

The Level of Commercial Bank's Compliance with CBN Monetary Policy Credit Guidelines

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ABSTRACT Monetary policy circular is a letter of directive issued to Banks in Nigeria by Central Bank in which they are directed on level of credit, and charges to be adopted in different sectors of the economy. It is this letter that formulates what is known as the country's monetary policy". The objective of this research is to use Monetary Policy Compliance Rate Models, to assess the level of commercial banks compliance to the specified monetary policy credit guidelines. The researcher used secondary data on the sectoral distribution of credits commercial banks submitted to the Central Bank of Nigeria. The economic sectors were classified as production which embraces Agriculture, Forestry Fishery, Manufacturing Mining and Quarrying, Real Estate and Construction. Statistically, the compliance rate models were used to assess the level of compliance of commercial banks to the stipulated monetary policy. The research tested two hypotheses which have revealed that in sectoral allocation era 1991-1993, commercial banks did not comply to the monetary policy credit guidelines, but during the high priority and others, 1994-1996, commercial banks complied to the monetary policy credit guidelines. The policy implication of the research has shown that public utilities, transportation, telecommunication and general welfare in Nigeria had performed below expectation, because commercial banks under-complied to the monetary policy credit guidelines, in these sectors.

INTRODUCTION

The Nigeria House of Representatives passed an act which established Central Bank of Nigeria in 1956, but commenced business in 1960 following the recommendation of Paton's commission in 1958. One of its major traditional functions is to manage the nation's money and economy through the issue of various money and monetary policy circulars (MPCs).

We can view monetary policy circulars as measures designed to regulate and control volume, cost and direction of money and credit in the economy to achieve some specified macro-economic policy objectives, which can change from time to time depending on the economic position of a particular country. In a nutshell, we can say that the objectives of monetary policy are as follows:

- a) To facilitate full employment
- b) To generate rapid economic development
- c) To maintain price stability
- d) To ensure effective credit control
- e) To encourage liquidity control in the economy
- f) To ensure balance of payments equilibrium
- g) To maintain an effective supply and demand for money.

The monetary policy circular issued after meetings between the Central Bank officials, Federal Ministry of Finance and Managing Directors of various banks or their represen-

tatives. When the rate of increase or decrease in various sectors of the economy must have been discussed and agreed, they are sent to the presidency through the Minister of Finance to be incorporated into the national budget.

In Nigeria, monetary authorities are the machinery of government that formulate and execute monetary policy. The authorities are the Federal Executive Council (FEC), Ministry of Finance and the Central Bank of Nigeria (CBN). However, under the present arrangement, each has a specific statutory function in monetary policy formulation and execution.

The problem is that there are considerably concurrent authority, because the function of the Ministry of Finance under the Recurrent and Capital Estimates are basically statutory functions which are now assigned to the Central Bank of Nigeria under the Central Bank of Nigeria Act of 1956, this act was amended in 1969, but now replaced by BOFID in 1991. With this conflict in functions of the two bodies, how can the monetary policy circulars be effective in the control of the economy? The monetary management functions are assigned to the minister, but the Central Bank decides on the monetary policy, therefore, the process of monitoring monetary policy seems difficult. The authority has issued about thirty-seven (37) monetary policy circulars (MPCs) from 1970 to 2001, but there has not been much statements on

the level of compliance by banks to the monetary policy because there is no acceptable monetary policy compliance model to test banks level of compliance to monetary policies.

The research shows how the monetary policy compliance rate models can be used to assess the performance of banks to the stipulations in the monetary policy credit guidelines.

RESEARCH METHODOLOGY

This research evaluates the level of compliance of the commercial bank sector to the monetary policy circulars during the sectoral era and during re-classification era. The commercial banking sector as a group is used because the researcher wants to comply with the privacy Act. The industry embraces both private limited liability banks and quoted banks.

Statement of Hypothesis: The activities of commercial banks in the areas of credit guidelines, which led to the enactment of decree No. 24 & 25 of 1991. It was followed by financial malpractices decree No.18, with the above legal requirements, behind us we can propose as follows:

Ho₁: Commercial Banks had not complied to the monetary policy credit guidelines during the sectoral allocation era 1991-1993.

Ho₂: Commercial Banks had not complied to the monetary policy credit guidelines during the re-classification of high priority and others era 1994-1996.

Method of Data Collection: The major sources of data collection are the published data in statistical bulleting, commercial bank reports and monetary policy circular booklets of various issues. The annual financial statements of commercial banks covering 1991-1993 for sectoral loan, allocation and the re-classified period 1994-1996 were very useful for the research. The Central Bank of Nigeria annual reports and statement of accounts added value to the result.

