increase or decrease the interest rate it charges on discounts or overdrafts (loans from the central bank to commercial banks). If the interest rate on such transactions is sufficiently low, commercial banks can borrow from the central bank to meet reserve requirements and use the additional liquidity to expand their balance sheets, increasing the credit available to the economy.

(c) Reserve requirement: The reserve requirement refers to the proportion of total liabilities that banks must keep on hand overnight, either in their vaults or at the central bank. Banks only maintain a small portion of their assets as cash available for immediate withdrawal; the rest is invested in illiquid assets like mortgages and loans. Lowering the reserve requirement frees up funds for banks to increase loans or buy other profitable assets. This is expansionary because it creates credit. However, even though this tool immediately increases liquidity, central banks rarely change the reserve requirement because doing so frequently adds uncertainty to banks' planning. The use of open market operations is therefore preferred.

(d) Unconventional monetary policy at the zero bound: Other forms of monetary policy, particularly used when interest rates are at or near 0 per cent and there are concerns about deflation, are referred to as unconventional monetary policy. These include credit easing, quantitative easing, forward guidance, and signalling (Roubini, 2016). In credit easing, a central bank purchases private sector assets to improve liquidity and improve access to credit. Signalling can be used to lower market expectations for lower interest rates in the future. For example, during the credit crisis of 2008, the US Federal Reserve indicated rates would be low for an "extended period", and the Bank of Canada made a "conditional commitment" to keep rates at the lower bound of 25 basis points (0.25 per cent) until the end of the second quarter of 2010.

Monetary and Fiscal Policies' Coordination

Generally, numerous literature exists on monetary-fiscal policy coordination but few exist on the quantification of the extent of policy coordination and in the case of Nigeria, there is hardly any work on this except Englama, Tarawaile and Ahorto (2013), which studied the degree of coordination between fiscal and monetary policies in the West African Monetary Zone (WAMZ) with Nigeria included.

Precisely, Englama, Tarawaile and Ahorto (2013), employed the set theoretic approach (STA) and the VAR model to determine the degree of coordination between fiscal and monetary policies in the West African Monetary Zone (WAMZ). Results of the STA showed an overall level of monetary and fiscal policy coordination for the WAMZ to be about 38.6 per cent. Impulse response from the VAR analysis also revealed a weak response to shocks as it took long periods for variables to attain convergence to long-run equilibrium path. Arby and Hanif (2010) explore how the monetary and fiscal policies have been coordinated in Pakistan between 1965 and 2009 using Set Theoretic Approach (STA). Results show that the extent of monetary and fiscal policies coordination as revealed by changes in policy indicators conditional upon economic shocks has only been 0.27 (27 per cent) during the sample period. They argued that monetary and fiscal policies have been executed independently throughout the study period and there were very few instances of coordination between the two policies while addressing prevailing economic conditions. That there was no difference between the behavior of monetary and fiscal policies before and after the establishment of the Monetary and Fiscal Policies Coordination Board in 1994. According to them, whatever instances of coordination that were found were clustered in military regimes; which may be one of the reasons of macroeconomic stability in such regimes.

Abdel-Haleim (2016) quantified the extent of coordination between monetary and fiscal policies in Egypt over the period (1974-2015) using Set Theoretic Approach (STA). The finding was that coordination of policies was absent or weak during most of the period under study, with a coordination level of 0.31 (31 per cent). Accordingly, the study emphasized the need for proper coordination of policies in Egypt. Melitz (1997) used pooled data for 15 member states of the European Union (EU) to investigate the coordination between monetary and fiscal policies. The study revealed that coordinated macroeconomic policies are in practice in the region. Specifically, they conclude that easy-fiscal policy leads to tight-monetary policy and easy-monetary policy leads to tight-fiscal policy. Andlib, Khan and Haq (2012) also investigated fiscal and monetary policy coordination in Pakistan using unrestricted VAR model. The model consists of four variables, two macroeconomic variables (output / unemployment and inflation) and two policy variables describing the monetary and fiscal policy stance. Using time series data from 1980 through 2011, they found that there was a weak coordination between monetary and fiscal authorities in Pakistan. They, therefore, suggested the need for an intense policy coordination in order to achieve economic stabilization as well as protect the economy from external shocks.

