CENTRAL BANK OF LIBERIA
POLICY STATEMENT
2009

I. INTRODUCTION

This Policy Statement serves as one of the key instruments for promoting public awareness of the main objectives of monetary policy of the Central Bank of Liberia (CBL) and its activities with respect to the development, regulation and supervision of the financial sector. Also, the Statement gives a brief overview of developments in the domestic economy and the outlook for 2009. Through this medium, the Government is apprised of the strategic direction being taken by the CBL in carrying out its responsibilities in keeping with the CBL Act of 1999.

The CBL will continue to work in close cooperation with the fiscal arm of Government for policy harmonization. There will be enhanced dialogue with other key stakeholders, especially the House and Senate Committees on Banking and Currency and the Liberia Bankers Association. The CBL is cognizant of the importance of accountability, which encompasses adherence to high standards of governance and performance. This gives legitimacy to the activities of the institution. Put simply, the CBL believes that accountability and functional independence are complementary, and the institution intends to build its reputation by engaging the relevant authorities and the public to get their views on its policies and the means by which it carries out its mandate.

The CBL intends to deepen the reform of the banking sector and further improve microfinance opportunities. Its overall goal is to work to maintain a stable macroeconomic environment with a view to promoting sustained economic growth.

II. THE DOMESTIC ECONOMY

The economy continued on the path of recovery in 2008, with a growth rate of 7.1 percent. In the wake of the ongoing global financial and economic crisis, GDP growth is expected to slow down to around 4 to 5 percent in 2009. Growth is expected to be mainly driven by a rebound in agricultural production and increase in mining, forestry and services. Like many other developing countries, the Liberian economy is being adversely affected by weakening external demand, which has resulted in falling prices of commodities such as rubber, our main export. The global economic crisis has led to the scaling down of foreign direct investment and a reduction in inward personal remittances.

Inflation peaked at 26.5 percent in August, 2008, but declined to 9.4 percent at end-December, 2008. The situation was driven largely by movements in the international prices of food and oil, which increased sharply during the first half of the year and then declined during the latter half of the year. Efforts by the CBL to help stabilize the exchange rate also helped to contain inflationary pressures. Inflation is projected to remain in the single digits range in 2009.

The CBL pursued a guarded policy of expanding the banking sector, consistent with the stance announced at the beginning of 2008. Provisional licenses were issued to 3 internationally reputable financial institutions: AccessBank Liberia Limited (ABLL)—*The Microfinance Bank*, Guaranty Trust Bank Liberia Limited (GTBLL) and Oceanic Bank Liberia Limited (OBLL). This reflected the CBL's efforts aimed at creating a vibrant and competitive banking sector in the country, which could also provide financial services to the poor. The number of bank branches increased from 19 in 2007 to 28 at the end of 2008, while 14 windows were opened during the year. The increased level of bank advertising and the provision of new services suggest that a new competitive environment is taking shape.

Aggregate commercial bank credit increased by 46.5 percent in 2008, from L$4,250.8 million in 2007 to L$6,227.8 million, at end-December, 2008. The US dollar component of loans and advances rose by US$27.0 million, from US$62.2 million in 2007 to US$89.2 million. The Liberian dollar credit also increased by L$154.5 million, from L$364.7 million to L$519.2 million for the same period. Credit to various sectors of the economy accounted for 11.8 percent of nominal GDP for 2008, increasing by 2.3 percentage points over the 9.5 percent ratio for 2007. Also, credit to the economy has been largely to the private sector — accounting for 60.2 percent of total credit in 2006; 89.3 percent in 2007; and 98.6 percent in 2008.

Money supply (M1)[1], consisting of currency in circulation plus demand deposits, increased by 29.6 percent to L$4,565.7 million between January and December of 2007. Also, it rose by 21.6 percent to L$5,551.9 million for the same period of 2008. The growth in money supply for 2008 was less than that of 2007, a situation that reflected prudent liquidity management and tightening of monetary policy by the CBL to help ensure a stable inflationary environment.

