CENTRAL BANK OF LIBERIA
POLICY STATEMENT
2008

I. INTRODUCTION

The Monetary Policy Statement (MPS) reviews the implementation of monetary policy by the Central Bank of Liberia (CBL) for the preceding year and the intended policy stance of the Bank for 2008. It also covers the economic and financial conditions in the country, including exchange rate developments, trends in inflation and their underlying causes in 2007, CBL's efforts at ensuring price stability, as well as the reform of the banking system. Additionally, the Statement deals with the management of the CBL's financial resources and the efforts being made to strengthen the Bank's capacity to function more effectively as the monetary authority of the country.

In submitting this Statement to the government of Liberia, the CBL is fulfilling the statutory requirement of PART XI Section 50 of the Central Bank Act. As a public document, it also affords the public the opportunity to be apprised of how the CBL is exercising its mandate. Operations of the CBL will continue to be characterized by transparency and accountability, as this must be the anchor of its functional independence.

The CBL will continue to work closely with the fiscal authorities and other stakeholders, including the respective Committees of the House of Representatives and the Senate on Banking and Currency and the Bankers Association, to improve the Liberian banking system with a view to promoting economic growth and development.

II. THE ECONOMY

The year 2007 witnessed a stable macroeconomic environment, reflecting the implementation of prudent monetary and fiscal policies. Although national accounts data are weak, growth in real Gross Domestic Product (GDP) was estimated at 9.5 percent. GDP growth was driven mainly by recovery in rubber production, resumption of diamond exports, and continued strong growth in the services sector. Inflation broadly remained stable in the low double digits.

For 2008, the economic recovery is expected to continue, albeit at a slightly lower rate (8.8 percent) than in 2007. the projected slowdown in the growth rate is due to the delay in beginning logging activities and the slow pace of mining. There are further downside risks to the growth outlook if rubber production declines more than expected and the sharp slowdown in global economic growth adversely affects Liberian exports.

The Government initiated Liberia's Poverty Reduction Strategy (PRS) that spans April 2008 to June 2011. it focuses on enhancing national security, revitalizing economic growth, strengthening governance and the rule of law and rehabilitating infrastructure and improved delivery of basic services.

Any economy experiencing economic growth must endeavor to translate such growth into economic development—i.e., infrastructural development, improved provision of basic social services, increased job opportunities, wider dispersion of economic activities, etc. This is the challenge for the Poverty Reduction Program, requiring policy reforms, enhanced donor coordination so that external assistance can better reflect the prio9rities of the Government and that such assistance is made on a timely basis. Recent developments regarding the food situation suggest that the question of food security has taken on added importance, and should be addressed as part of the Poverty Reduction Strategy.

Against this background, several steps taken by the Government aimed at supporting private sector development are in the right direction, as the private sector has to be the engine of growth and development. A Public-Private Sector Dialogue on legal and regulatory reforms, strengthening public and private sector capacity, and improving infrastructure services and access to finance was established by the Government with assistance from the World Bank. The Government, in partnership with the International Finance Corporation (IFC), also began work aimed at improving the investment climate in the context of providing an environment that will reduce the cost of doing business in Liberia. It is important that the development of Liberian entrepreneurship be a central element of efforts to promote the private sector in Liberia.

On the global front, international growth is projected to slow from 4.9 percent in 2007 to 3.7 percent in 2008. IMF now states that there is a 25.0 percent chance that global growth will drop to 3.0 percent or less in 2008 and 2009.

For 2008, inflation in Liberia is expected to remain in double digits on account of the recent sharp increases in world fuel and food prices. Also, depreciation of the United States dollar against the Euro and other major foreign currencies has implications for domestic inflation. At end-March, 2008, €1.00 was exchanged for US$1.55. The Euro-zone accounted for 13.6 percent of Liberia's imports in 2007 compared to 6.0 percent for the USA. A weak dollar would mean more US dollars have to be offered in exchange for imports and this leads to higher import costs and higher domestic prices for the imported goods.

