MPRI-JHSS | INTERNATIONAL JOURNAL OF HUMANITIES & SOCIAL SCIENCE
VOL. 11 NO.6 JUN-2020 ISSN: 1021-3197

ECONOMIC RECESSION AND MONETARY POLICY IN NIGERIA

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Abstract

Recession is a business cycle contraction, and it refers to a general slowdown in economic activity for two consecutive quarters. During recession, there is usually a decline in certain macroeconomic indicators such as GDP, employment, investment spending, capacity utilization, household income, business income, and inflation, with the attendant increase in the rate of unemployment. Technically, when an economy recorded two consecutive quarters of negative growth in real GDP, it can be said to be in recession. The Gross Domestic Product (GDP), investment and consumption spending, savings rate, imports and exports, capacity utilization, household income, trade, capital flows, business profits and inflation decline, while indebtedness, illiquidity, bankruptcies and the unemployment rates rise. On the other hand, monetary policy has always been seen as a fundamental instrument over the years for the attainment of macroeconomic stability, often viewed as prerequisite to achieving sustainable output growth. Thus, in

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the pursuit of macroeconomic stability, the managers of monetary policy have often set targets on intermediate variables which include the short term interest rate, growth of money supply and exchange rate. This studies hopes to assess recession and monetary policy in Nigeria.

KEYWORDS: *Recession, macroeconomics, growth, unemployment and inflation.*

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INTRODUCTION

There were symptoms of recession in the Nigerian economy, just that it became full blown under the President Mohammadu Buhari regime due to certain drastic actions taken to solve perennial domestic economic problems. Economic crisis come in a cycle. (Agri M.E., Mailafia D., and Umejiaku R.I., 2017).

Recession is a business cycle contraction, and it refers to a general slowdown in economic activity for two consecutive quarters. During recession, there is usually a decline in certain macroeconomic indicators such as GDP, employment, investment spending, capacity utilization, household income, business income, and inflation, with the attendant increase in the rate of unemployment. Technically, when an economy recorded two consecutive quarters of negative growth in real GDP, it can be said to be in recession. The Gross Domestic Product (GDP), investment and consumption spending, savings rate, imports and exports, capacity utilization, household income, trade, capital flows, business profits and inflation decline, while indebtedness, illiquidity, bankruptcies and the unemployment rates rise (Agri M.E., Mailafia D., and Umejiaku R.I., 2017). GDP is the market value of all legitimately recognized final goods and services produced in the country in a given period of time, usually one year.

Monetary policy has always been seen as a fundamental instrument over the years for the attainment of macroeconomic stability, often viewed as prerequisite to achieving sustainable output growth. Thus, in the pursuit of macroeconomic stability, the managers of monetary policy have often set targets on intermediate variables which include the short term interest rate, growth of money supply and exchange rate. Among these intermediate variables of monetary policy, the exchange rate is argued to have a greater influence on the economy through its effect on the value of domestic currency, domestic inflation, the external sector, macroeconomic credibility, capital flows and financial stability (Usman O.A., and Adejare A.T., 2014).

Statement of the problem

The economic recession experienced in Nigeria is a manifestation of long-term ills in the structure of the economy that became present. The recession seems to affect socio-political structures, Nigeria's credit condition, general living standard, imports, production and employment as well as consumption demand in Nigeria. Fast developing economies like China, India, Brazil, and Thailand depend on exports to drive their economies, but Nigeria cannot afford to do likewise. For many years, The importation of petroleum products covers 30 percent of Nigeria's GDP, importation of rice took 20 percent; importation of garments and fabrics 15 percent, importation of cars and electronics 20 percent; resulting to sky-rockets inflation of 17.8 percent in 2016. Nigeria is faced with the problem of reduced volume of exports and reduced price of crude, resulting to low revenue. The implications are that the federal and state budgets cannot be funded adequately resulting to external borrowing and debt financing. These have negative implications on foreign exchange and imports of raw materials, unemployment, increased tax evasion and avoidance, low purchasing power, low standard of living caused by economic recession (Agri M.E., Mailafia D., and Umejiaku R.I., 2017).

One of the major objectives of monetary policy in Nigeria is price stability. But despite the various monetary regimes that have been adopted by the Central Bank of Nigeria over the years, inflation still remains a major threat to Nigeria's economic growth. There must be a strong monetary policy to stimulate the economy, by diversification of the structural base of the economy away from oil which can only be possible when the real sectors of the economy such as the manufacturing, agriculture, etc. are also taken as priority sectors (Farayibi,A.O., 2016).