[1] Liberian dollars only.

There is a high degree of dollarization in the Liberian economy. Money supply (M1), including US dollar deposits in the banking sector[2] converted to Liberian dollars, totaled L$12,747.8 million at end of 2008. This represents a rise of 43.9 percent over the level of L$8,859.2 million recorded for 2007. Of the total level recorded in 2008, the US dollar component accounted for about 90.4 percent. Also, broad money (M2), inclusive of both Liberian and US dollars, stood at L$16,931.0 million at end of 2008—showing an increase of 41.4 percent over 2007. The US dollar component of broad money for 2008 accounted for 68.1 percent.

The US dollar demand deposits grew by 62.1 percent to US$130.2 million at end-December, 2008, from US$80.3 million at end of 2007; the Liberian dollar demand deposits rose by 48.1 percent to L$775.9 million, from L$524.0 million for the same period. Also, Time & Savings deposits in US dollar increased by about 31.0 percent to US$65.4 million at end-December, 2008, from US$49.9 million recorded for 2007. The Liberian dollar component increased by 36.9 percent, from L$724.3 million in 2007 to L$991.9 million in 2008.

In 2008, the Liberian-US dollar exchange rate remained generally stable at L$63.50/US$1.00, reflecting in part, the impact of the CBL's regular foreign exchange auction.

Personal remittance inflows, a major source of income to a large segment of the Liberian population, have been declining. A total of US$201.2 million was recorded for 2008, 33.6 percent less than the amount of US$303.2 million recorded for 2007. Outlook for personal remittance inflows for 2009 is on the downside should the global financial and economic crisis continue, especially with job losses in the USA and UK that account for the larger share of personal remittance inflows to Liberia.

A trade deficit of US$571.1 million was recorded for 2008 compared with US$301.3 million at end of 2007. This reflects the need for more attention towards increased production of commodities such as rice, the staple food, which could contribute significantly to a reduction in the nation's import bill and save foreign exchange. Also, improvement in the investment climate for both domestic and foreign direct investment is needed to help boost exports.

[2] It is difficult to determine the actual amount of US dollars in circulation in Liberia as a component of money supply largely due to the dual currency regime and the liberalized nature of the system. Hence, use is made of demand and other deposits in the banking sector to generally capture the amount of US dollars in money supply.

III. POLICY IMPLEMENTATION: 2008

In 2008, the conduct of monetary policy, anchored on foreign exchange reserve management, was targeted towards ensuring broad stability in the exchange rate of the Liberian dollar vis-à-vis the US dollar, with a view to maintaining low inflation. The main policy instrument was the auction. Increasing the frequency of the auction from bi-weekly to weekly was one of the factors responsible for the broad stability of the exchange rate during the year. A total of US$26.0 million was offered and sold through the auction during the year, US$7.5 million more than the amount sold in 2007.

The Board approved operational rules for a possible introduction of a foreign exchange purchase auction as market conditions dictate, where the CBL would be buying US dollars from the commercial banks and the public.

Consistent with its policy of providing reliable macroeconomic statistics to members of the public for informed decision making, the CBL, with technical assistance from the IMF, published the first Balance of Payments (BOP) statement for Liberia since 1988. This BOP statement highlighted the need for Liberia to create an investor-friendly environment to attract foreign direct investment in anticipation of the eventual scale down of UNMIL operations, which is a major source of support for the current account position of the country. Also, the Bank introduced a monthly fact sheet on Key Economic and Financial Indicators of the economy.

Working towards financial sector stability and supporting the international fight against money laundering, the CBL began work aimed at establishing a Financial Intelligence Unit (FIU) during the year. This Unit will help to combat financial crimes including money laundering, terrorist financing, counterfeiting, etc. In support of the CBL’s effort to engender integrity in the financial system, banks are strengthening their due diligence and reporting suspicious transactions for investigation. It is important that these investigations be done thoroughly by the relevant authorities.

