

1.1.13 Corporate Social Responsibility

The CBN sustained its commitment to corporate social responsibility through financial incentives to individuals and organizations. In this regard, financial assistance was given to the following organizations with similar strategic objectives: the Abuja Association of the Deaf, the Nigerian Economic Society, the Nigerian Statistical Association and the Girls Guide. The Bank also sponsored the best graduating cadet in Economics and Accounting from the Nigerian Defence Academy, in addition to encouraging intellectual pursuit through financial assistance to several book launches.

1.1.14 Staff Social Responsibility

The staff of the CBN continued the Alms Collection Scheme to support the upliftment of the welfare of the less privileged in Nigerian society. To this end, regular monetary contributions by staff were sustained to keep beggars off the streets of Nigeria's metropolitan cities. A total of N6.035 million was realized during the year, thus bringing the cumulative sum so far to N25.9 million. Funds generated were being channeled towards supporting projects that promote the objectives of assisting the less privileged in society in the revitalization of vocational training centres for capacity building/skills acquisition.

1.2 Research and Collaborative Activities

The Bank conducted research and disseminated information on key issues relating to the management of the economy, in line with its core functions. The Bank was involved in a number of empirical studies culminating in the completion of several studies, notable among which were: "Inflation Dynamics in Nigeria", "Construction of a Monetary Sector Model of the Nigerian Economy", "Technical Efficiency of Small and Medium Enterprises", "Capital Market Dynamics in Nigeria" and "Capital Flight in Nigeria: An Empirical Estimation". Also, the Bank continued the collaboration with the National Bureau of Statistics (NBS) for generating the strategic economic indicator series, through the conduct of the 2006 National Economic Survey. The regular publications of the Bank were issued, including: the 2005 Annual Report; the 2006 Half Year Economic Report; the quarterly journal, CBN Economic and Financial Review; CBN Statistical Bulletin; and the CBN Briefs. Furthermore, fourteen (14) seminar papers on topical issues were presented, some of which were published in the Bank's journal after being subjected to thorough reviewing, refereeing and editorial processes. The Bank organized the annual Executive Policy Seminar on the theme "Capital Account Liberalization: Issues, Problems and Prospects". The proceedings of the seminar are being edited for final publication. Similarly, the Annual Conference of the Research and Statistics Offices in the CBN Branches nationwide was organized in Bauchi during the year on the theme, "Inflation Targeting in Nigeria". The proceedings of the conference are being processed for publication. During the year, the Bank initiated the Diaspora/Visiting Scholar Programme which is aimed at encouraging international scholarly research in the core areas of the Bank's activities. Respondents to the advertisements on the programme were screened but have not yet commenced work. In recognition of the existence of a pool of expertise in various disciplines in the CBN, the Bank received and honoured requests for the presentation of lectures from various institutions, including regional organizations, such as WAIFEM.

1.3 CBN BALANCE SHEET

1.3.1 Income and Appropriation

The audited financial statement of the Central Bank of Nigeria showed that total revenue increased substantially from N94.4 billion in 2005 to N162.5 billion in 2006, an increase of 72.1 per cent. The improved revenue reflected largely the increase in interest income (96.5 per cent), especially income from term deposits with foreign banks. Operating expenses increased by 77.9 per cent, due mainly to the increase in currency issue expenses and pension costs. Consequently, the operations of the CBN in 2006 resulted in a surplus before provision of N31.6 billion, compared with N20.9 billion in 2005. At N31.1 billion, the net operating surplus showed a substantial increase of 283.9 per cent over the level in 2005. In accordance with the provisions of Part

II, Section 5(3) of the CBN Act, 1991 (as amended), the sum of N25.9 billion was transferred to the Federal Government, while the balance accrued to general reserves.

1.3.2 Assets and Liabilities

At end 2006, total assets of the CBN rose by 47.6 per cent to N6.2 trillion, compared with the level at end-2005. The development reflected largely the increase in external reserves (49.6 per cent), 'other assets' (300.4 per cent), loans and advances (369.8 per cent) and government securities (37.5 per cent).

The increase in assets was mirrored largely by the increase in some liabilities of the Bank, notably deposits (35.6 per cent), CBN instruments (44.5 per cent), and notes and coins in circulation (21.3 per cent). The paid-up capital of the CBN was increased to N5.0 billion in 2006, from N3.0 billion in 2005, while the general reserves rose by 6.7 per cent to N50.7 billion.

CHAPTER 2

MONETARY POLICY, SURVEILLANCE ACTIVITIES AND OPERATIONS OF THE CBN IN 2006

Monetary policy faced a major challenge during the year in containing domestic liquidity to maintain price stability. This arose from the improved statutory allocations to the three tiers of government, the monetization of part of excess crude proceeds, the population census and pre-election spending. Measures taken to ensure that the monetary targets under the PSI were met included: introduction of non-discountable Special Nigerian Treasury Bills (NTBs), gradual increase in interest rates at the open market and discount window operations, the proactive upward adjustment of the policy rate at mid-year, and the downward adjustment of the cash reserve requirement in the last quarter of 2006, coupled with an aggressive intervention strategy including the use of foreign exchange swaps in the foreign exchange market. Also, a new framework for monetary policy implementation with an interest rate corridor was introduced. Notwithstanding the measures, the growth in reserve money was excessive and above the target although broad money supply growth moderated at end-year. Furthermore, lending rates declined, while the intermediation spread narrowed. The surveillance activities of the CBN showed that the health of banks in Nigeria improved in the post-consolidation era as no bank was rated unsound.