Literature review

There are remote and immediate causes of the economic recession in Nigeria. Globally, there is geopolitical tension around the world, causing global crisis and commodity prices dropping such as the drop in crude oil prices, Russia-Syria crisis, ISIS, illegal migration and refugee crisis, disease outbreak like corona virus (COVID-19) which is remote but important causes of the recession as Nigeria is an integral part of the global economy. Following the mortgage crisis of 2009 which started in the USA, there have been a couple of actions which, given the size of US economy in the world, has had certain impact, both positive and negative on emerging markets and frontier markets (Adelmann, 2011), where Nigeria unfortunately stands today. Amongst the immediate causes, the recession in Nigeria is a symptom of monoproduct economic structure, lack of economic diversification and over-reliance on imports. The Nigerian economy contracted due to global oil price shocks and volatility, worsened by oil pipeline vandalism and depletion of foreign reserves by the previous governments. Nigeria's recession was triggered by a sharp drop in government revenues and /or a drop in consumer spending. A drop in global oil prices(which Nigeria cannot control), triggered a drop in revenue and government spending due to Nigerian government not being able to earn what it used to earn before the drop. The monoproduct economic structure, heavy dependent on crude oil export and corruption are the root causes of the economic recession.

In Nigeria, where federal and state governments are the highest spenders in the economy, a drop in Government spending can dovetail into a drop in consumer spending which in turn means businesses cannot invest in products and services, and also cannot employ. Instead, there is lying off of workers and high rate of job losses. What Nigeria should realize is that, by allowing the import of goods that can be produced in Nigeria, we export wealth and jobs to those countries and import recession, unemployment and poverty to Nigeria. The country has had no control over the price and output of oil at the domestic and international market. The structure of the economy has not only been export dependent, but also on a resource that is non-renewable. Nigeria is not the only country that has experienced economic recession. If any known market economy would have escaped a recession, it would have been the US economy, however, despite prudent economic management, the US economy experienced periodic recessions and the last global economic crisis was triggered by the collapse of the sub-mortgage sector, (Adelmann, 2011).

Interest Rate, Inflation Rate and Economic Growth in Nigeria

Interest rate is the rental payment for credit usage by borrowers, investors and returns for parting with lenders' liquidity. Also, Interest rate may be regarded as the price of the credit that is ambiguous due to inflationary pressure. A low interest rate strengthens the banks to relax the lending policy in order to promote and guild firms and household spending pattern. A low interest rate can force local currency to be devalued, as a result of demand for domestic goods rises, most especially when imported goods become costly. These factors among others would necessitate economic growth, consumer spending pattern and investment (Caporale, G., Cipollin, A., and Demetriades, P., (2005), Hajela, T., 2009).

However, economic growth is a proportion of a country's potential output. Economic growth has re-examined the reality behind the disparity in growth rate of countries overtime; and this act has influenced government decisions on spending pattern and tax rate regime in order to realize easy growth rate (Isiaka, S., Abdul- Raheem, A., and Mustapha, I., 2011). The average real GDP rate was less than 6% in 1970s, and later became worse, until the economic reform of August, 1986. Since then, positive GDP has been sustained till date, (5.5%), but at a very low rate.

Inflation remains the continuous rise in prices of goods and services without corresponding increase in output. The Nigerian economy seemed to have

experienced moderate inflation before the economic reform in 1986. There exists a positive relationship between inflation and growth in the short run, but economies with continuous increase in inflation rate may be forced to face some macro-economic challenges - low purchasing power of the local currency, poor price system and fluctuation of exchange rate etc. (Obamuyi, T., and Olorunfemi, S., 2011,) argued that the instability in the financial market and banks, have shown that the Central Bank's inability to actively manage the monetary policies have negative effect on the economy, thereby leading to increase in demand for dollars and with undesirable effect on resource allocation. High inflation has been found to have undesirable consequences on economic parameters. Inflation was 12.24% in 2012 and 9.1% as at June, 2013, 7.1% in 2014 and as February, 2015, it was 8.2%. However, as at February, 2020, inflation in Nigeria had risen to 12.20% with the following breakdown; food inflation stood at 14.85%, core inflation stood at 9.43%, rural inflation stood at 11.61% and urban inflation stood at 12.85%. This could be attributable to the crash in the price of crude oil in the international market as a result of the outbreak of COVID-19 (NBS, 2020).
Nigeria has experienced high inflation, thereby targeting the real interest rate on a negative trend most of the time. This act has made interest rate to be difficult to control, and the real interest rate remaining negative, savings and investment have remained low, and the economy has experienced weak industrial infrastructure.