The CBL has consistently met quantitative targets as agreed upon by the Fund and the Liberian authorities since the introduction of IMF Staff Monitored Programs (SMPs) and the Poverty

Reduction and Growth Facility (PRGF). Meeting these targets is geared towards reaching the completion point under the Heavily Indebted Poor Countries (HIPC) Initiative. On account of the commitment by relevant institutions of Government, including the CBL, under the PRGF, the IMF and World Bank jointly announced in 2008 that Liberia had reached the "Decision Point" under the HIPC Initiative. This was the first step towards securing debt relief covering Liberia's bilateral, multilateral and private creditors. It is expected that Liberia will reach the HIPC completion point not later than mid-2010.

THE BANKING SECTOR

The CBL's reform agenda focused on ensuring the stability of the banking sector, especially against the backdrop of the global financial crisis; enhancing efficiency in the delivery of banking services; and improving access to banking services by the general public. Major policy measures put in place during the year included increasing the minimum capital requirement of all operating banks from US$2.0 million to US$6.0 million by end of 2008. The minimum capital adequacy ratio (CAR) was also increased, from 8.0 percent to 10.0 percent, effective end-December, 2008.

A new regulation on corporate governance —Regulation No. CBL/SB/002/2008—was issued, intended to strengthen the oversight responsibilities of the boards of commercial banks. The Prudential Regulations on Asset Classification, Loan Loss Provisions, and Suspension of Interest on Non-performing Loans—Regulation No. CBL/003/2008—was amended to accommodate microfinance lending by commercial banks as part of CBL's goal of promoting lending to low income families and the economically active poor.

These measures were intended to make the Liberian banking sector internationally competitive; create the incentive for banks to properly and adequately manage their risks; put the sector in a stronger position to help meet the financing needs of the economy; and strengthen public confidence in the sector.

The CBL continued its supervisory strategy of a robust inspection of banks, which involved conducting two comprehensive on-site examinations for each bank during the year. This was complemented by a vigilant off-site surveillance system. The continuous oversight of the CBL has led to increased public confidence in the banking sector, as evidenced by the increase in deposits.

MICROFINANCE

The CBL worked along with potential investors to establish financial institutions that specialize in microfinance services. As a result, AccessBank Liberia Limited — *the Microfinance Bank,* was issued a provisional license to begin organizational work in 2008 and was granted final license to commence operation in 2009. Also, the CBL collaborated with the organizers of Building Resources Across Communities (BRAC), to facilitate the establishment of BRAC Liberia Microfinance Company Limited, which is capitalized at more than US$4.0 million. The CBL in collaboration with UNDP, conducted a 4-month foundation course in microfinance, in concert with Cuttington University and the University of Liberia, where 53 individuals from various institutions and 21 students received certificates.

With technical assistance from the UNCDF/UNDP, the CBL drafted a 5-year National Microfinance Strategy for microfinance operations in the country. This strategy is intended to empower those who have little or no access to financial services. The CBL also drafted a National Microfinance Policy and Regulatory Supervisory Framework.

FINANCIAL REPORTING

In an effort to allay concerns about CBL financial reporting, the CBL took a decision in 2006 to transition to the International Financial Reporting Standards (IFRS) by 2008. That objective has been accomplished.

IV. POLICY STANCE FOR 2009

The CBL will continue to work towards broad stability of the exchange rate, the main policy anchor for helping to contain inflation. Maintaining the purchasing power of the Liberian dollar at a time when the global crisis is affecting employment, is key to helping fight poverty. Accordingly, the CBL will keep under review the foreign exchange sale auction, with the aim of enhancing its use in the management of Liberian dollar liquidity.