These periods were selected because of the comparative nature of the study. The idea of credit guidelines was abandoned in 1997 because of de-regulation of the economy in the country.

METHOD OF DATA ANALYSIS AND RESULTS

The monetary policy compliance rate models were developed in 1996 by Dr. P. Osiegbu, it states that the actual banks loan activities can be determined by the monetary authority against

its standard guidelines. They are in three (3) parts as follows:

$$\frac{\text{Sectoral Amount of Loan}}{\text{Total Loan to the Economy}} \times \frac{100}{1} = \%$$

1. To determine Actual Rate:
It shows the percentage of loan given to customers by a particular bank.
2. To calculate the Monetary Policy Compliance Deviation rate is:
(AMPR – SMPR) = Level of Deviation from the Standard = %
3. To know that level of Compliances/Non-compliance
Compliance Rate Deviation Level =

$$\frac{\text{Deviation}}{\text{SMPR}} \times \frac{100}{1} = \%$$

Note:

1. The standard monetary policy rate (SMPR) is the target percentage provided by the monetary authority.
2. AMPR = Actual monetary policy rate of banks
3. MPC = Monetary policy circulars

The data adopted in this research are secondary in nature to illustrate the application of monetary policy compliance models. Nigerian monetary authority divided the economy into sectors and the concept of sectoral allocation of credit was used. The economy was sectorised from 1969 to 1993 (see Table 1).

In 1994, sectoral classification was replaced by two classification of high priority and others only. High priority included agricultural, manufacturing, soil mineral exports etc.

Table 1 and 2 show the sectoral allocation by commercial banks from 1991-1993 and 1994-1996 respectively. The production sector was distinct sector till 1994, commercial banks gave out loans were 64%, 63% and 61% from 1991-1993. Commercial banks over loaned this sector by 38% which created over compliance rate of 76%. This over compliance to monetary policy rate led to an inflationary trend in the economy which increased from 44.5% in 1991 to 57% in 1993.

In the general commerce sector (see Table 1), commercial banks achieved an acceptable performance because the actual rate and standard rate to equate each other which shows 100% compliance with stipulated monetary policy guidelines. This action is good if the figures were not padded or adjusted to meet the aspirations of the Central Bank of Nigeria. In 1991, the

Table 1: Commercial bank sectoral loan allocation (1991-1993, N million)

Date	(a) Production						(b) (General) Commerce						(c) Service						(d) Others					
	Loan Amount	AR %	SR %	D %	CR %	Loan Amount	AR %	SR %	D %	CR %	Loan Amount	AR %	SR %	D %	CR %	Loan Amount	AR %	SR %	D %	CR %	Loan Amount			
1991	20,099	64	50	14	28	5,102	16	18	-2	-11	2,108	7	16	-9	-56	4,058	13	16	-3	19	31,207			
1992	27,202	63	50	13	26	7,393	17	18	-1	-6	2,764	6	16	-10	-63	5,378	13	16	-3	-19	42,737			
1993	40,693	61	50	11	22	13,493	21	18	3	-17	4,419	7	16	-9	-56	7,059	11	16	-5	-31	66,665			
Total	87,994	188	150	38	76	25,989	54	54	0	0	9,291	20	48	-28	-175	16,495	37	48	-11	-69	139,609			

Source: Amount of loan and total loan derived from CBN Statistical Bulletin, Vol.7, No.1, June 1996.

Note: AR = actual rate, SR = standard rate, LD = level of deviation, CR = compliance rate, D = deviation

Table 2: Commercial bank loan allocation during reclassification period (1994-1996, N million).

Years	High priority					Others					Total loan to the economy	
	Loan Amount (N M)	AR %	SR %	D %	CR %	Loan Amount (N M)	AR %	SR %	D %	CR %	N Million	
1994	60,194	64	70	-6	-9	33,990	36	30	6	30	94,184	
1995	342,439	70	70	0	0	143,840	30	30	0	0	486,279	
1996	534,105	82	-	-	-	115,359	18	18	-	-	649,464	
Total	936,739	134	140	-6	-9	239,189	84	78	6	30	1,229,927	

Source: Loan Amount and Total Loan to the Economy were derived from CBN Statistical Bulletin, 7:26, June 1996.

monetary policy stipulated 18% but banks loaned out 17% under loaned but in 1993, the standard was 18% but commercial banks loaned out 21%, which was 3% over loaned. The three years (1991-1993), analysis has revealed that the standard was 54% while commercial banks actual loan rate was 54%, which has given 100% compliance rate. The monetary policy question is, should banks comply to the monetary policy guidelines on short term basis (one year) or intermediate term of three years (3 years)? For good financial and economic planning, banks should comply on annual or quarterly basis rather than intermediate term basis.

