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Monetary Policy In The 1990 Budget

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A. Introduction

Monetary policy measures in the 1990 budget appear to be restrictionary and to worsen the situation there was no compensating or offsetting expansionary fiscal measures in the budget. For instance the real magnitude of the Federal budget itself of ₦39.758 billion is a shade less than the attained magnitude of ₦30.107 billion if the 50% inflation, the highest in many years, is taken into consideration. Thus the spending limit itself has fallen in real terms and cannot be said to be expansionary. The nominal value of the 1990 budget when deflated with the appropriate price index comes short of the 1989 level.

All the tight monetary measures put in place in 1989 were retained and reinforced in the 1990 budget. Growth in money supply was pegged at 13% from its erstwhile level of 14.65%. This is intended to put a check on the inflationary spiral which has been the bane of the Nigerian economy. This desire to check inflation is also consistent with the objective of reducing pressure on the foreign exchange market to realise a more acceptable exchange rate. By keeping money supply down it will not be possible to finance increased consumption of both domestic and foreign produced goods. A fall in demand for foreign goods would be reflected in a favourable exchange rate with its favourable impact on prices of foreign produced items. The inflation rate would also tend to fall when put along the reduced demand for domestic items.

Aggregate bank credit was raised from 9.5% in 1989 to 13.5% in 1990. This appears to be an expansionary measure as government believes that adequate credit should be made available to priority sectors to sustain growth But this new enhanced ceiling will apply to all forms of credit granted to the private sector rather than only loans and advances as was the case in the previous period. Such off balance sheet items as commercial papers and bankers acceptances will now be included in the calculation of bank's credit. Also in calculating the base for credit growth in 1990 adjustments that reflect compliance with permissible credit expansion for 1989 will be made for banks that exceeded the 1989 ceiling. In effect banks that exceeded their credit targets in 1989 will have the excess deducted from their permissible range in 1990. These innovations were made by the Central Bank to improve the efficiency of credit ceilings. The implication is that most banks will be unable to lend in 1990 although the permissible rate of expansion seems to be in the upswing[1].

The same argument could be used in relation to the seemingly increased allocation of credit to Government sector 8.3% in 1989 and 10.9% in 1990 and the increased allocation to the private sector—10.7% in 1989 and 15.8% in 1990. Given the inclusion of earlier off balance sheet items in the calculation of bank's credit and the innovations of the C.B.N. that excess of earlier years will be deducted from the permissible limits of succeeding years, banks will find it difficult to lend in 1990. Banks are now allowed to do equipment leasing, this would seem to be an outlet for loan expansion provided it is not also included in credit ceilings. Since most equipments are imported, availability of scarce foreign exchange will effectively checkmate expansion in this area. Banks (both merchant and commercial) are permitted to provide equipment

leasing up to 15% of their assets.

Gearing refers to the ratio between banks paid up capital and all retained earnings on the one hand and their loans. and advances on the other.[2] The Banking Act empowers the Central Bank to specify this ratio. The ratio of 1:10 was applicable for a long time until the Central Bank raised this to 1:12. Raising the ratio implies increasing bank lending capabilities as the bank's asset base can now support increased accommodation. But in the 1990 budget this ratio was reduced to the erstwhile level of 1:10. This is a further constraint on credit expansion and is considered a restrictionary monetary measure.

B. Implications of Policy Measures

In a period of depression, monetary policy should work towards stimulating the economy in an expansionary direction[3]. Expansionary monetary policy will be able to stimulate growth in the economy and help initiate an upswing in output and employment. Although inflation may be worsened in the short run, the output effect of an expansionary policy would tend to moderate the inflationary consequences in the long run.

The credit squeeze has led to high cost of funds and lowered investment potential in the economy. For those who continue to produce, the cost of production edges upwards leading to higher prices through cost push inflation.[4] Although demand pull inflation is reduced, cost push inflation takes over.

Inflation of the cost push variety has a dampening effect on productivity. As costs of production rise, output and employment fall. Compared with inflation of the demand pull variety, the cost push inflation is an argument for economic recession.

Apart from reducing the cost of funds by lowering interest rates, expansionary monetary policy has an amplifying effect on productivity. Cost of production is lowered and output increased along with increases in employment. Since inflation is always with us, if we should be given a choice of inflation type, the nation in a period of recession should go for the demand pull type which is effected through the mechanism of expansionary monetary and fiscal policy.

C. Conclusion

The monetary and credit policy measures in the 1990 budget are restrictionary. The impact of the policy measures is increased illiquidity in the operating economic environment with its consequences of high cost of funds and cost-push inflationary spiral. The high cost of funds discourages investments, leads to a fall in output and employment and worsens a recessionary situation. A turnaround in the economy should follow a mild expansionary monetary policy, moderated just enough to reduce cost of funds, interest rates so as to increase output and employment. Since inflation is always with us, the nation should sacrifice the attainment of price stability and external balance for growth in output and employment which a fairly expansionary monetary policy can help initiate.

NOTES

1. Chinyemike Torti et al, "Budget 90: Recipe for a super Naira" The Financial Post, Vol 2, No. 11 January 1990 pp. 7.

2. Don N. Ike, "Constraints to Bank Lending and the Economic Considerations to the Review of the Nigerian Banking Act" *International Journal of Development Banking,* Vol 7, No. 2 1989 pp. 101.