Regulatory policies relating to diamond exports were put in place to make Liberia Kimberly compliant. As a result, Liberia can now export diamonds, which should contribute towards enhancing employment and its economic recovery. Efforts that are underway to develop a national mineral policy and a legal and fiscal mineral framework to govern mining activities should also help the economy to benefit more from mineral resources.

Government's policies must continue to emphasize putting in place appropriate regulations to better manage national resources and strengthen measures to increase agricultural productivity. The Agriculture Ministry is already taking steps aimed at increasing yields and building its institutional capacity. Also, the new forestry law is expected to lead to a sustainable forestry industry. Bidding for timber sales and forest management contracts are expected to begin in the coming fiscal year. The government made some progress in the restoration of power to parts of Monrovia and its environs and the rehabilitation of roads, health facilities, and schools. However, strong donor support for the timely rebuilding of key infrastructure is necessary.

The clearance of Liberia's arrears and debt cancellation will not immediately translate into higher resources since Liberia had been making only minimal payments on its external debt. An eventual resolution of the debt overhang will afford Liberia the opportunity to begin considering borrowing. This will have to be done within the context of a comprehensive debt management strategy, and development of appropriate institutional arrangements to manage new debt accumulation.

Aggregate foreign trade in 2007 expanded to US$716.0 million, an increase of US$158.0- million over the level recorded for 2006. The trade deficit increased, from US$243.0 million in 2006 to US$266.0 million in 2007. The current account deficit, excluding grants, is projected to widen to about 99.0 percent of GDP in 2008 fueled by solid growth in imports of goods and services to support increasing economic activity. However, the large inflow of foreign direct investment (FDI) into the mining sector in 2007 and the projected increase in 2008 will help finance the current account deficit and support further accumulation of international reserves.

A major challenge for the Liberian economy is the unprecedented 40.0 percent increase in global food prices, including that of rice, in the last 12 months and the steep rise in the price of oil. International rice price has risen by 73.0 percent and oil price by 85.0 percent between January 2007 and March 2008. We have already begun to see the impact on the cost of living in Liberia. World rice production in 2008 is expected to stagnate, which indicates that its international price is very likely to remain high. Also, the price of a barrel of oil on the world market rose to a record high of US$120.0 in the third week of April, 2008. The Liberian economy cannot escape these cost-push pressures, given its high dependence on oil and rice imports. The incidence of poverty in the country might warrant some form of short-term relief, balancing the many demands on the Government against the fiscal actions that it might have to take. A consensus on the way forward will be important, including enhanced action to increase local rice production.

III. IMPLEMENTATION OF MONETARY POLICY

During 2007, the CBL remained focused on achieving its primary monetary policy objective of maintaining price stability. The CBL, during the course of the year, continued to implement prudent monetary policy geared toward maintaining low and stable inflation while ensuring availability of sufficient credit to the private sector by the commercial banks. Banks' credit to the private sector rose by 61.4 percent in 2007. The CBL held several auctions totaling US$18.9 million in 2007, compared to

US$5.5 million in 2006. The auctioning of United States dollars continues to help ensure broad stability in the exchange rate of the Liberian dollar. The general lack of monetary policy instruments in the dual currency regime limits the scope for monetary policy implementation.

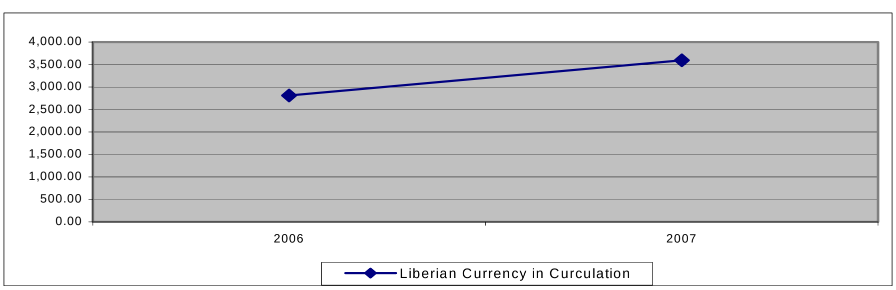
The Bank's Money Management and Policy Review Committee (MMPRC), which meets regularly under the chairmanship of the Executive Governor, guided the decision-making process relating to the strategic direction and monetary policy stance of the CBL. The Bank continued to use the exchange rate as the main indicator of domestic monetary conditions; and the management of Liberian dollar liquidity was generally geared toward maintaining a broadly stable exchange rate of the Liberian dollar relative to the US dollar.