Monetarist Theory of Inflation

The study is anchored by the Monetarist theory of inflation. The theory opines that inflation is always a monetary phenomenon. The tenet of the theory was buttressed with the identity of Fisher's equation of exchange: $MV = PQ$. Where M is the money supply, V is the velocity of money, P is the price level, and Q is the level of real output. Assuming V and Q as constant, the price level (P) varies proportionately with the supply of money (A/). With flexible wages, the economy was believed to operate at full employment level. The labour force, the capital stock, and technology also changed only slowly over time. Consequently, the amount of money spent did not affect the level of real output so that a doubling of the quantity of money would result simply in doubling the price level. Until prices had risen by this proportion, individuals and firms would have excess cash which they would spend, leading to rise in prices. So inflation proceeds at the same rate at which the money supply expands. In this analysis the aggregate supply is assumed to be fixed and there is always full employment in the economy. Naturally, when the money supply increases it creates more demand for goods but the supply of goods cannot be increased due to the full employment of resources. This leads to rise in prices. But it is a continuous and prolonged rise in the money supply that will lead to true inflation. According to Friedman, inflation is always and everywhere a monetary phenomenon that arises from a more rapid expansion in the quantity of money than in total output. He argues that changes in the quantity of money will work through to cause changes in nominal income (Chand, 2015).

Overview of Monetary and Fiscal Policy Performance in Various Periods

a. Monetary policy conduct and non-inflationary economic growth in Nigeria before SAP

The economic environment that guided monetary policy before 1986 in Nigeria was characterized by the dominance of the oil sector, the expanding role of the public sector in the economy and over-dependence on the external sector. In order to maintain price stability and a healthy balance of payments position, monetary management depended on the use of direct monetary instruments such as credit ceilings, selective credit controls, administered interest and exchange rates, as well as the prescription of cash reserve requirements and special deposits. The use of market-based instruments was not feasible at that point because of the underdeveloped nature of the financial markets and the deliberate restraint on interest rates. The most popular instrument of monetary policy was the issuance of credit rationing guidelines, which primarily set the rates of change for the components and aggregate commercial bank loans and advances to the private sector. The sectoral allocation of bank credit in CBN guidelines was to stimulate the productive sectors and thereby stem inflationary pressures. The fixing of interest rates at relatively low levels was done mainly to promote investment and growth. Occasionally, special deposits were imposed to reduce the amount of free reserves and credit-creating capacity of the banks. Minimum cash ratios were stipulated for the banks in the mid-1970s on the basis of their total deposit liabilities, but since such cash ratios were usually lower than those voluntarily maintained by the banks, they proved less effective as a restraint on their credit operations (CBN, 2016).

From the mid-1970s, it became increasingly difficult to achieve the aims of monetary policy. Generally, monetary aggregates, government fiscal deficit, GDP growth rate, inflation rate and the balance of payments position moved in undesirable directions. Compliance by banks with credit guidelines was less than satisfactory. The major sources of problems in monetary management were the nature of the monetary control framework, the interest rate regime and the non-harmonization of fiscal and monetary policies. The monetary control framework, which relied heavily on credit ceilings and selective credit controls, increasingly failed to achieve the set monetary targets as their implementation became less effective with time. The rigidly controlled interest rate regime, especially the low levels of the various rates, encouraged monetary expansion without promoting the rapid growth of the money and capital markets. The low interest rates on government debt instruments did not sufficiently attract private sector savers and since the CBN was required by law to absorb the unsubscribed portion of government debt instruments, large amounts of high-powered money were usually injected into the economy. In the oil boom era, the rapid monetization of foreign exchange earnings resulted in large increases in government expenditure which substantially contributed to monetary instability. In the early 1980s, oil receipts were not adequate to meet increasing levels of demands and since expenditures were not rationalized, government resorted to borrowing from the Central Bank to finance huge deficits. This had adverse implications for monetary management (CBN, 2011).

b. Monetary policy after SAP to 2006

The Structural Adjustment Programme (SAP) was adopted in July, 1986 following the crash in the international oil market and the resultant deteriorating economic conditions in the country. It was designed to achieve fiscal balance and balance of payments viability by altering and restructuring the production and consumption patterns of the economy. These would be achieved by eliminating price distortions, reducing heavy dependence on crude oil exports and consumer goods imports, enhancing the non-oil export base and achieving sustainable growth. Other aims were to rationalize the role of the public sector and accelerate the growth potentials of the private sector. The main strategies of the programme were the deregulation of external trade and payments arrangements, the adoption of a market-determined exchange rate for the Naira, substantial reduction in complex price and administrative controls and more reliance on market forces as a major determinant of economic activity (CBN, 1990).