The Wholesale Dutch Auction System (WDAS) was adopted as a framework for managing the foreign exchange resources and the determination of the exchange rate. The foreign exchange market was also further liberalized with the direct sale of foreign exchange to bureaux de change, while the Foreign Exchange Manual was reviewed. Consequently, demand pressure moderated at the WDAS as aggregate demand for foreign exchange fell by 9.9 per cent. The exchange rate stabilized, and for the first time in many years, the convergence of rates in the various segments of the market was achieved. Also, the exchange rates appreciated in all the segments of the market. The reform of Nigeria's payments system continued. The Bank embarked on a currency redesign of the lower denomination currency notes, including N5, N10, N20, and N50 as well as 50 kobo, N1 and N2 coins. The introduction of the real time gross settlement facility and the Temenos (T24) banking application by the CBN and the deployment of more ATMs by banks during the year engendered competition and a more efficient payments system.

The CBN continued its developmental function, especially through the Agricultural Credit Guarantee Scheme Fund (ACGSF) and the SMEEIS.

2.1 MONETARY OPERATIONS

2.1.1 Monetary and Credit Developments

Monetary management remained challenging in 2006, following the persistence of excess liquidity in the banking system. The major sources of the excess liquidity included the monetization of excess crude receipts in July and October, the population census and pre-election spendings, and the distribution of enhanced statutory allocations to the three tiers of government following higher crude oil prices in the international market.

Various measures were, therefore, taken to ensure that the monetary targets under the Policy Support Instrument (PSI) were met. Provisional data indicated that broad money (M2) grew by 30.6 per cent, compared with the maximum target of 27.8 per cent for fiscal 2006, while narrow money (M1) grew by 20.3 per cent. The rise in money stock was attributable wholly to the significant increase in the foreign assets (net) of the banking system,

arising from the sustained increase in crude oil prices in the international oil market. Base money, the Bank's operating target for monetary policy, at N918.9 billion, was far in excess of the end-December 2006 Policy Support Instrument (PSI) target ceiling of N820.0 billion. Aggregate bank credit to the domestic economy (net) fell by 65.0 per cent, reflecting wholly the substantial fall in credit to the Federal Government by 676.2 per cent, compared with a programmed decline of 40.0 per cent in fiscal 2006. The development reflected largely the increase in Federal Government deposits with the banking system. Credit to the private sector rose by 28.2 per cent, comparing favourably with the target of 30.0 per cent.

Table 2.1
Key Policy Targets and Outcomes (per cent)

	2004		2005		2006 1/	
	Target	Outcome	Target	Outcome	Target	Outcome
Growth in Base Money	12.8	5.2	6.5	10.2	7.5	20.5
Growth in broad money (M ₂)	16.0	14.0	15.0	16.2	27.0	30.6
Growth in narrow money (M ₁)	13.4	8.6	11.4	15.9	n.a.	20.3
Growth in aggregate bank credit	22.5	12.0	22.5	21.9	-72.3	65.0
Growth in bank credit to private sector	22.0	26.6	22.0	29.3	30.0	28.2
Inflation rate	10.0	10.0	10.0	11.6	9.0*	8.5
Growth in real GDP	5.0	6.5	5.0	6.2	7.0*	5.6

1/ Provisional

* 2006 budget document

Table 2.2
WAMZ Convergence Criteria

	Target	Achievement	
		2005	2006
Inflation Rate	< 5.0 per cent	11.6	8.5
Ways & Means Advances	≤ 10.0 per cent of retained revenue of the Government	5.1	Nil
Deficit to GDP ratio	≤ 4.0 per cent	1.1	0.6
Gross Official Reserve	6 months import cover	19.78	24.9

2.1.2 Liquidity Management

A relatively high level of liquidity subsisted in the money market in 2006, arising mainly from the improved statutory allocations to the three tiers of government, following higher oil revenue, monetization of excess crude receipts, population census and pre-election spendings. At N797.6 billion, the Bank met the first PSI target of a maximum of N800 billion for base money in June, 2006. However in August, it was N838.2 billion, above the third quarter target of N810.0 billion. To moderate the growth of liquidity and ensure that the monetary targets under the PSI were met, several monetary policy measures were undertaken. The measures included the introduction of non-rediscountable special Nigerian Treasury Bills (NTBs), arising from the shortage of intervention instruments, gradual increase in interest rates at the open market and discount window operations to boost public patronage, and allowing Deposit Money Banks (DMBs) direct access to the reverse repo transactions with the CBN. The Bank also reviewed its nominal anchor for interest rates, the Minimum Rediscount Rate, upwards by 100 basis points in June. In order to achieve effective transmission of monetary policy actions and stabilize the inter-bank rate, the Bank adopted a new framework for monetary policy implementation in which the Monetary Policy Rate (MPR) replaced the MRR as the new anchor rate. The Cash Reserve Requirement (CRR) was further reviewed downwards, from 5.0 to 3.0 per cent in December 2006, and banks were required to invest the freed reserve balances in the Special NTBs. Special sales and swap transactions were also undertaken at the foreign exchange market to complement liquidity management during the year. Notwithstanding these measures, at end-December 2006, the reserve money stood at N918.9 billion, well above the end-December 2006 Policy Support Instrument (PSI) target of N820.0 billion.