As part of its policy of exchange rate stabilization, the CBL will continue to improve its external reserves position, without jeopardizing the fundamental role of ensuring price stability, to build the capacity to be able to intervene in the market when condition dictates. Besides, supporting the domestic and international banking operations of the CBL with adequate foreign exchange reserves is one way of rebuilding public and international confidence in the Bank.

Monetary Developments

Currency in circulation in terms of Liberian dollars rose by 27.7 percent in 2007, reflecting the need for liquidity to support the economic recovery (Chart 1).

Chart 1: Liberian Currency in Circulation
(Dec. 2006 – Dec. 2007)
(In Millions L$)



Demand deposits of the banking industry in US dollars rose by 31.6 percent in 2007, from US$61.0 million in 2006 to US$80.3 million. Liberian dollar demand deposits also moved up by 53.2 percent, from L$342.1 million in 2006 to L$524.0 million. Aggregate savings and time deposits in US dollars rose by 57.6 percent to US$38.3 million in 2007, from US$24.3 million in 2006. Savings and time deposits in Liberian dollars increased by 49.8 percent, from L$483.6 million in 2006 to L$724.3 million. These developments broadly indicate the gradual rebuilding of confidence in the banking sector, partly attributable to effort being made by the CBL to reform the banking system.

The Liberian economy is predominantly cash-based and highly dollarized. For 2007, US dollars accounted for 64.0 percent of broad money. One of the reasons for the high level of dollarization is the existing dual currency arrangement. The Central Bank is critically studying the issue. At some point, it will be necessary to determine the long-term suitability of the present currency regime for Liberia.

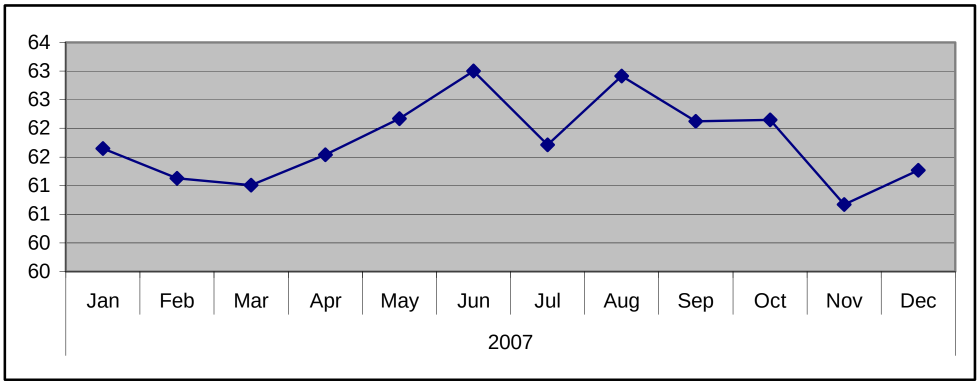
Strengthening the banking system through its bank-reform program and removing mutilated banknotes from circulation are among steps CBL is taking to restore confidence in the Liberian dollar. In support of CBL's effort at encouraging a wider use ot eh Liberian dollar, there is a need for the fiscal authority to consider measures that would increase demand for Liberian dollar. Satisfying such demand will require concerted efforts to ensure the availability of Liberian dollars to service the economy.

For 2008, the CBL will continue the implementation of its foreign exchange auction program aimed at maintaining broad stability in the exchange rage to help ensure price stability. Additionally, the Bank will continue to improve its liquidity monitoring framework to help guide liquidity management.

IV. EXCHANGE RATE DEVELOPMENTS

During 2007, the CBL made significant effort at trying to ensure exchange rate stability, as indicated by a more than three-fold increase in the amount of US dollars sold through its auction program. The rate was broadly stable in 2007, fluctuating between L$60.00 and L$63.00 per US dollar (Chart 2). Depreciation of the annual rate slowed to 5.0 percent in 2007, compared to 6.7 percent at end of 2006.

