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NATIONAL BANK OF ETHIOPIA

# Monetary Policy Management and Communication

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# I. Introduction



- NBE's establishment act was amended by proclamation number 591/2008.
- According to article 5 of this proclamation:  
*“The purpose of the National Bank is to maintain stable rate of price and exchange, to foster a healthy financial system and to undertake such other related activities as are conducive to rapid economic development of Ethiopia.”*

# I. Introduction



- In other words, the Bank is given full mandate to regulate monetary and financial policy in the country.
- This presentation focuses on introducing NBE's experience in monetary policy management and communication.

## II. Monetary Policy Management

### **2.1 Background**

- Monetary policy of central banks in a simplified analysis seems to be the determination of the “optimal” quantity of money or (in a dynamic sense) the optimal rate of growth of the money stock.
- However, there is more to monetary policy than the determination of the optimal stock or growth rate of money.

## II. Monetary Policy Management



- More generally, monetary policy refers to a bundle of actions and regulatory stances taken by the central bank including, but not limited to:
  - Setting minimum interest rates on deposits or the rediscount rate charged to commercial banks;
  - Changing commercial bank reserve holding through open market purchases or sales of government securities;

## II. Monetary Policy Management



- Setting reserve requirements on deposits;
- Regulatory actions to constrain commercial bank financial activity or to set minimum capital requirements; and
- Intervention in foreign exchange markets to buy and sell domestic currency for foreign exchange.

## II. Monetary Policy Management



### **2.2 Monetary Policy Objectives**

- As stated above, the principal objective of the monetary policy of the National Bank of Ethiopia is to:
  - maintain price & exchange rate stability, and
  - support sustainable economic growth of Ethiopia.
- Price stability: key indicator of macroeconomic stability which is vital in private sector's decision making in investment, consumption, international trade and saving.



## II. Monetary Policy Management



- Maintaining exchange rate stability: key to maintain competitiveness of domestic firms in international market and to use exchange rate intervention as policy tool for monetary policy to affect both foreign reserve position and domestic liquidity.

## II. Monetary Policy Management



- More specifically, the objectives of Ethiopia's monetary policy are to:
  - Foster monetary, credit and financial conditions conducive to orderly, balanced and sustained economic growth and development.
  - Preserve the purchasing power of the national currency – ensuring that the level of money supply is generally consistent with macroeconomic developments and intervening in the forex market to stabilize the rate when conditions necessitate.

## II. Monetary Policy Management



- Encourage the mobilization of domestic and foreign savings and their efficient allocation for productive economic activities.
- Facilitate the emergence of financial and capital markets that are capable of responding to the needs of the economy through appropriate policy measures.

## II. Monetary Policy Management



### **2.3 Monetary Policy Strategy/Targeting Framework**

- The Ethiopian monetary policy system uses a three-stage targeting framework:
  - Ultimate or final target,
  - Intermediate target and
  - Operating target.

## II. Monetary Policy Management

- **Final targets:** In line with proclamation number 591/2008, the final targets of monetary policy in Ethiopia are:
  - Maintain price and exchange rate stability and
  - Support sustainable economic growth
- **Intermediate targets:** In order to achieve the final target mentioned above, NBE considers money supply as an intermediate target.
- It should be noted that intermediate targets are not directly controlled by the central bank

## II. Monetary Policy Management

- NBE takes the broader definition of money or M2 as money supply. It is the sum of narrow and quasi money.
- **Operational target:**
  - The operational target is an economic variable that the central bank wants to influence, largely on a day-to-day basis, through its monetary policy instruments.

## II. Monetary Policy Management



- The growth of base money/reserve money is being used as operational target of the National Bank of Ethiopia.
- Reserve money (base money) is defined as the sum of currency in circulation and deposits of commercial banks at NBE.
- The current target is to ensure that the reserve money growth is in line with nominal GDP growth rate.

## II. Monetary Policy Management



### **2.4 Monetary Policy Instruments**

- National Bank of Ethiopia uses a mix of diversified monetary policy instruments so as to effectively carry out the monetary management function:
  - Open Market Operations
    - ✦ Include sale & purchase of bonds or securities issued by governments.
    - ✦ NBE uses open market operations through sale and purchase of government securities (Treasury bills) as one of its monetary policy instruments.
  - Setting of floor deposit interest rate
  - Use of selected credit control when necessary



## II. Monetary Policy Management



- A standing central bank credit facility
  - This credit facility gives banks the assurance that, when confronted with problems of shortfall in the clearing and a lack of alternatives for raising immediate funds in the inter-bank market, they can settle the clearing with the central bank's funds
- Reserve requirement
  - Banks are obliged to deposit minimum reserve requirement at NBE as percent of their net deposits. Currently it is 5%.
- Direct borrowing/lending in the inter-bank money market and introducing re-purchase agreement (repo/reverse repo operations).

## III. Monetary Policy Decision Making Body



- According to article 3 of proclamation number 591/2008, NBE shall be accountable to the Prime Minister and has its own Board of Directors.
- Article 9(1) declares that the powers, responsibilities and functions of the Bank provided for in this Proclamation are vested in the Board of Directors.

### III. Monetary Policy Decision Making Body



- Therefore, the Board of Directors has the final say on monetary policy of the Bank.
- Meetings of the Board of Directors are to be held at least once every three months; but the Chairperson or the person delegated by him, may call a meeting at any time or when the Governor or three board members so request.
- All decisions of the Board of Directors shall be made by a simple majority vote of the members present. In case of a tie, the Chairperson shall have a casting vote.



Besides the board of Directors, there is **an Executive Management committee** comprised of V/Governors, Senior advisor to the Governor and Director, Change management, Planning and Communication Directorate under the Chairmanship of the Governor which decided policy issues that don't require Directors attention.

## IV. Communicating Monetary Policy Objective and Strategy



- Proclamation number 591/2008 states that the primary objective of monetary policy is to maintain price and exchange rate stability. But it does not define a strategy to achieve that goal.
- Monetary policy communication helps markets to better understand how monetary policy is likely to respond to adverse shocks and potential risks to price stability, thus establishing a basis for assessing the predictability and credibility of monetary policy.

## IV. Communicating Monetary Policy Objective and Strategy



- Cognizant of this fact, NBE has developed its own strategy. The strategy includes a quantitative definition of price stability and employing economic and monetary analyses to assess risks to price stability.
- By defining and communicating its policy strategy, NBE adopted a framework for internal analysis and decision-making which also provides the basis for explaining policy decisions to the public. The quantitative definition of price stability is single digit annual inflation.

## V. Communicating Monetary Policy Stance



- NBE aims to explain clearly and systematically the economic rationale underlying each monetary policy decision by providing detailed and comprehensive analyses of the current economic and monetary conditions and its assessment of the medium and longer-term risks to price stability.
- Several forms and channels of communication are employed.

# V. Communicating Monetary Policy Stance



- Quarterly and annual bulletins of the Bank are among the main channels of the NBE's communication in this respect. The bulletins provide more comprehensive and detailed information and analysis pertaining to monetary policy decisions and stance.
- NBE also organizes a press conference to reach out to a much wider audience whenever special monetary policy decisions are taken.



# V. Communicating Monetary Policy Stance



- The speeches and interviews given by Governors to many different audiences provide additional opportunities to explain monetary policy decisions and to comment on other topics within NBE's sphere of competence.
- There is also a quarterly bi-lingual magazine, named Birritu, published by NBE and it presents information and analysis on monetary policy stance.
- Information also be given to different researchers, university students and other stakeholders up on demand.



**Many thanks for your  
undisturbed attention!**