The Nigerian Banking and Monetary Policy System

The Monetary Policy Rate (MPR) is the rate at which banks borrow from Central Bank to cover their immediate cash shortfall. The higher the cost of such borrowing, the higher also will be the rate banks will advance credit to the real sector. Unfortunately, reverse is the case in Nigeria, the monetary policy rate has increased from 12% to 13% in 2014 (CBN, 2014).
The Nigerian banking system started in the late 19th century, but grew with influence of colonial masters, who introduced banking services in Nigeria. The apex bank has continued to play the traditional roles of regulating the stock money in order to promote monetary stability, sound financial system, to achieve high employment opportunities, rapid economic growth, price stability, effectively managing inflation and creating enabling environment to achieve national economic growth. However, these objectives among others have been realized via the use of monetary policy tools (Fasanya, I. et al, 2013, Onanuga, A. et al, 2000,).

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However, CBN use methods to stabilize the economy via economic parameters such as Open Market Operations (OMO). These operations are conducted wholly on Nigerian Treasury Bills (TBs) and complimented with the use of reserve requirements, the Cash Reserve Ratio (CRR) etc. The Cash Reserve Ratio (CRR) is the amount of cash that banks have to keep with the Central Bank and is often used to control excess liquidity in the economy. Cash Reserve Requirement (CRR) has increased from 50% to 75% on all government deposit with commercial banks and increase from 12% to 15% on private deposit with commercial banks (MPC, 2014). The adoption of 75% on public deposit and 15% on private deposit of CRR would not protect the pressure on exchange rate and inflation as a result of continuous increase in government spending culture most especially during election year. But, it is good to know that these set of instruments are used to influence the monetary aggregates via a monetary processes. Changing monetary policy has a very crucial effects on aggregate demand, and thus on both output and prices. There are number of ways in which policy actions get transmitted to the real economy, which may be via the interest rate channel. During the rise in borrowing costs of CBN, consumers are a likely to involve in finance and businesses, which may hardened the likelihood of channeling funds to investment opportunities; and this reduced the level of economic activity, but with a consistent lower inflation, this would likely result to lower demand, which usually means lower prices. It must be noted that a rise in interest rates also tends to reduce the net worth of businesses and individuals (i.e. making it tougher to qualify for loans at any interest rate and reducing spending and price pressures).

Monetary policy has an important additional effect on inflation through expectations. Many wage and price contracts are agreed to in advance, based on projections of inflation, if policymakers hike interest rates and further communicate anticipated hikes at appropriate time, this may convince the public that policymakers are serious about keeping inflation under control. Long-term contracts will then build in more modest wage and price increases over time, which in turn will keep actual inflation low.

It must be noted that the Minimum Rediscount Rate (MRR) was used as the price-based technique to influence the movement of cost of funds in the economy; though, the changes in this rate provides a platform for the monetary disposition of the Bank. This rate has continuous been pecked within the range of 26 and 8 percent since Structural Adjustment Programme (SAP) regime in August, 1986. However, to compliment the use of the MRR, the CBN eventually introduced the Monetary Policy Rate (MPR) in 2006 which establishes an interest rate corridor of either plus (+) or minus (-) two (2) percentage .

Ostensible Causes of the Recession

The following are the ostensible causes of recession in Nigeria;

1. Delay in forming the cabinet: the first tenure of the present administration ran like a sole administrator in its first eleven months. This contravened the international best practice which recommended forming cabinet within first three months in office. This delay gave room for leakages in the economy. There was no finance and coordinating minister of the economy to make concrete decisions and implement policy directions of government. Since there can't be a vacuum in decision chain businessmen and women as well as politicians made decisions for the people.
2. The introduction of the treasury single account (TSA): the TSA that was supposedly meant to block loopholes in the economy and minimize corruption mopped up liquidity in the circulation and stifled credit creation and economic activities in the country. This has a great effect on the economy. The subsidy removal also contributed its toll. Though intended to remove the cabals and liberalize the petroleum sector, its ripple effects on the economy was very severe. Because everything in Nigeria revolves around oil, when the pump price increased, it caused a serious inflationary pressure. Interestingly, the NNPC is already saying that the N149 pump price is no longer feasible. So there is an impending likelihood of another increase in the pump price. There was a delay in signing the 2016 appropriation bill into law. This delay stifled economic activities because the zero-based budget approach apparently adopted rendered most ministries, departments and agencies of government (MDAs) partially inactive as there were no capital votes for project implementation, this delay also generated other attendant problems such as budget padding which stymied its full implementation.
3. The fall in the global crude oil prices: Nigeria being a mono-product dependent economy is easily susceptible to fluctuations in the global economy. Thus, the benchmark oil price for 2016 and 2020 budgetary allocation was changed to reflect the current realities respectively. This later translated into a restrictive budgetary allocation as well as contractual monetary and fiscal policies. Especially, most state government in the country could not pay their workers' salaries

because of the dwindling budgetary allocation from the federal government. Then there was the exchange rate policy of Central Bank of Nigeria (CBN). This replaced the fixed exchange rate with a floating one and escalated the foreign exchange rates. For instance, Dollar sold at different prices at the inter-bank rate and the parallel markets. This translated into high commodity prices since the Nigerian economy is import dependent and had a boomerang effect on living standards as the Nigerian masses have to contend with stagflation.