However, it is recognized that the auction alone is insufficient for liquidity management. Therefore, priority will be given to developing the modalities for establishing a market for Liberian dollar short-term liquidity instruments, including Government Treasury Bills (T-bills). This is a new direction for monetary policy, and should build the foundation for the development of money and capital markets in the Liberian financial system and set in motion the process whereby interest rates can become viable tools for implementing monetary policy. The introduction of a money market should contribute to the narrowing of the interest rate spread, which has been decreasing in the last 2 years. The CBL has asked for technical assistance from the IMF in this endeavor, and indications are that this request will be acted upon favorably.

Added attention will be paid to the monitoring of liquidity through the framework which has been developed. Monthly reports on liquidity will be provided by the Research and Strategic Planning Department to the Money Management and Policy Review Committee. As data improve, the report will become more forward looking.

During the course of 2009, the CBL will continue to encourage a wider use of the Liberian dollar. The “Clean Banknote Policy” should help in this regard. Increased payments in Liberian dollars made by the Government should also contribute towards this objective. However, having two currencies as legal tender has the propensity to counter efforts to increase demand for the Liberian dollar. Meaningful de-dollarization in the face of the dual currency regime seems to be a difficult proposition. That is not to say that simply making the Liberian dollar the only legal tender would de-dollarize the economy. There are countries with only one legal tender currency that are highly dollarized, but they have no legal commitment to accept or make payments in other than their domestic currency.

THE FINANCIAL SYSTEM

The ongoing global financial crisis has highlighted the importance of financial stability as an essential factor for economic growth and development. Against this background, the CBL remains focused on (i) ensuring stability and protecting the integrity of the banking sector through more robust regulation and supervision, (ii) improving the operating environment, (iii) enhancing the supervisory capacity of the CBL, and (iv) enhancing transparency and disclosure of financial information.

ENSURING STABILITY OF THE SECTOR

We expect a further strengthening of the banking sector in 2009, characterized by higher capitalization, high liquidity, better corporate governance and improved risk management practices. Credit to the private sector is expected to increase, thereby contributing to the projected growth of the economy and, with improved credit risk management, enhancing the profitability of the banking sector. In order to position the banking sector to provide needed financial resources to the economy, while remaining stable and competitive, the following broad policy measures will be pursued:

<u>Increasing the Minimum Capital</u>: The minimum capital will be increased by end-December 2009 from US$6.0 million to US$8.0 million, while maintaining the minimum capital adequacy ratio at 10.0 percent. Meanwhile, the CBL will review the existing prudential regulations for capital adequacy requirement with a view to taking into account the changing environment and the risk profile of the banking sector.

<u>Measures Aimed at Minimizing the Potential Impact of the Global Financial Crisis</u>: Although the current global financial crisis has not had any major direct impact on the banking sector, any deterioration of the macro-economic environment in which the banking sector operates has the propensity to adversely impact US dollar liquidity in the economy, reduce the earning capacity of the banking sector, increase non-performing loans and provisions, and erode capital. Against this background, the CBL will pursue the following measures:

a) work with the relevant authorities of government to put in place the appropriate legal provisions to deal with potential gaps in the New Financial Institutions Act with a view to strengthening the authority of the CBL to resolve matters involving problem banks in a timely manner, including the facilitation of mergers and acquisitions;

b) establish cooperation with home-country supervisory authorities of foreign banking institutions operating in Liberia regarding arrangements for the sharing of information on risk assessment of the parent banks and their crisis management plans;

c) pursue more vigorously its policy on the diversification of ownership of the banking sector to minimize potential contagion effects from any one country;

d) develop a contingency plan and strategy to address potential weaknesses in the banking system; and

e) develop a strategy to address US dollar liquidity management.

The experience from bank failure in Liberia, without concrete mechanisms for settlement of deposit claims, is considered to be one of the factors responsible for eroding confidence in the banking sector. Against this background, the CBL will begin considering, in a medium-term context, the matter of establishing a deposit insurance scheme. Meanwhile, there will be continued priority given to reducing non-performing loans and addressing other systemic weaknesses so that any such insurance scheme is not construed to be an encouragement for risky behavior on the part of the banks.