Box 1: The Policy Support Instrument (PSI)

Nigeria continued her Policy Support Instrument (PSI) programme, which was approved by the IMF Executive Board on October 17, 2005. The PSI is a facility designed for low income countries that may not need IMF financial assistance, but seek close cooperation with the Fund in the preparation and endorsement of their policy frameworks. It is voluntary, demand-driven, and intended to be supported by strong country ownership. Therefore, it is available only upon the request of a member country. The PSI aims at promoting a close policy dialogue between the IMF and a member country; providing more frequent Fund assessments of a member's economic and financial policies than is available through the regular consultation process, known as surveillance; and delivering clear signals on the strength of these policies.

Nigeria's PSI-supported programmes are based on her National Economic Empowerment and Development Strategy (NEEDS) which is in line with making PSI a country-owned poverty reduction strategy adopted in a participatory process, involving civil society and development partners. The programme was also consistent with the principle of having a comprehensive framework for macroeconomic, structural and social policies to foster growth and reduce poverty.

Some of the key features of the PSI are as follows: the Programme must meet the same high standards as required under the Fund's financial arrangement; PSIs have a fixed schedule of reviews to assess programme implementation, with reviews normally scheduled semi-annually; Only limited flexibility is allowed in the timing of the reviews, and the Board reviews are conducted irrespective of the status or prospects of programme implementation. The provision of timely and accurate information from the member with a PSI is essential for the Fund's assessments: A framework for dealing with possible cases of misreporting is in place to safeguard the integrity of the IMF assessments. In the event of a shock, an on-track PSI could provide the basis for rapid access to Poverty Reduction and Growth Facility (PRGF) resources, through the Fund's new exogenous shocks facility; and the publication of PSI documents is voluntary, but presumed.

The two scheduled PSI reviews for 2006 were successfully concluded in April and December. Nigeria met all the

quantitative macroeconomic assessment criteria and indicative targets under the PSI programme, in the first three quarters of 2006. The quantitative targets that were monitored included the non-oil primary balance of the federal government, reserve money, broad money supply and net foreign assets of the CBN. The reserve money target for December 2006 was, however, missed reflecting largely the effect of the unexpected rapid growth in currency in circulation (CIC) in the fourth quarter, influenced by seasonal factors as well as pre-election activities by the various political parties during the period.

Nigeria's implementation of the PSI, in 2006, enhanced the sustenance of macroeconomic stability exemplified by a single-digit inflation, a stable exchange rate, real gross domestic product growth rate of 5.6 per cent compared with 6.5 per cent in 2005, and external reserves of US\$42.3 billion capable of financing 28.4 months of import equivalent. The country successfully exited the Paris Club debt by paying off the balance of US\$4.6 billion in April, 2006 following the debt relief of US\$18.0 billion obtained in 2005 thereby freeing resources for economic growth and development in the domestic economy. Efforts were also intensified to exit the London Club debt in 2006. Consequently, the PSI assisted greatly in renewing foreign investors' confidence in the Nigerian economy, and thus induced increased inflow of foreign private capital. The successful implementation of the PSI in 2006 was greatly facilitated by the political will on the part of fiscal and monetary authorities and the dogged implementation of policy measures.

2.1.3 Interest Rates Policy and Developments

The Bank sustained the market-based interest rates regime in 2006. In order to influence the direction of interest rates in line with monetary conditions, the Bank's minimum rediscount rate (MRR) was reviewed upwards at the end of the first half of the year by 100 basis points to 14.0 per cent. However, a new monetary policy implementation framework was introduced in December 2006 to: remove the volatility in inter-bank rates, encourage inter-bank trading and engender a transactions rate that would improve the transmission of monetary policy actions. Consequently, the new anchor interest rate, the CBN's MPR, replaced the MRR. The MPR was fixed at 10.0 per cent with a band of 600 basis points range. The deposit money banks availed themselves of the CBN standing facilities with surplus funds deposited at 7.0 per cent (300 basis points below the MPR), while those that were short of funds borrowed at 13.0 per cent (300 basis points above the MPR). This repositioned the CBN as a lender of last resort.