In the service sector, the credit ability of commercial banks fell below the 16% standard stipulated by the monetary policy in 1991-1993, respectively. Therefore, the level of non-compliance to the monetary policy-guidelines are -56%, -63% and -56% respectively. We can conclude that from 1991-1993, commercial banks undermined monetary policy credit stipulations by -175% level which was not good for the economy.

Other sectors reveal that commercial banks did not comply to the monetary policy guidelines (see table 1). The monetary authority (CBN) recommended the standard to be 16% in 1991, 16% in 1992 and 16% in 1993 respectively, but the Actual Rate commercial banks met was 13% in 1991, 13% in 1992 and 11% in 1993. The level

of compliance in 1991 was -19%, in 1992 was 19% while in 1993 it was -13% within the three year period (1991-1993) the commercial bank sector non-compliance rate was -16% which was detrimental to the economy.

In 1994, CBN reclassified the economic sector into high priority and other (see table 2). In this year of reclassification, the standard rate was 70% but the actual rate was 64%, there was deviation of 6% and level of non-compliance was -9%. The standard rate for others was 30% but actual rate bank gave out was 36% which created over loan of +6% while the over compliance rate was +20%.

In 1995, the standard rate was 70%; there was no deviation while the compliance rate was 100%. In other sector, standard rate was 30% and the actual rate was 30% therefore the compliance rate was 100% with 0% deviation.

In 1996, when we used the monetary policy model, the actual rate was 82% under high priority, but CBN did not set up any standard, therefore, the compliance rate cannot be determined, the same applies to others with actual rate of 18% without a stipulated standard rate.

Test of Hypothesis

H_{01} : Commercial Banks had not complied with the monetary policy guidelines during the sectoral loan allocation era 1991-1993. By the use

of monetary policy compliance rate models we found as follows:

- i. Production sector: (see Table 1)
AR – SMPR
 $188\% - 150\% = +38\%$
- ii. General Commerce Sector
AR – SMPR
 $54\% - 54\% = 0\%$
- iii. Service Sector
AR – SMPR
 $20\% - 48\% = -28\%$
- iv. Other Sectors
AR – SMPR
 $37\% - 48\% = -11\%$

Net Result

Production sector	= 38% over-compliance
General commerce	= 0 which shows 100% compliance level
Service sector	= -28% under compliance
Others	= -11% under compliance
Net Result	= -1% under compliance

H_{01} : Commercial banks has not complied to the monetary policy guidelines during the sectoral loan allocation era 1991 – 1993. Based on the use of compliance rate model, we reject H_{A1} but accept H_{01} : that commercial banks had not complied to the monetary policy credit guidelines because they have –1% under compliance rate.

H_{02} : Commercial banks had not complied to the monetary policy credit guidelines during the reclassification era of high priority and others.

Others

Actual Rate – Standard Monetary Policy Rate
 $134 - 140 = -6\%$ under compliance

We accept H_A : that commercial banks complied to the monetary policy guidelines during the reclassification era 1994-1996. Under high priority, commercial banks under complied by -6% and other sector they over complied by +6% which gives 100% compliance level.

CONCLUSION

The research has used secondary data to show the level of compliance to the monetary policy circular from 1991-1993, and 1994-1996. Problem of monetary policy management has been the role conflicts between the monetary authority and the ministry of finance. These conflicts had created a wide lead-time in the monetary policy implementation.

The views expressed such as lack of compliance rate assessment models made the monetary authority to have problem in knowing the level of compliance by banks. The research

objective introduces to the financial community and the general public the concept of the monetary policy compliance models which can be used to assess the level of banks compliance to the monetary policy, stipulations of the central bank.

The research tested two hypotheses using monetary policy compliance rate models. We accept H_{01} that commercial banks did not comply to the monetary policy in the areas of utilities, transportation, telecommunication, general personal welfare in Nigeria. These organizations performed below expectation, because of shortage of funds or credit to these economic sectors.

RECOMMENDATIONS

Central Bank of Nigeria should continue with the four sectoral allocation of credit rather than the current classification of two sectors, because it will have a better focus on the economy.

CBN should establish a compliance department that can effectively monitor the non-compliance level of monetary policy credit guidelines.

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