Improving the Performance of the Banking Sector: Although the banking sector recorded a net profit at end-2008, profitability of the sector over the years has been relatively modest. Many factors, including the high incidence of non-performing loans, limited investment opportunities, and high overhead costs are largely responsible for the under performance of the sector. In addition, the potential decline in economic activities and remittance flows are likely to affect the profitability of the sector.

Improving the profitability of the sector is a major pillar of the CBL's banking sector reform agenda. In this connection, the CBL will continue to press for reduction in the level of non-performing loans, while taking steps to prevent imprudent lending practices. Among other measures, banks will be required to carry out more rigorous collection and recovery efforts of non-performing assets, and to maintain adequate information systems for timely monitoring of their loan portfolio. These measures, coupled with the improvement in the operating environment and the development of a money market (which will provide opportunities for the banks to begin to deploy their excess liquidity), are expected to improve the performance of the sector.

PROTECTING THE INTEGRITY OF THE BANKING SECTOR

During 2008, the banking sector, including the CBL, experienced several incidents of financial impropriety. Such negative developments detract from the ongoing efforts by the CBL to restore confidence in the system. Going forward, the CBL will work with the banks to strengthen the existing corporate governance regulations to include minimum standards of a code of ethics for individuals employed and/or seeking employment in the banking sector.

The CBL will continue to take necessary steps to strengthen the institutional environment to prevent money laundering and other criminal uses of the banking sector. In this regard, the Bank will work with relevant national authorities and the Government Action Group Against Money Laundering (GIABA) to finalize the reviewing and upgrading of the Liberian Anti-Money Laundering legislation to be consistent with international standards. The Bank will also work with the National Law Enforcement System, through the Ministry of Justice, to staff the Liberian National Financial Intelligence Unit (FIU) that it intends to establish. The Unit will collect, analyze and disseminate information of financial crimes, including money laundering and its predicate offenses. Technical assistance will be sought from GIABA to build the operational capacity of the Unit.

IMPROVING THE OPERATING ENVIRONMENT

Despite the positive developments in the banking sector, there are still a number of external factors that continue to challenge progress in the sector. These include structural constraints, such as a legal environment that does not provide for the speedy adjudication of cases, including those involving commercial contracts and a poor credit culture. A fast-track commercial court would be a step in the right direction, complementing steps being taken by the CBL to strengthen its credit reference system. Guidelines for strengthening the management of the current system are being developed, to include the process of accessing the database and ensuring the confidentiality of information. Technical assistance is being sought from the World Bank for a study on the establishment of a full-fledged credit reference bureau.

ENHANCING THE SUPERVISORY CAPACITY OF THE CBL

The expansion in the banking sector calls for the enhancement of the supervisory capacity of the CBL. Against this background, the CBL has taken a decision to temporarily place a hold on the granting of new banking licenses, except proposals for non-deposit-taking financial institutions wishing to meet specific banking needs of the economy, such as agricultural and mortgage financing. The Bank will continue to give priority attention to the training and recruitment of additional staff to meet the expansion of the industry. As such, additional technical assistance will be sought from the donor community, including the IMF and World Bank. The current supervisory policy will continue to focus on bi-annual comprehensive examinations, complemented by a robust off-site surveillance and well-articulated corrective action plans for banks that fall below the minimum prudential requirements.

Work will also be done on developing a framework for macro-financial risk analysis and monitoring of the banking sector through stress testing to detect any potential systemic risk, such as concentration in the loan portfolio by sectors of the economy, borrowers and currency. This framework will enhance the early warning tools of the CBL.

PROMOTING ACCESS TO FINANCIAL SERVICES AND LIBERIAN PARTICIPATION IN THE OWNERSHIP OF BANKS

The CBL remains committed to ensuring access to financial services by all segments of the population, including low-income earners. The public is now benefitting from the expansion in bank branches in various parts of the country. The CBL remains supportive of institutions such as Liberty Finance and LEAP in their efforts to provide better microfinance services to a larger segment of the population. Priority attention will be given to concluding the national microfinance policy and strategy and the regulatory framework for microfinance institutions.