Chart 2: Monthly Average Exchange Rate: Liberian Dollars per US Dollar (January – December, 2007)



The fundamental problem relating to movements of the exchange rate is the high demand for US dollars. There is a great need for US dollars in Liberia to facilitate imports of goods and services as well as to settle other external obligations. Meanwhile, export earnings remain subdued.

Part of the demand pressure for US dollars has to do with the significant amount of government taxes that are paid in US dollars. This suggests that the fiscal and monetary authorities must coordinate efforts to have resources rechanneled to the economy as may be necessary, thereby assisting the CBL in achieving its intermediate target of maintaining broad exchange rate stability.

The CBL will continue to improve its external foreign reserves position which was recorded at US$35.1 million at end of 2007. Reserves accumulation will be carried out in the context of the objective of maintaining broad exchange rate stability. The CBL will revise its method of auctioning foreign exchange as needed to enhance its effectiveness in terms of helping to broadly stabilize the exchange rate. It will also finalize the framework for the possible introduction of credit and deposit auctions and for the issuance of CBL short-term Paper.

V. INFLATION

Inflation is the rate of increase in the general level of prices of goods and services, which affects the purchasing power of consumers, among others. The CBL has price stability as its primary objective because it provides the basis for price signals to serve as a better guide for planning by investors and other market participants. Price stability also protects the poor.

The rate of inflation as measured by the Harmonized Consumer Price Index (HCPI), accelerated sharply to 16.5 percent in January 2008, from 11.7 percent at end-December 2007, before moderating to 14.3 percent in March. The higher inflation in the first quarter of 2008 was due mainly to a sharp rise in world food prices. Inflation is expected to remain in double digits in 2008. Further increases in world food and energy prices would also affect the inflation outlook for Liberia.

The HCPI was developed and subsequently adopted in 2007 as the method for computing inflation. It replaced the Monrovia Consumer Price Index (MCPI) that was constructed in 19645, which had become obsolete in light of the changed household consumption patterns. The HCPI has an enlarged market basket of 234 commodities compared to 79 items that comprised the MCPI.

Food and Non-alcoholic Beverages were the major driving force of inflation in 2007. When excluded, core inflation was 6.0 percent in 2007. Although relatively low, the CBL will monitor closely this measure of inflation in terms of the implementation of monetary policy.

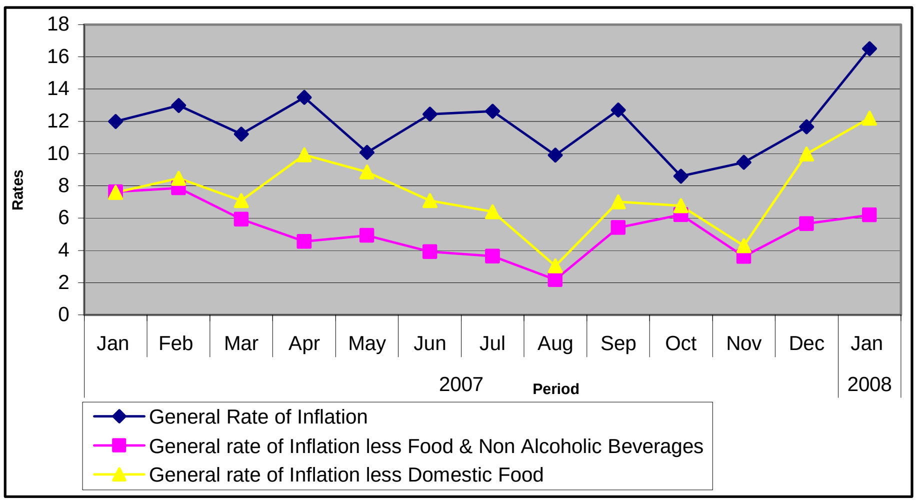
The average price of domestic food items recorded a rise of 25.8 percent in 2007. Domestic food accounted for 3.5 percentage points of the general rate of inflation (Table 1 & Chart 3).