2.1.3.1 Money Market Rates

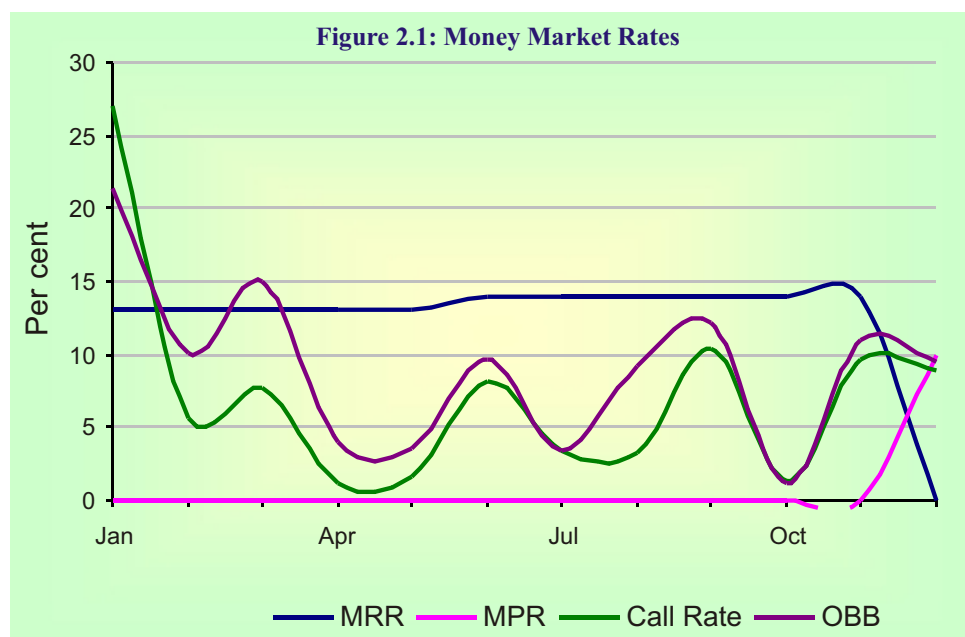
The profile of rates in the money market during the year reflected the monetary conditions. The inflow of funds from the Federation Account, Joint Venture Cash Call payments, the disbursement of excess crude oil proceeds and the implementation of the new framework for monetary policy operations all helped to moderate interest rates and curtailed the volatility of inter-bank rates towards the end of the year. On a monthly basis, the weighted average inter-bank call rate, tenored rate, and open-buy-back rate averaged 7.38, 11.99 and 9.20 per cent, respectively, compared with 7.96 per cent, 10.86 per cent and 7.79 per cent in 2005.

Table 2.3: Money Market Rates (Per cent)

Month	MRR	MPR	WEIGHTED AVERAGE			
			Call Rate	OBB	NIBOR 7-days	NIBOR 30-days
Jan-06	13	-	27.06	21.45	14.98	14.36
Feb-06	13	-	5.59	10.03	7.59	10.14
Mar-06	13	-	7.77	15.00	8.42	11.56
Apr-06	13	-	1.13	3.98	5.49	11.55
May-06	13	-	1.57	3.58	4.49	10.66
Jun-06	14	-	8.16	9.71	8.31	12.54
Jul-06	14	-	3.37	3.49	14.77	12.51
Aug-06	14	-	3.33	9.25	5.66	11.80
Sep-06	14	-	10.45	12.21	6.64	12.31
Oct-06	14	-	1.40	1.13	2.44	11.78
Nov-06	14	-	9.70	11.04	7.49	12.28
Dec-06	-	10	8.98	9.55	7.98	12.83

The Nigeria Inter-Bank Offered Rate (NIBOR) fell significantly when compared with the corresponding figures in 2005. The 7-day and 30-day NIBOR rates averaged 7.86 per cent and 12.03 per cent, respectively, on a monthly basis, down from 10.68 per cent and 12.63 per cent, respectively in 2005.

However, the weighted average inter-bank call rate, which stood at 7.0 per cent in December 2005, rose to 8.98 per cent at end-December 2006.



2.1.3.2 Deposit Rates

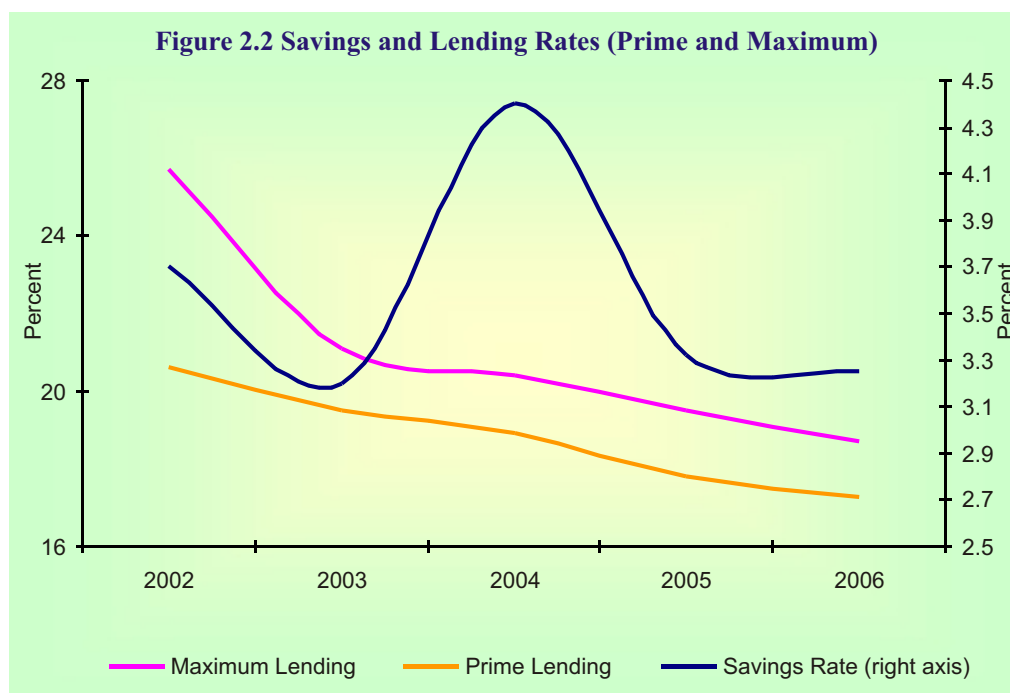
The declining trend in bank deposit rates that characterised 2005 was reversed in 2006. With the exception of the average savings deposit rate, which fell slightly (by 0.13 percentage point) to 3.25 per cent in December 2006, other rates on deposits of various maturities rose to a range of 5.210.3 per cent in December 2006, from a range of 4.6 9.1 per cent in December 2005. The increase in banks' deposit rates reflected essentially enhanced competition in the banking system, following the bank consolidation exercise.