The objectives of monetary policy since 1986 remained the same as in the earlier period, namely: the stimulation of output and employment, and the promotion of domestic and external stability. In line with the general philosophy of economic management under SAP, monetary policy was aimed at inducing the emergence of a market-oriented financial system for effective mobilization of financial savings and efficient resource allocation. The main instrument of the market-based framework is the open market operations. This is complemented by reserve requirements and discount window operations. The adoption of a market-based framework such as OMO in an economy that had been under direct control for long, required substantial improvement in the macroeconomic, legal and regulatory environment (CBN, 1992).

In order to improve macroeconomic stability, efforts were directed at the management of excess liquidity; thus a number of measures were introduced to reduce liquidity in the system. These included the reduction in the maximum ceiling on credit growth allowed for banks; the recall of the special deposits requirements against outstanding external payment arrears to CBN from banks, abolition of the use of foreign guarantees/currency deposits as collaterals for Naira loans and the withdrawal of public sector deposits from banks to the CBN. Also effective from August, 1990, the use of stabilization securities for purposes of reducing the bulging size of excess liquidity in banks was re-introduced. Commercial banks' cash reserve requirements were increased in 1989, 1990, 1992, 1996 and 1999 (CBN, 2002).

The rising level of fiscal deficits was identified as a major source of macroeconomic instability. Consequently, government agreed not only to reduce the size of its deficits but also to synchronize fiscal and monetary policies. By way of inducing efficiency and encouraging a good measure of flexibility in banks' credit operations, the regulatory environment has improved. Consequently, the sector-specific credit allocation targets were compressed into four sectors in 1986, and to only two in 1987. From October, 1996, all mandatory credit allocation mechanisms were abolished. The commercial and merchant banks were subjected to equal treatment since their operations were found to produce similar effects on the monetary process. Areas of perceived disadvantages to merchant banks were harmonized in line with the need to create a conducive environment for their operations. The liquidity effect of large deficits financed mainly by the Bank led to an acceleration of monetary and credit aggregate in 1998, relative to stipulated targets and the performance in the preceding year. Outflow of funds through the CBN weekly foreign exchange transaction at the Autonomous Foreign Exchange Market (AFEM) and, to a lesser extent, at open market operation (OMO) exerted some moderating effect (CBN, 2004).

The reintroduction of the Dutch Auction System (DAS) of foreign exchange management in July, 2002 engendered relative stability and stemmed further depletion of reserves during the second half of 2002. However, the financial system was typically marked by rapid expansion in monetary aggregates, particularly during the second half of 2000, influenced by the monetization of enhanced oil receipts. Consequently, monetary growth accelerated significantly, exceeding policy targets by substantial margins. Savings rate and the inter-bank call rates fell generally due to the liquidity surfeit in the banking system though the spread between deposit and lending rates remained wide (CBN, 2006).

c. The introduction of monetary policy rate (MPR)

Overtime, the CBN has recognized that achieving stable prices would require continuous reassessment and evaluation of its monetary policy implementation framework to enable it respond to the ever-changing economic and financial environment. It is against this background that the Bank introduced a new monetary policy framework that took effect on 11th December, 2006. The ultimate goal of the new framework is to achieve a stable value of the domestic currency through stability in short-term interest rates around an

“Operating Target”, the interest rate, which is determined and operated by the CBN. The “Operating Target” rate i.e., the “Monetary Policy Rate” (MPR), serves as an indicative rate for transaction in the inter-bank money market as well as other deposit money banks (DMBs) (CBN, 2008).