Table 1: Year-on-Year Core Inflation
(December 2005=100)
2007-Janaury, 2008

Definition	Measure of Core Inflation (Year-on-Year)	Items Excluded	Weight	Variations of Total Inflation Explained
Core inflation is a measure of inflation which excludes certain items that face volatile (rapid or unexpected) price movements	6.2	Food & Non-alcoholic Beverages	45.20%	Excluding the contribution of Food & Non-alcoholic Beverages and Domestic Food items to the overall rate of inflation recorded at 16.5 percent at end-January 2008, the general rates of inflation would be 6.2 percent and 12.2 percent, respectively.
	12.2	Domestic Food items	21.30%	

Source: Central Bank of Liberia, Monrovia, Liberia

Chart 3: Core Inflation: General Rates of Inflation and Exclusion of Food and Non-alcoholic Beverages and Domestic Food (December 2005=100) (January 2007 – January 2008)



Structural factors play a major role in driving inflation in the economy. Some of these factors include: poor condition of the road network, which adds to the cost of getting agricultural commodities to the market; low level of food production due in part to inadequate farm inputs; and high cost of electric power, which is passed on to consumers. Other structural factors that could add to price pressures include the numerous bureaucratic procedures relating to the processing of transaction documents by relevant ministries and agencies of government, the costs associated with the clearing of containers by business entities and individuals and that of freight and insurance charges on shipping. The cost of imports is also affected by the general poor condition of the Freeport of Monrovia.

While we have no control over exogenous shocks on domestic prices, it is important that steps be taken to address the domestic side of the problem. Consideration must be given to reviewing existing policies or formulating new ones with a view to addressing some of the structural issues relating to prices in Liberia, such as full liberalization of the rice and cement markets, revitalization of the agricultural sector, improvement of roads and port facilities and reducing bureaucratic procedures for processing transaction document. Full liberalization of the rice and cement markets will minimize the shortage of these commodities on the Liberian market.

Government-administered prices for certain basic commodities such as cement and rice, are largely not adhered to, with prices well above the government's stipulated prices. Price control usually proves to be counterproductive. It can lead to the creation of a parallel market, where prices are far higher than what has been set officially.

Regarding the reintroduction of coins in the market as a means of helping to contain inflation, this is a matter that is under advisement in the Central Bank. However, it is important to keep two related points in mind. One is the low value of change coins relative to the US dollar, which, in fact, provides the basis for transactions in the Liberian economy. Presently, L$1.00 is equivalent to 2 US cents. The other point is that the cost of minting coins must be weighed against the value of the coins. The cost of producing coins has been rising in the past few years. For instance, the US Mint reports that for the first time in US history, the cost of manufacturing both a penny and a nickel is more than the value of the coins themselves. Prices of metals used in the production of coins have been rising worldwide: for the past two years, the price of zinc rose by 76.0 percent, cooper, 68.0 percent and nickel, 42.0 percent, according to the London Metal Exchange.

VI. TOWARDS A STRONGER BANKING SYSTEM

General Outlook

The CBL sees the task of strengthening the banking system as a cooperative endeavor with the board and management of each of the commercial banks. There are some encouraging developments in a number of areas. Both credit and deposits are up significantly. Total capital has increased as well. There has also been a marked increase in bank branches and windows. It is also noteworthy that new products, technology and services, have been introduced, such as automated teller machines (ATMs) and internet banking. This reflects the response of the commercial banks to the urging of the CBL to commit to the modernization of the Liberian banking system. The CBL recognizes these improvements as part of developing a healthy competitive market, and will continue to encourage competition in the banking system. Meanwhile, the CBL will encourage the exchange and the harmonization of banking technology among the banks.