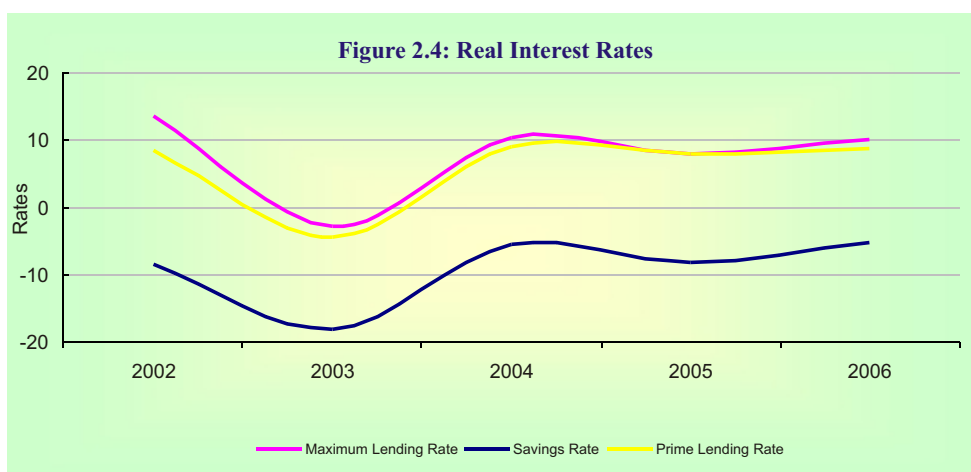
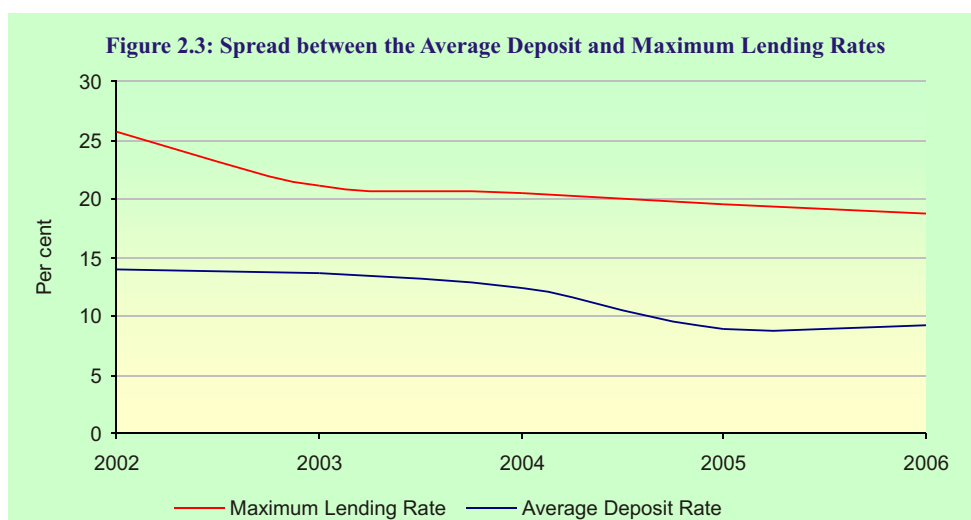
2.1.3.3 Lending Rates

The weighted average prime and maximum lending rates declined marginally from 17.8 and 19.5 per cent in December 2005 to 17.3 and 18.7 per cent, respectively, in December 2006. The downward movement in bank lending rates was traceable to the liquidity surfeit in the banking system and enhanced competition in the credit market.

Consequently, the spread between the weighted average deposits and maximum lending rates narrowed to 11.3 percentage points in 2006, from 13.1 percentage points in 2005. Similarly, the margin between the average savings deposit rate and the maximum lending rates narrowed from 16.22 percentage points at end-December 2005 to 15.41 percentage points in 2006. The relatively lower spread between the deposit and lending rates implied improved efficiency in banks' intermediation process.

With the year-on-year inflation rate at 8.5 per cent in December 2006, deposit rates on one, three and six-month maturity, were all positive in real terms, although rates paid to small depositors (mainly savings deposits) continued to be negative in real terms; lending rates were, however, generally positive in real terms.





2.1.4 Payments, Clearing and Settlement Developments

2.1.4.1 Institutional Arrangements

The reform of Nigeria's payments system continued in 2006, particularly in the wholesale and retail payments segments. The introduction of the real time gross settlement facility and the Temenos 24 (T24) banking application by the CBN and the deployment of more ATMs by banks during the year engendered a more efficient payments system. Moreover, the reduction in cash transactions, evidenced by the lower ratio of currency outside banks to money supply, added impetus to an enhanced monetary management.