The main operating principle guiding the new policy is to control the supply of settlement balances of banks and motivate the banking system to target zero balances at the CBN, through an active inter-bank trading or transfer of balances at the CBN. This is aimed at engendering symmetric treatment of deficits and surpluses in the settlements accounts, so that for any bank, the cost of an overdraft at the Central Bank would be equal to the opportunity cost of holding a surplus with the Bank. The Central Bank intervention in the market takes the form of a standing lending facility that ensures orderly market operations or behaviour by alternating avoidable interest volatility. The standing lending facility is available as an overnight lending to banks with deficits, at a fixed interest rate, i.e., the upper band of the CBN standing facility. The Bank stands ready to supply any amount the banks may require at the lending rate. The Central Bank also set up a standing facility that pays banks with surplus funds, a fixed interest rate in their deposit or reserves which they keep with the Bank. This arrangement allows the Bank to keep the overnight inter-bank interest rate in between the corridor with an upper and lower limit on interest rate. MPR was set at 10 per cent, using the then rate of inflation rate and the expected inflation rate outcome of 9.0 per cent in 2006 as a guide to ensure that interest rates remain positive in real terms. There is a spread of 600 basis points around the rate, i.e 300 basis points below and 300 basis points above. This translates into an upper limit of 7 per cent, representing that rate at which CBN takes deposit from the banks (CBN, 2008).

A major advantage of the new framework is that the Central Bank is able to operate in the market daily and ensures that adequate liquidity is provided to enable banks trading in the inter-bank market to complete settlement at interest rates around the MPR. Inter-bank rate is, therefore, maintained at a level between the lending and deposits rates at CBN. The maintenance of interest rates band has helped significantly to reduce volatility in the market compared to the inter-bank rates experienced in the past (CBN, 2008).

d. Monetary policy and non-inflationary growth, 2006 through 2011

In 2006, the new monetary policy framework for monetary policy implementation was introduced. The ultimate goal of the new framework was to achieve a stable value of the domestic currency through stability in short- term interest rates around an operating target of the CBN monetary policy rate (MPR). The MPR serves as an indicative rate for transactions in the inter-bank money market as well as other interest rates in the money market transactions. The MPR which replaced the MRR was set at 10 per cent with spread of 600 basis points around the rate, i.e. 300 basis points above and 300 basis points below. This translates into an upper limit of 13 per cent and a lower limit of 7 per cent. The Whole Sale Dutch Auction System (WDAS) replaced the Dutch Auction System (DAS) in the first quarter of the year under review. In pursuant of further liberalization of the foreign

exchange market the bureaux de change was admitted into the WDAS window during the second quarter of 2006. The admittance of the BDC's to the WDAS window led to the unification of the exchange rate between official and parallel market (CBN, 2008).

The objective of monetary policy in 2006 was sustaining price stability and non-inflationary growth, as enunciated in the National Economic Empowerment and Development Strategy (NEEDS). The target for single digit inflation was, however, achieved as at December 2006 when the inflation stood at 8.5 per cent. The GDP growth rate for 2006 declined to 5.63 per cent compared with what was obtained in 2005 when it stood at 6.51 per cent, but the external reserves rose rapidly from US\$28.3b to US\$41.9b, representing an increase of US\$13.6b. At the end of 2006, the overall performance indicated that the broad money supply (M2) target was overshoot as it grew by 30.6 per cent compared with the target of 27.8 per cent. The Reserve money target for December 2006 was missed. The actual Reserve money (RM) at end December stood at N974.9 billion, compared with the target of N820 Billion.

The non-attainment of RM target at end December was largely due to the rapid growth in currency in circulation (CBN, 2007). The framework for monetary policy management in 2007 remained that of monetary targeting. The Central Bank of Nigeria (CBN) adopted various policy measures aimed at maintaining the growth of monetary aggregates in order to achieve monetary and price stability. Open Market Operations (OMO) remained the major tool of liquidity management. Other policy measures included increased issuance of treasury securities in the primary market to mop-up excess liquidity; use of deposit and lending facility to encourage inter-bank transactions as well as special sales of foreign exchange, including swap arrangements. NTBs of various tenors 91-, 182- and 364-day were auctioned during the period (CBN, 2008).