Despite the improvements, many challenges remain. Liberian banks are faced with the problem of excess liquidity, mainly owing to fear of further deterioration in the quality of loan assets. The CBL will continue to work on this problem in cooperation with all stakeholders, particularly on the question of making it easier to collect debt through the legal system. It is only by enhancing intermediation on the part of the banking system that it will be able to support the revitalization of the Liberian economy. In this regard, the CBL will strongly support initiatives that will fast-track the enforceability of financial contracts. In addition, the CBL will work with stakeholders towards the establishment of a more robust credit registry as a means of improving the credit culture in the country. The present credit reference system, which continues to be helpful in the assessment of the credit worthiness of potential borrowers, will be strengthened and enhanced. These efforts are expected to reduce informational problems for the banks, and consequently reduce lending rates to good borrowers.

There is also the issue of concentration of bank branches. The CBL remains aware of the need to expand banking services to the wider population. This is consistent with the Government's objective of promoting economic activities in all parts of the country. Improved access to banking services will also make the banking system a major player in wealth creation in the country, thereby contributing to the fight against poverty. It is in this context that the CBL is working to promote the microfinance industry, including working with potential investors to establish a bank that specializes in microfinance.

While there will be continued emphasis on branch expansion, permission for such activities will be cautiously exercised, taking into account the financial, operational and managerial capacity of the banks.

Systemic Reforms

The Basic Approach

The reform agenda will remain focused on: (1) ensuring the stability of the banking sector and minimizing the risk of financial crisis, (2) enhancing efficiency in the delivery of services to make the cost of banking services more affordable, and (3) improving access to banking services to the general public.

Key elements of the reform strategy include recapitalization, merger and acquisition, and rehabilitation of existing banks on a case-by-case basis. The restructuring plan also focuses on improving corporate governance, and encouraging partnership between existing banks and reputable international banking institution to bring improved operational and managerial skills, and financial resources to the Liberian banking system. The partnering and/or merger of weak banks with reputable international banking institutions are expected to benefit all stakeholders and the overall economy.

The role of improved corporate governance cannot be overemphasized, and is a necessary complement to steps being taken to strengthen the capital base of the banks. Particular attention is being paid to the issue of insider lending, ensuring that all such existing debts to the banking system are paid-off in a timely manner. The fact that the majority of the board members of individual banks now reside in Liberia, as required by the CBL, has been helpful in improving their oversight responsibility. The CBL will issue a corporate governance regulation in 2008 that should improve the commitment of directors to their respective banks.

The Board of Governors of the CBL has decided to raise the minimum required capital for individuals banks from the current level of US$2.0 million to US$6.0 million and the minimum capital adequacy ratio from 8.0 percent to 10.0 percent, required capital will be raised to US$8.0 million by end-December 2009; and US$10.0 million by end-December 2010. This is intended to make the Liberian banking system internationally competitive; create the incentive for banks to properly and adequately manage their risks; and put the banking system in a stronger position to help meet the financing needs of the economy.

Banking Supervision

The CBL remains committed to enhancing its supervisory capacity, to which the International monetary Fund is making a major contribution through technical assistance. Emphasis is being placed on recruitment and training of staff so that the CBL can maintain a robust program of on-site inspection and off-site early warning surveillance system. The CBL is aware that strong supervision is central to an expending banking system in order to ensure the safety and soundness of the system and minimize the risk of bank failure. Perseverance in this endeavor is key to rebuilding public confidence in the banking system. Already, the more aggressive bi-annual comprehensive examinations of each bank is beginning to improve risk management and internal controls.

Expanding the Banking System

The CBL will remain cautious in licensing new banks. However, a further expansion of the system is expected in 2008, following the requisite due diligence on some of the applications received. In 2007, provisional license was granted to United Bank for Africa (UBA), an international bank, to establish a subsidiary bank in Liberia with an initial capital base equivalent to the new minimum capital requirement. The bank is expected to start operations in the second quarter of 2008. also, one non-bank financial institution, Liberia Enterprise Development Finance Company (LEDFC), was licensed to provide credit to Liberian businesses. This should help spur economic growth as well as support Liberian entrepreneurship.

Going forward, the CBL considers it prudent that steps be taken to diversify foreign participation in the Liberian banking system at the initial stages of the reform exercise, in order to guard against adverse developments that may occur in any one country. Recent experience has shown quite clearly that financial regulatory authorities must be attentive to the potential contagion effects associated with globalization.