In addition, the Nigerian Cheque Standard was launched to address the prevalent high MICR reject rate in the clearing system. Consequently, the Nigeria Cheque Printers Accreditation Scheme (NICPAS) was carried out during the year. As a result, eleven cheque printers, comprising nine foreign firms and two indigenous firms, were accredited by the CBN.

2.2 CURRENCY AND BRANCH OPERATIONS

2.2.1 Issue of Legal Tender

The CBN's clean notes policy stance was sustained in 2006. To this end, a penalty of N 3,000.00 per box imposed on deposit money banks that failed to sort their notes was retained; the stock of processing equipment and sorting activities were increased; and the campaign against the abuse of the naira was stepped up. In order to achieve higher efficiency in currency management, the Bank embarked on a currency restructuring programme which involved the redesign of the lower denomination currency notes, namely, N 5, N 10, N 20, and N 50 notes and 50 kobo and N 1 coins as well as the introduction of a N2 coins.

Box 2: THE CURRENCY RESTRUCTURING PROGRAMME IN NIGERIA

The Central Bank of Nigeria (CBN) embarked on a Currency Restructuring Programme in 2006, following a comprehensive assessment of Nigeria's currency structure in 2005 which revealed the following:

- the prevalence of cash in the economy, a large volume of currency-in-circulation, and dirty notes in circulation arising from poor handling and climatic conditions;
- high cost of currency management, arising from the printing, stocking, processing, replacement of unfit notes and disposal of unfit ones;
- low usage of coins and the rounding up of prices to the lowest banknote denomination;
- the inability of the Nigerian Security Printing & Minting (NSPM) Plc to meet CBN's currency requirements; and
- low private sector participation in currency management.

The objectives of the reform, which are consistent with international best practice, were to:

- achieve greater efficiency and cost effectiveness;
- safeguard the integrity of the Naira;
- enhance the durability of the currency notes; and
- promote the use of coins.

The elements of the reform are as follows:

- a redesign of the lower banknote denominations (N5, N10, N20 and N50), involving a reduction in the size of the notes;
- the use of polymer substrate for the printing of the N20 denomination and varnishing of N5, N10 and N50 paper banknotes to enhance durability and sustain the Bank's clean notes policy;
- streamlining of the security features for greater efficiency;
- a redesign of 50 kobo and N1 coins and the introduction of a N2 coin, involving a reduction in their size and weight;
- publicity campaign against abuse of the Naira; and
- the restructuring of the Nigerian Security Printing & Minting (NSPM) Plc to achieve self-sufficiency in currency production and meet the currency requirements of the Nigerian economy in the short term and those of the West and Central Africa in the medium to long term.

The second phase of the currency restructuring programme will involve the redesign of the higher denomination currency notes and the outsourcing of currency processing and distribution (which are non-core currency management processes) to private sector service providers to enable the Bank focus more on policy and strategic/directional functions.

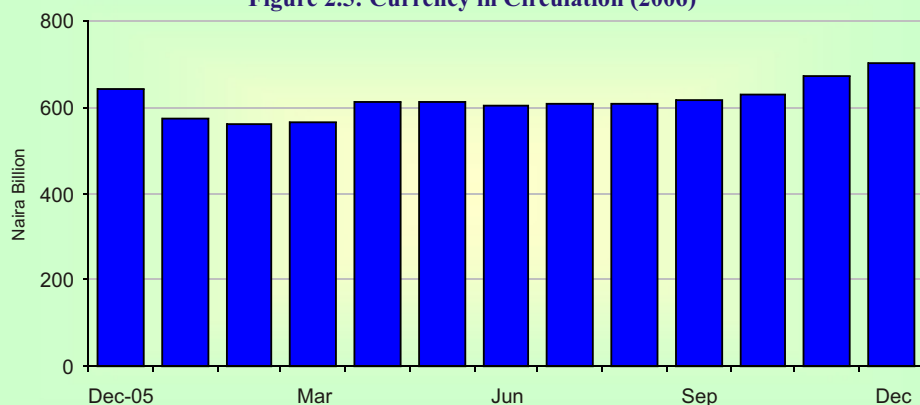
2.2.2 Currency in Circulation (CIC)

At N779.1 billion, the value of currency in circulation increased by 21.3 per cent over the level at end-December 2005. The growth in CIC was attributable to the increase in demand for currency due to expanded economic activities that have remained predominantly cash-based. Other factors responsible for the growth in currency included the draw-down of N570 billion from the excess crude account and the payment of N25 billion arrears owed to local contractors by the Federal Government.