The liquidity management efforts of the CBN yielded the expected results as the single-digit inflation rate was sustained during the year. In addition, the exit reserve money target under the Policy Support Instrument (PSI) was achieved in June 2007. Over the end-December 2006 level, provisional data indicate that broad money supply (M2) grew by 11.03 per cent in June 2007 and further by 21.3 and 25.31 per cent in September and October, 2007 respectively. When annualized, the M2 grew by 28.44 and 30.25 per cent, in September and October, 2007 respectively, compared with 33.3 and 39.6 per cent in the corresponding months of 2006. The growth of M2 was driven by the increase in foreign assets (net) of the banking system as well as the rapid rise in credit to the private sector since the end of the second quarter. With the CBN's drive to contain excess liquidity in the banking system, both M2 and reserve money may be within targets by the end of 2007. At the end of the second quarter, aggregate domestic credit (net) to the economy declined by 56.11 per cent, but increased by 98.99 per cent in October 2007. Also, credit to government (net) declined by 51.9 per cent in September compared to a decline of 56 per cent at the end of the second quarter. But credit to the private sector, which had maintained an upward trend in most of 2007, rose to 34.37 and 62.0 per cent in June and September, respectively.

As at November 2007, the economy has achieved a commendable level of external reserves of about US\$50.0 billion that is capable of supporting approximately 23 months of current foreign exchange disbursements. This represented an increase of 18.06 per cent when compared with the level of US\$42.42 billion recorded in the corresponding period of 2006. With the implementation of the new MPR and the adoption of the CBN standing facilities, volatility in inter-bank rates remained subdued with rates hovering within the MPR. The MPR was reviewed thrice during the year. The first was in June 2007 when it was reviewed downward by 200 basis points, from 10.0 per cent to 8.0 per cent, with the width of the interest rate corridor reduced from +/- 300 to +/- 250 basis points. The second was in October 2007 when the MPR was raised by 100 basis points, from 8.0 to 9.0 per cent, with the interest rate corridor removed, in response to anticipated changes in economic and financial conditions. The MPR was then made to serve as the overnight (repo) rate. The last was in December 2007 when the MPR was increased by 50 basis points, from 9.0 to 9.5 per cent (CBN, 2008).

The conduct of monetary policy by the Central Bank of Nigeria since 2008 has been designed to: influence the growth of money supply consistent with the required aggregate Gross Domestic Product (GDP) growth rate, ensure financial stability, maintain a stable and competitive exchange rate of the naira, and achieve positive real interest rates. The conduct of monetary policy in the review period was largely influenced by the global financial crisis which started in 2007 in the U.S. and spread to other regions and emerging markets including Nigeria. The crisis created liquidity crisis in the banking system, large quantum of non-performing credits, large capital outflows and pressure on the exchange rate, decline in oil prices and falling external reserves, sharp drop in government revenue, huge fiscal injections and collapse of the capital market (CBN, 2009).

Consequently, in the wake of the global financial crisis, the Bank largely adopted the policy of monetary easing to address the problem of liquidity shortages in the banking system from September 2008 to September 2010. The monetary policy easing measures taken during the period included:

- a) Stoppage of aggressive liquidity mop-up since September 18, 2008
- b) Progressive reduction of monetary policy rate (MPR) from 10.25 to 6.0 per cent
- c) Reduction of cash reserve requirement (CRR) from 4.0 to 2.0 and 1.0 per cent
- d) Reduction of liquidity ratio (LR) from 40.0 to 30.0, and 25.0 per cent
- e) Introduction of Expanded Discount Window (EDW) to increase DMB's access to facilities from the CBN, and by July 2009 was replaced with CBN Guarantee of interbank transactions
- f) Reduction of Net Open Position (NOP) limit of deposit money banks from 20.00 to 10.00, 5.00 and 1.00 per cent
- g) Injection of N620 billion as tier 2 capital in 8 troubled banks

Following the restoration of stability and re-emergence of liquidity surfeit in the banking system, the Bank adopted a tightening stance from September 2010 to December 2011. The monetary policy easing measures coupled with huge fiscal expansion put much pressure on inflation, exchange rate and external reserves. To curtail these threats the stance of monetary policy changed from monetary easing to tightening, from September 2010 to December 2011 and the following monetary policy actions were taken during the period:

- I. The Resumption of active Open Market Operations for the purpose of targeted liquidity management
- II. Progressive increase in the monetary policy rate (MPR) from 6.00 to 12.00 per cent
- III. Increase in the Cash Reserve Requirement (CRR) from 1.00 to 2.00, 4.00 and 8.00 per cent
- IV. Increase in liquidity ratio (LR) from 25.00 to 30 per cent
- V. Introduction of reserve averaging method of computing Cash Reserve Requirement (CRR), which was later stopped
- VI. Increase of Net Foreign Exchange Open Position (NOP) of banks from 1.00 to 5.00 per cent; but later reduced to 3.00 per cent
- VII. Shift in the mid-point of the foreign exchange band from N150/US\$1 +/-3 per cent to N155/US\$1 +/-3 per cent

The above policy actions taken by the CBN were within the statutory mandate of the Bank and in the overall interest of the Nigerian Economy. The Bank's monetary policy decisions strengthened financial system stability and supported the growth of the Nigerian economy. The maintenance of price stability remained the main focus of monetary policy in the second half of 2011. The challenge of managing the excess liquidity from monetary easing of 2009 – 2010 fiscal years combined with the expansionary fiscal stance, and the relatively uncertain global economic outlook, defined the monetary policy stance in the review period. The CBN employed the Monetary Policy Rate (MPR) to anchor short-term interest rates, and to rein-in inflation expectations. Open market operations (OMO) supported by reserve requirements and discount window operations (including the Standing Facilities, repos and reverse repos), remained the major instruments of monetary policy in the second half of 2011. Efforts were made to improve communication through more regular dialogue with market and other critical stakeholders, to shape-up market sentiments and to track the pace of economic activity during the review period. The Monetary Policy Committee (MPC) held three regular meetings and one extraordinary meeting and increased the Monetary Policy Rate (MPR) by a cumulative 400 basis points to 12.0 per cent during the review period. The Bank also implemented some administrative and regulatory measures to rein-in excess liquidity and the attendant pressures in the foreign exchange market (CBN, 2012).

a. Monetary policy conduct from 2012

The monetary policy environment in 2012 was characterized by continuing threat of inflationary pressures against the backdrop of declining trend in output growth. Other key concerns included sustaining a stable exchange rate for the naira, creating a buffer for the external reserves, sustaining stability in money market rates, narrowing the spread

between the lending and deposit rates and mitigating the impact of the continued slowdown in global economic activities on the domestic economy. In view of these multi-dimensional challenges, monetary policy during the period focused on deploying the mix of appropriate instruments to deliver on price stability. In addition, the slow pace of recovery in the advanced economies, the reduced growth momentum in the emerging economies and the prolonged financial fragilities in the Euro Area were some of the key considerations that defined the thrust of monetary policy in the period. (CBN, 2013)

Accordingly, the Bank continued with its tight monetary policy stance, which commenced in the third quarter of 2010, using the Monetary Policy Rate (MPR) as the signaling interest rate to affect money supply and rein-in inflation expectations. Open Market Operations (OMO) continued to be used as the main instrument of monetary policy, supplemented by Repurchase Agreements and Discount Window Operations to ensure optimal liquidity management. These tools were complemented with prudential requirements such as cash reserve requirement (CRR), liquidity ratio (LR) and foreign exchange Net Open Position (NOP) limit for Deposit Money Banks. Primary market transactions in government securities and foreign exchange market interventions were also used for monetary management. The Bank sustained efforts towards improving communication with market operators and other stakeholders. The Monetary Policy Committee (MPC) held six regular meetings in the review period, during which it maintained the MPR at 12.0 per cent with a symmetric corridor of +/- 200 basis points. To further sustain the tightening stance, CRR was raised from 8.0 to 12.0 per cent and NOP limit reduced from 3.0 to 1.0 per cent at the July 2012 meeting. The LR was retained at 30.0 per cent with the mid-point of exchange rate maintained at N155/US\$ within a band of +/-3.0 per cent. Monetary policy in 2013 aimed primarily at sustaining the already moderated rate of inflation which was achieved in the first half of 2013. The benign headline inflation rate of 8.0 per cent at end-December 2013, from 8.4 per cent at end-June 2013, is evidence of the effectiveness of the policy. Besides, monetary policy also aimed at limiting pressure on the exchange rate, boosting the external reserves position, sustaining stability in the money market and reducing the spread between lending and deposit rates. These goals were largely achieved through a mixed-grill of a number of instruments, which helped to strengthen investor confidence in the economy (CBN, 2015).