3. Don N. Ike "Monetary Policy In a Period of Depression: The Nigerian Case" In Nzewi (ed) *Economic Emergency in Nigeria,* Anambra Polytechnic Press 1986 pp. 133.

4. See Torti et al, *op. cit.*

Book Review

Title: The Foundations of Nigeria's Financial Infrastructure.

Editor: Prof. J.K. Onoh

Publishers: Croom Helm Ltd, London, 1980.

Reviewer: Dr. Don. N. Ike

This book, *The Foundations of Nigeria's Financial Infrastructure* is divided into five parts and contains 21 papers contributed by Nigerian economists and financial analysts. The book as the title indicates is a survey of Nigeria's financial infrastructure encompassing banking, finance, insurance, government revenue and the balance of payments.

Part one is a General Survey of Nigeria's Financial System, Two papers were contributed in this section by Prof. J.K. Onoh and Prof. W. Uzoaga on Nigeria's traditional financial system and modern financial system respectively. Types, objectives, functions and organisation of traditional financial institutions were discussed. Also central banking, commercial banks and other specialised credit institutions in Nigeria, their operation and functions in creating a modern financial system were discussed by Professor Uzoaga.

Part two deals with the banking system and the financial markets and consists of seven papers.

The section discussed the development of central banking and the attendant problem of controlling the operation of the commercial and merchant banks as well as the Nigerian capital market. It was shown that the Central Bank has not been provided with adequate weapons to fight the myriad economic problems of the nation (p. 69). Further the orthodox orientation of Nigerian banking system were highlighted. This latter fact is evidenced by the very low banking density and lopsided banking development in the country (p. 73). Also Professor Onoh showed that while monetary policy instruments such as liquidity ratio, cash reserve ratio, moral suasion, bank rate, open market operations, stabilisation securities, special deposits, credit ceilings et. al. might have restricted credit in Nigeria, the credit guidelines embodied in the monetary policy circulars of the Central Bank of Nigeria have proved a more formidable instrument of monetary control in the economy (p. 92). The under-development of Nigeria's money and capital markets was also highlighted.

Part three which contains five articles deals with aspects of public and private sector finance.

The recommendations of the Financial System Review Committee for a more active capital market were highlighted by P.N.O. Ejiofor and F.O. Okafor to wit: That each state should be allowed free access to the capital market to issue and redeem its own bonds . . . each local government should be allowed to issue project tied bonds . . . and that State owned companies be empowered and encouraged to seek funds directly from the capital market through the issue of their securities (p. 161). The authors showed that traditional revenue sources for Government funds have shrunk considerably and tax revenue cannot be relied upon for elastic supply of funds for Government services. Direct borrowing by States and parastatals is still an untapped source for project financing. Further Professor Nwosu in this section discussed the different revenue allocation formula in use in Nigeria and the various principles that have guided funds allocations from the centre to the States. He recommends deemphasis on the principle of derivation in favour of population and need. Professor J.K. Onoh in his contribution advocated

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for short-term and long-term policy objectives to match with our short-term and long-term budgetary plans as evidenced by the annual budgets and the development plans. The various sources of funds for Nigerian companies and housing schemes were also discussed in this section by Dr. Obi Mordi, Professor Ezejelue and Moses Bakpa.

Part four treats other financial institutions especially the development banks and insurance.

It was shown that the N.I.D.B. provides both loan and equity capital for public and private companies. The loans are on medium and long-term basis. Participation has been in manufacturing, non petroleum mining activities and in all aspects of tourism including development of hotels of international standard. By 31st December, 1977 total sanctions by NIDB totalled ₦258.6m for 318 projects, ₦25.7m was in equity and ₦234.9m was in loans (p. 254). The Nigerian Agricultural Bank on the other hand finances agricultural projects. It makes short medium and long-term loans to individuals, co-operatives and governments. A catalogue of projects in the agricultural sector have been financed by the N.A.B. Insurance premium incomes and their role in the Nigerian capital market were also discussed in this section. It was shown that insurance companies have contributed reasonably towards mobilisation of savings for investment in the Nigerian economy.

Part five deals with Nigeria's external financial relations and consists of four papers.

Nigeria's currency which is not convertible was devalued in 1973. A mechanism of managed float is now in existence under which the Central Bank chooses a basket of currencies involving Nigeria's major trading partners and through cross rates of exchange computes the parity of the naira (p. 282). It was shown that the balance of payments situation has further deteriorated due to a decline in the production of cash crops, the poor world market commodity prices and the increasing food imports (p. 289). On Nigeria's external assets it was shown that prior to 1980 the nation had been holding reserves in excess of what she required to finance her foreign obligations when compared to Triffin's rule-of-thumb guide on minimum reserve level (p. 296). The problem thus was to ensure that the excess reserves are not eroded by inflation necessitating diversification into interest yielding stable assets. It was shown that Nigeria did not diversify enough into stable assets and thus suffered huge losses because of the cascading dollar and sterling rates in the foreign exchange market (p. 300). In their chapter on "Nigeria and the I.M.F.", J.K. Onoh and A.U. Chijindu showed that Nigeria's position in the fund had continued to improve following repurchase of local currency in 1973 and 1974, improving Nigeria's borrowing power from the fund.

However, the book is fairly comprehensive in elucidating the fundamentals of Nigeria's financial system. It should be required reading for students of economics, political science, public finance, accountancy, banking and other practitioners in the Nigeria's financial system.

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