Table 2.4
Structure of Currency in Circulation

Coins	2005		2006	
	Value (₦ billion)	Volume (million)	Value (₦ billion)	Volume (million)
₦ 1	0.45	447.2	0.45	447.8
50k	0.22	437.6	0.22	437.9
25k	0.04	172.5	0.04	172.5
10k	0.01	128.8	0.01	125.9
1k	0.004	40.7	0.004	40.9
Sub total	0.72	1,223.9	0.72	1,225.0
₦1000	34.60	34.6	116.30	116.3
₦500	371.00	742.0	349.20	698.4
₦200	155.31	776.6	222.50	1,112.5
₦100	44.00	439.8	66.00	660.1
₦50	15.74	314.8	9.20	184.1
₦20	12.44	622.0	8.90	445.4
₦10	5.86	586.1	3.80	384.3
₦5	2.56	513.8	2.50	496.3
Sub Total	641.51	4,029.7	778.30	4,097.4
Total	642.23	5,253.6	779.12	5,322.4

Figure 2.5: Currency in Circulation (2006)



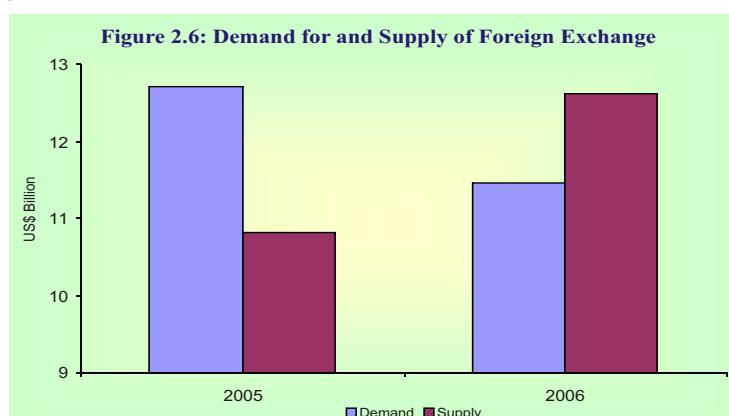
The objective of encouraging the local production of banknotes was pursued with vigour in 2006. Thus, the restructuring of the Nigerian Security Printing and Minting (NSPM) Plc. involving the upgrade and refurbishment of the Lagos and Abuja factories, as well as the installation of a new production line, progressed satisfactorily. The ultimate aim of the turnaround programme is to increase the production capacity of the firm and promote the clean notes policy while enhancing its profitability.

2.3 FOREIGN EXCHANGE MANAGEMENT

2.3.1 Foreign Exchange Flows

Foreign exchange inflows and outflows through the economy totalled US\$58.0 billion and US\$26.8 billion, respectively, compared with US\$51.7 billion and US\$26.4 billion in the preceding year. This resulted in a net inflow of US\$31.2 billion, compared with US\$25.3 billion in 2005. Of the total foreign exchange inflows, receipts through the CBN accounted for 63.3 per cent, while 36.7 per cent was from private sources. Receipts through autonomous sources rose from US\$16.0 billion in 2005 to US\$21.3 billion, reflecting the impact of government policies on growing the private sector. The improved receipts were largely influenced by increases in non-oil exports proceeds, capital importation, domiciliary inflows and purchases from oil companies. The gross inflow through the CBN rose by 2.9 per cent to US\$36.7 billion, while outflow amounted to US\$24.3 billion. The decline in outflow was as a result of the fall in external debt service payments, following the exit from the Paris Club debts. Consequently, a net inflow of US\$12.5 billion was recorded, compared with US\$11.4 billion in the preceding year. The improved inflow was attributable to the enhanced receipts from higher oil prices at the international oil market.

The foreign exchange market was relatively stable during the year as the demand pressure moderated under the Wholesale Dutch Auction System (WDAS) which was introduced early in the year. The development was due to a combination of factors which included: the non-accommodating monetary policy stance of the CBN, stringent fiscal policy measures of the government, increased surveillance over the activities of the authorized dealers by the CBN, as well as increased depth of the foreign exchange market. To this end, a total of US\$11.3 billion was sold in ninety five (95) trading sessions, including special auctions at the WDAS segment of the foreign exchange market in 2006, compared with US\$10.7 billion in 102 trading session, in 2005. An analysis of total sales to the foreign exchange market showed that the official market (WDAS) was supplied with foreign exchange worth US\$8.6 billion, while sales to BDCs was US\$2.7 billion. The increase in the supply of foreign exchange was as a result of the buoyant reserves which led to a renewed surge of confidence in the market and, consequently, improved supply outlets. On the other hand, aggregate demand for foreign exchange amounted to US\$11.9 billion, indicating a decline of US\$0.8 billion or 9.9 per cent from the level a year earlier. The drop in demand was due to effective liquidity management by the CBN. Overall, the CBN purchased foreign exchange worth US\$0.9 billion, which resulted in net sales of US\$10.4 billion, the same level as in the preceding year.