The MPR was the principal instrument used to control the direction of interest rates and anchor inflation expectations in the economy. The other intervention instruments included open market operations (OMO), discount window operations, cash reserve ratio (CRR) and foreign exchange net open position (NOP). OMO was the other major tool for liquidity management in 2013; achieved through the issuance of CBN bills. The sale of CBN bills declined by 52.8 per cent in the second half compared with the first half. In the second half, the volume of transactions of the standing lending facility window rose by 30.66 per cent, while that of standing deposit facility window rose by 53.6 per cent, compared with the first half (CBN, 2015).

The Monetary Policy Committee (MPC) held six regular meetings during the review period, and the MPR was successively maintained at 12.0 per cent with a symmetric corridor of +/- 200 basis points. The MPC introduced a higher Cash Reserve Ratio (CRR) for public sector deposits with the Deposit Money Banks (DMBs), in order to further tighten money supply. Beside the change in the CRR on public sector deposits, other existing policies were retained, and complemented with administrative measures. The Net Open Position (NOP) limit was sustained at 1.0 per cent, Liquidity Ratio (LR) at 30.0 per cent and the mid-point of the exchange rate at N155/US\$ +/-3.0 per cent. The decision of the MPC to retain most of the existing measures was to assure the market of the continuity of the tight monetary policy regime. Monetary policy continued to contribute significantly to the robust performance of the economy after the shock of the global financial crisis in 2008 (on the one hand and the domestic banking crisis of 2009 on the other). In spite of these developments, output remained relatively high while inflation decelerated in 2013 (CBN, 2014).

Most measures of inflation moderated throughout the period in response to the policy measures implemented by the Bank. Year-on-year headline inflation decreased to 8.0 per cent in December 2013, from 8.4 per cent in June 2013 and 12.0 per cent in December 2012. Food inflation also declined marginally to 9.3 per cent from 9.6 per cent over the same period. However, core inflation rose from 5.5 per cent to 7.9 per cent between June and December 2013. In 2014, monetary policy was focused on achieving the objective of price and exchange rate stability. Accordingly, the Bank sustained its tight policy stance with a view to ensuring that electioneering spending did not result in uptick in inflation. Headline Inflation remained within single digits, and fluctuated between 7.7 and 8.5 per cent, in the review period due to the combined effect of the declines in the prices of clothing and footwear; and transport components as well as the relative stability in the price of education in response to the tight liquidity measures taken at the MPC meetings during the year (CBN, 2014). The exchange rate experienced significant pressure especially during the second half of the review period, due largely to the impact of the US Fed tapering, declining oil prices, depletion of the foreign exchange reserves, and the absence of fiscal buffers. As a response, the Bank moved the exchange rate mid-point from N155/US\$ to N168/US\$ and widened the band around the midpoint from +/-3 per cent to +/-5 per cent. The financial market was generally stable for 2014, although, significant fluctuations were noticed towards the end of the year. A number of policy instruments were deployed to achieve price and financial system stability, with a view to boosting investor confidence and reducing concerns about declining foreign exchange reserves.

The policy instruments used to achieve price and financial system stability objectives were the MPR, and other intervention instruments such as OMO, discount window operations, CRR and foreign exchange NOP limit. During the period, the MPC raised MPR by 100 basis points from 12.0 to 13.0 per cent while maintaining the symmetric corridor of +/- 200 basis points around the MPR. The CRR on private sector deposits was raised by 500 basis points from 15.0 to 20.0 per cent, while CRR on public sector deposits

was raised from 50.0 per cent to 75.0 per cent. The MPC also retained the Liquidity Ratio at 30.0 per cent, in order to address liquidity surfeit in the banking system. OMO was principally used to mop up or inject liquidity into the system as a strategy for monetary management by the Bank. OMO auction increased over the corresponding period of 2013 as a result of injections into the system arising from the maturity of FGN Bonds and NTBs as well as AMCON bonds. In the period under review, the economy continued to experience fluctuations in liquidity levels. To compliment OMO, the CRR was also used to manage liquidity in the system in order to smoothen the liquidity cycle and reduce pressure on the exchange rate. Reserve money and its components trended upwards relative to their volume in the first half of 2014. Relative to the end-June 2014 values, the broad measure of money supply trend upwards, while narrow measures of money supply fell, reflecting the liquidity surfeit attributable to cyclical Federal Account Allocation Committee (FAAC) allocations and increased spending towards the 2015 general election (CBN, 2014).