The CBL sees the possibility of using credit unions as a direct means of promoting rural and agricultural financing. Accordingly, it will work with other stakeholders to restructure and strengthen the credit union apex body, the Liberia Credit Union National Association (LCUNA), and individual credit unions.

Existing collateral requirements will be reviewed with regard to real property for commercial lending to see what can be done to be more supportive of access to financing by small- and medium-scale enterprises. In this regard, the existing regulation may be amended, taking due consideration of prevailing market developments and collateral valuation standards.

The CBL has obtained the commitment of commercial banks to provide for meaningful Liberian participation in their ownership structure. Steps will be taken during the course of the year to engage the banks to move this process forward. The hiring of Liberians in senior management positions and the building of local managerial capacity also remain key objectives of the CBL.

THE ISSUE OF THE INACTIVE GOVERNMENT-OWNED BANKS

There is a need to pay increased attention to the question of the Agriculture and Cooperative Development Bank (ACDB) and the National Housing and Savings Bank (NHSB) in the ongoing reform program of the banking sector. The CBL will continue to engage the relevant Government authorities on the way forward regarding these two institutions. At this juncture, the CBL is consulting with various parties on finding ways to provide financing to the agriculture and housing sectors through non-deposit-taking financial institutions.

ENHANCING TRANSPARENCY AND DISCLOSURE OF FINANCIAL INFORMATION

The recent global financial crisis has heightened the need for transparency and disclosure of information on the operations of financial institutions. As the banking system of the country develops, it will be necessary for the CBL to undertake a review of the existing accounting guidelines for banks to ensure that they are relevant to the changing environment. It is important that accounting guidelines lead to standardization and comparability of financial statements of individual banks.

REGULATION AND SUPERVISION OF THE INSURANCE SECTOR

Revamping the insurance sector can play a supportive role to the banking sector, in terms of boosting domestic savings and providing resources for long-term financing needs of the economy.

With the level of progress being made in the ongoing reform of the banking sector, the CBL has begun developing the regulatory and supervisory framework for the insurance sector pursuant to its authority provided under Sections 4(6) and 5(1) of the CBL Act of 1999 and Section 8 of the New FIA of 1999. Steps are being taken to build capacity within the CBL to effectively carry out this work.

PAYMENTS SYSTEM IMPROVEMENT

A modernized national payments system is critical to the development of our economy, reducing transactions cost and enhancing efficiency in the banking system. In this context, the CBL intends to undertake the following actions:

- progressively disengage from the GoL payroll checks encashment function, leaving that activity to be performed by the commercial banks. By doing so, the CBL will have more time to focus on its core functions;
- encourage the wider use of checks, direct payroll credits to individual accounts, and debit cards in financial transactions;
- work with the Ministry of Finance in executing the one-stop-shop revenue collection program being established at the Freeport of Monrovia in order to minimize delays and bureaucratic bottlenecks in the payment of taxes; and
- encourage enhanced collaboration with the Ministry of Finance in the exchange of data to ensure timely reconciliation of information.

COMMUNICATION STRATEGY

Regular exchange of views between the CBL and the Liberia Bankers Association will continue. It should be reemphasized at this juncture, that consultation with the banks being supervised in setting and modifying regulations is an integral part of the CBL's efforts to promote accountability and maintain a smooth working relationship with these institutions. The CBL shall also continue to work cooperatively with its international partners, including the IMF, the World Bank, the African Development Bank (AfDB), ECOWAS, etc.

Also, in furtherance of strengthening public confidence in the financial system, the CBL will seek to have periodic engagements with the general public in order to provide more information on measures to ensure the stability of the banking sector in the face of the ongoing global financial and economic crisis. The communication strategy will include press conferences, dialogues and publication of information notes on the operation of the banking sector and macroeconomic developments.