CHAPTER SEVEN

EXTERNAL SECTOR POLICIES

7.01 The Central Bank of Nigeria Decree No. 24 of 1991 makes the Central Bank responsible for formulating and realising the external sector policy objectives of the country. Section 2, Sub-Section (b) of the Decree charges the Bank to maintain an adequate level of external reserves in the form of monetary gold, reserve position at the International Monetary Fund (IMIO, holdings of Special Drawing Rights (SDR) and holdings of convertible currencies of other countries to safeguard the international value of the country's legal tender currency and ensure the Country's external economic stability. Section 24 requires the Bank to maintain the reserves in specified external assets while Section 25 requires it to use its best endeavour to maintain these assets at levels it considers to be appropriate for the monetary system of Nigeria.

THE EXTERNAL RESERVE MANAGEMENT

Objectives

7.02 The management of a country's external reserves has basically four main objectives. The first is to provide liquidity for the settlement of transactions with the rest of the world in periods of temporary imbalances in the balance with Nigerian. The higher the domestic propensity to import, as is the case with Nigeria, the higher the level of reserves required to sustain such level of transactions. The accepted norm is to maintain, at all times, enough reserves to cover four months' imports. In Nigeria, before the promulgation of the Central Bank Decree No. 24 of 1991, the law required the Central Bank to hold at all times external reserves of not less than 25% of its total demand liabilities. From available data, and considering the level of public and private sector imports of goods and services, Nigeria's present external reserves can hardly cover five weeks' obligation.

7.03 The second objective is to ensure the availability of foreign exchange for intervention in the foreign exchange market in support of the exchange rate.

This role differs substantially from one Central Bank to another. Sonic Central Banks intervene in their respective countries' foreign exchange market only periodically and even then only when there is a need to stabilise the exchange rate.

7.04 The third objective is to enhance the country's international credit worthiness. External reserves represent the ultimate line of defence if the worthiness of a country is considered important for access to new ??? A respectable level of reserve serves as a notice to the watching international community that the country's economic prospects arc good, a situation that enhances international investors' confidence and serves to attract foreign investment.

7.05 Finally, the country may use the available stock of external reserves as a buffer against external shocks. A high level of external reserves provides a cushion against such developments as a sudden fall in the prices of exports of the country. It gives the country time to adjust its expenditure patterns to the external shock without seriously destabilising its economy.

The Strategy

7.06 The strategy of Central Bank's reserve management is inspired by the need to meet the objectives stated above. 1-Iowever, increasing government's external commitments, especially for debt service, and the compelling need for the government to be directly involved in the funding of the country's foreign exchange market have made it difficult for all the objectives to be achieved. Against this background, the country's reserve management strategy has, revolved around the following:

a) investment of the reserve funds in secure, short-term liquid assets in Order to ensure prompt availability of funds when required;

b) the rescheduling of the external debt in order to reduce the debt service burden, and thereby conserve the reserves;

c) the selection of only a few correspondent banks to operate documentary credits on an unconfirmed basis in order to enable Nigeria pay only when shipments are made. This way, although