The money market remained active in the second half of 2014 with CBN bills and government securities actively traded in the market. The improvement in liquidity conditions in the financial sector continued to influence market activities along with the demand pressure in the foreign exchange market. The interbank and open buy back (OBB) rates remained locked-in within the retained policy rate corridor of MPR +/-200 basis points in the review period, except in December, 2014. Despite the rebound in the activities of the uncollateralized segment of the money market, OMO and standing facilities dominated activities in the market. The daily Nigerian Interbank Offered rates (NIBOR) experienced occasional spikes but were generally stable, reflecting periods of liquidity tightness (CBN, 2015). The performance of the capital market declined in the second half of 2014, relative to the first half of 2014 and the corresponding period of 2013. The All Share Index (ASI) fell by 18.42 per cent to 34,657.15 at end-December 2014, from its level of 42,482.48 at end-June 2014, and by 16.14 per cent, when compared with 41,329.19 recorded at end - December 2013. The development was due largely to external factors such as the recovery in some developed economies and the effects of the US Federal Reserve tapering of its quantitative easing (QE) programme. Other macroeconomic developments that affected equities included the declining oil prices, depletion of external reserve, insurgency, and the uncertainties surrounding the 2015 general elections.

The Federal Government of Nigeria (FGN) bonds continued to dominate the fixed income securities market in Nigeria with fewer transactions recorded in the State/Local Government and Corporate Bond segments of the market. Activities in the global financial markets were characterized by uncertainties about economic recovery. For instance, while there have been rebounds in growth in the USA, growth in the EU, Japan and developing and emerging market economies continued to be constrained by a number of old and new fragilities. Accordingly, the exchange rates of major international currencies experienced mild fluctuations; and regional currencies such as the Ghanaian cedi, Kenyan shilling, the South African rand and the Egyptian pound also fluctuated (CBN, 2016).

The outlook for inflation is that the economy may experience a gradual rise in consumer prices but within single-digit target in the first half of 2015, due to increased spending in the run up to the 2015 general elections; depletion of the external reserves fuelling depreciation of the naira and its impact on food prices. These would be exacerbated by security concerns, disruption of agricultural activities and poor harvest in some areas affected by insurgency in the northern part of the country. Headline inflation is projected to oscillate around 8.6 and 9.4 per cent in the first half of 2015, and could rise to 10.8 per cent by year end. This outlook is premised on the assumption that the reduction in the pump price of refined fuels is expected to ameliorate the impact of import costs on domestic prices and that the Bank will continue to pursue a tight monetary policy stance. Output growth in the third quarter of 2014 was 6.23 per cent down from 6.54 per cent in the second quarter. Output is projected to grow by 6.2 per cent in 2014 and 5.5 per cent in 2015. The downward projection of growth forecast of 5.5% (FGN 2015 Budget) is conservative, compared with the 7.3 per cent estimated by the IMF (Oct 2014 WEO). This is against the backdrop of emerging global developments such as falling oil price, security challenges, and infrastructural constraints. With declining oil prices and production challenges in an oil-dependent economy, achieving the growth projection requires better coordination of fiscal and monetary policies in a way that supports the non-oil sector (CBN, 2016).

Conclusion and Policy Suggestion

This paper seeks to examine monetary and fiscal policy coordination in Nigeria. It discussed monetary policy as expansionary or contractionary, showing the various tools of monetary policy instruments in the country. The study also examined numerous literatures on monetary-fiscal policy coordination and performance in Nigeria. It concluded that with declining oil prices and production challenges in an oil-dependent economy, achieving the growth projection requires better coordination of fiscal and monetary policies in a way that supports the non-oil sector. The government must develop and strengthen effective monetary and fiscal policy using appropriate instruments and international best practices.

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