Empirical Review

Ujuju L.E. and Etale M. L. (2016) carried out a study on macroeconomic analysis of the relationship between monetary policy instruments and inflation in Nigeria. This study examined the role of monetary policy instruments in controlling inflation in Nigeria. The study adopted interest rate, minimum rediscount rate, liquidity ratio, and cash reserve ratio as proxy for monetary policy instruments and the independent variables. These were regressed against inflation rate, the dependent variable. Secondary time series panel data for the period covering 1982 to 2011, were collected from the Central Bank of Nigeria (CBN) Statistical Bulletin in 2011. The study employed multiple regression technique based on E-views 7 computer software to analyze data obtained on the study variables. Four hypotheses were tested and the null hypotheses were accepted based on the regression results. The study found that interest rate, minimum rediscount rate, liquidity ration and cash reserve ratio had no significant influence on inflation. The study recommended that Nigeria shift from being a consumption driven (import) economy to production based (export) economy for the impacts of these policies to achieve desired results.

Akabom-Ita Asuquo A.I (2012), conducted a study to evaluate Inflation accounting and control through monetary policy measures in Nigeria from 1973 to 2010. Secondary data were used empirically to do the assessment. Aggregate data on independent variables (monetary policy measures) that affect inflation were collected and analyzed using multiple regression model and the ordinary least squares estimation techniques. From the analysis carried out, it was found that some of the variables (money supply, interest rate and exchange rate) were statistically significant, which means that the studied variable could be used to predict inflation. Furthermore, domestic credit was not statistically significant, even though it could be used as a policy variable to account for inflation. Based on these findings

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VOL. 11 NO.6 JUN-2020 ISSN: 1021-3197

Duru, E.E. and Anochie, Uzoma .C. (2015) carried out a study on Stabilization Measures and Management of the Economy: The Case of Nigeria. The paper examined the policy framework for macroeconomic and observing the coordination of monetary and fiscal policies in Nigeria by looking at the purpose of the broad macroeconomics objectives as well as the measures used in economic stability and management in Nigeria economy. These measures or policies are used in the economy to control instability in the country's economy. The paper finds out that there is a positive relationship between money supply and GDP which is important instrument promoting stability in the economy.

Observation/ findings

It is evident that the weakening fundamentals of the economy, particularly the low output growth and rising unemployment, provide an opportunity to review the thrust of monetary policy. The recession confronting the economy and the prospects of negative growth to year -end provide strong grounds for easing monetary policy. The monetary authorities should recognize that the benefit of credibility in policy associated with inflation targeting is offset by real output losses from an overly tight policy. Further tightening the stance of monetary policy would not only weaken aggregate demand but also have an adverse effect on banking system stability given the already high non-performing loans in the books of Deposit Money Banks.

Indeed , the present economic reality calls for a rethink of monetary policy thrust so that the emphasis is on restarting inclusive economic growth and promoting employment creation while keeping an eye on price stability .

The CBN should spare no effort in ensuring that this time around, its attempt at easing liquidity into the system is directed at employment generating activities in the economy such as the SMEs, infrastructure and agriculture.

Until there is a shift from a consumption economy to a production economy, the trend is unlikely to change.

Recommendation

1. Government should examine its monetary policy to make them more relevant to economic development. If they are not effective, new policies which will be more relevant for economic growth and development should be established.
2. There must be a strong monetary policy to stimulate the economy, the country needs the diversification of the structural base of the economy away from oil which can only be possible when the real sectors of the

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economy such as the manufacturing, agriculture, solid minerals etc. are also taken as priority sectors (Farayibi,A.O., 2016).

3. The monetary authority should as a matter of priority monitor interest rate to ensure that it is relatively stable. This would boost investment and by extension reduce inflation. On the other hand, the monetary authority can come up with policies that will adequately find tune interest rate to achieve non-inflationary growth of the economy.
4. Nigeria should shift her focus from being a consumption based economy to a production based economy for the impact of monetary policies to achieve desired results.
5. Monetary supply, interest rates and exchange rates should be the principal policy variables to be manipulated in controlling inflation in Nigeria.

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