Promoting Investment opportunity

In addition to improving the credit environment, which is expected to lead to the absorption of the excess liquidity in the system through increased lending, the CBL will also pursue policies that will provide profitable opportunities for the banks. The CBL will consider efforts aimed at improving the balance sheet structure of commercial banks, including the development of secondary sources of liquidity. Such policy will be implemented with caution so as not to undermine the intermediation role of the banks and crowd out lending to the private sector, and must be balanced against the overall monetary objective of the CBL to ensure macroeconomic stability. Also, the wide gap between lending rates and deposit rates will be considered to ensure a fair return on savings and encourage deposit mobilization.

Anti-Money Laundering

The CBL is spearheading the fight against money laundering in Liberia. As part of the anti-money laundering strategy of Liberia, a review of the existing 2002 anti-money laundering law is being conducted with the aim of improving and upgrading it to international standard. Work done in this regard has been submitted to the Inter Governmental Action Group against Money Laundering in Africa (GIABA), the regional anti-money laundering agency, for its input. The draft legislation has also been submitted to the Ministry of Justice for its review.

Additionally, the CBL will continue to ensure that the banking system is not used for illicit transactions. To this extent, the existing Know-Your-Customer and Customer Due Diligence Regulation will be vigorously enforced.

Financial Transparency and Disclosure

Financial transparency and disclosure is a critical tool for market assessment and discipline in the banking system. Disclosure of financial information aid the public, potential investor, the regulator and government to make informed assessment of the banking system. It is also expected to provide incentive for produce banking practice. In this regard, the CBL will work with key stakeholders to ensure credible accounting and disclosure standards in the banking system. The present regular publication of the annual audited accounts and quarterly un-audited accounts will continue as a means of encouraging public assessment and market discipline in the banking system.

VII. PAYMENTS SYSTEM MODERNIZATION

A national payments system (NPS) is one of the principal components of a country's monetary and financial system and, therefore, crucial to a country's economic development. The development of the NPS is closely intertwined with the development of the nation's banking system. Accordingly, the development of the NPS is a shared responsibility of the Central Bank of Liberia, the banking system and other stakeholders and payments systems.

With this in mind, the CBL took a decision in 2007 to implement a strategic process for the modernization of Liberia's NPS. The establishment of the structures necessary to achieve this modernization commenced towards the end of 2007 with the commissioning of a new unit within the CBL, the Payments System Unit (PSU). Additionally, in early 2008, a National Payment committee (NPC) consisting of the Deputy Governor of the CBL, the heads of the commercial banks and the Deputy Minister of Finance and an NPC-Work Group consisting of members from the same organizations were established. The NPC-Work Group is responsible for developing a Vision and Strategic Framework for the NPS, which will result in Liberia implementing a modern, efficient and secure payments system.

The NPC-Work Group commenced the development of the Vision and Strategic Framework in March, 2008 and has formulated the Mission and Objectives of the NPS. The next steps by the Work Group will be the development of a serious of strategies, which will be prioritized for implementation over a period of approximately five years.

For the immediate future, the CBL intends to assist the Government in developing systems to pay employees directly via bank accounts established at the commercial banks.

VIII. CBL FINANCIAL MANAGEMENT

Financial Reporting

In an effort to build a transparent and credible system of financial reporting, the board of the CBL, in 2006, formally adopted the International Financial Reporting Standard (IFRS) as the Bank's accounting framework to be fully implemented in 2008. In this connection, staff members of the Finance Department and the Internal Audit Section are undergoing an intense IFRS training abroad, financed by the CBL, which should make it possible for the Bank to remain on course for the transition. This will be a major achievement, coming from a situation just two years ago when the Bank's external auditors had raised concern that the institution had no clear reporting standard for presenting its accounts.

CBL Retirement Scheme

Since the formation of the CBL, there has not been any formal retirement benefit scheme established for its staff. The Bank has hired the services of an actuary who has begun preliminary work on the accounting valuation of the CBL retirement benefit obligation to its staff. The Bank, based on the work of the actuary, hopes to finalize the development of the pension scheme and proceed to incorporate the resultant liability into the Bank's 2008 financial statements.