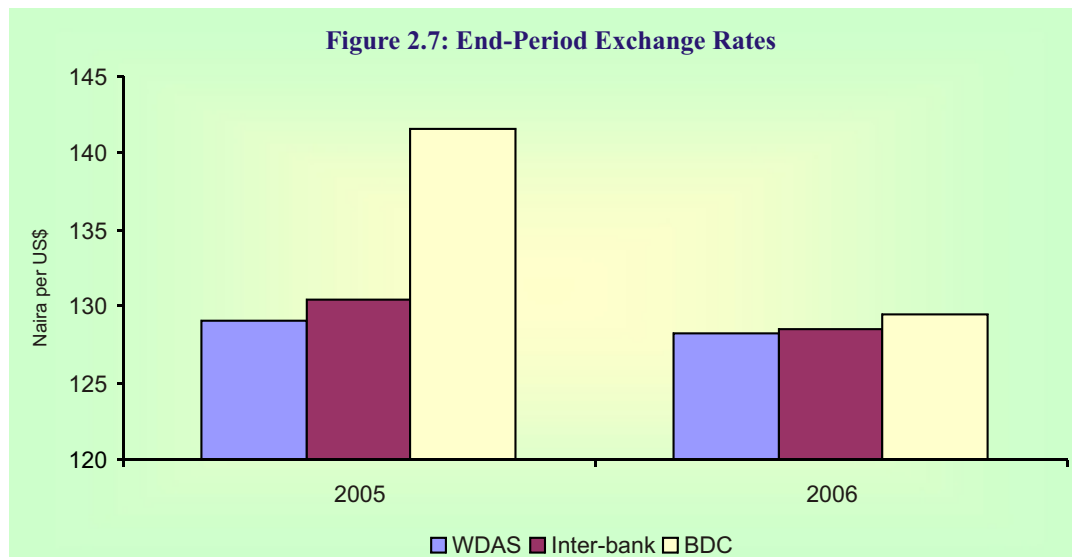


2.3.2 Management of the Wholesale Dutch Auction System (WDAS)

The Wholesale Dutch Auction System (WDAS) was introduced on February 20, 2006 as an improved framework for determining the exchange rate in the foreign exchange market. Under the arrangement, the CBN remains an active market participant and the dealing is based on a two-way quote. Authorized dealers are required to bid for foreign exchange on their own accounts and are also free to deal with such funds in the inter-bank market. The adoption of the WDAS was to consolidate the gains of the retail DAS, further liberalize the foreign exchange market to enhance its depth, and achieve convergence in rates between the official and other segments of the market. Other complementary policy measures that were introduced included:

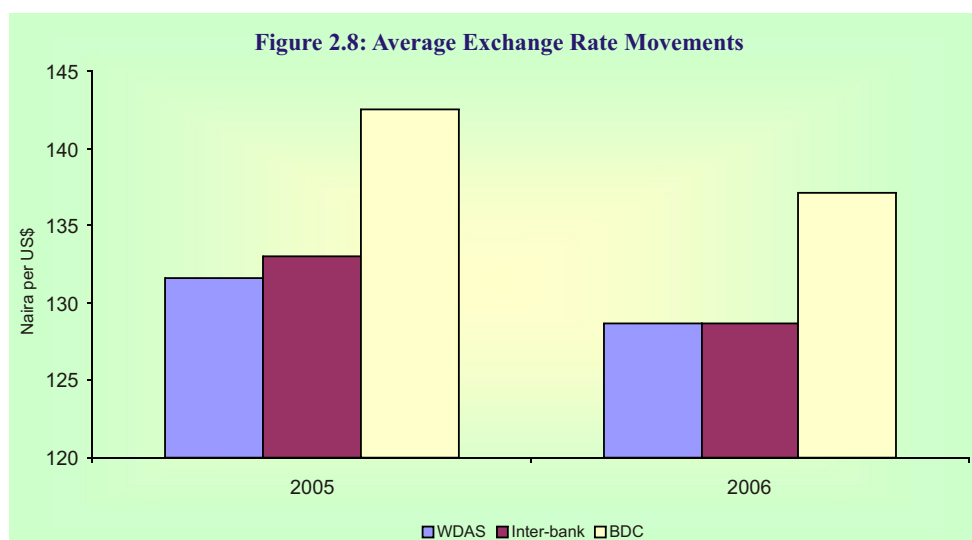
- Special foreign exchange auction offered to Deposit Money Banks (DMBs);
- Direct sales of foreign exchange to licensed Bureaux De Change (BDC) operators, effective April 2006;
- The Basic Traveling Allowance (BTA) was increased from US\$2,500.0 biannually to US\$5,000 per quarter, and the Personal Traveling Allowance (PTA) was also increased from US\$2,000 biannually to US\$4,000.0 per quarter; and
- The Foreign Exchange Manual, which guides the operations of all stakeholders in the foreign exchange market, was also reviewed to accommodate all the transactions that were liberalized during the year.

The end-period nominal exchange rate at the WDAS segment of the market was N128.27 per dollar, indicating an appreciation of 1.6 per cent relative to the preceding year's level. Similarly, at the Inter-bank and BDC segments of the foreign exchange market, the naira exchanged for N128.50 and N129.50 a dollar, showing an appreciation of 1.5 and 9.3 per cent, respectively, over the levels in 2005. The exchange rate was generally stable during the period under review and, for the first time, there was a convergence of rates among the various segments of the market. The average exchange rate of the naira in all the segments of the market appreciated throughout the year under review. Thus, the average effective exchange rate, at N128.65 per dollar, recorded an appreciation of 2.6 per cent when compared with the N132.05 a dollar in 2005.



Similarly, at the Inter-bank and BDC segments of the market, the average effective exchange rate of the naira vis-à-vis the US dollar appreciated by 3.4 and 4.0 per cent, respectively, during the year under review. The weighted average exchange rate also appreciated by 3.4 per cent in 2006. Consequently, the premia between the WDAS rate and IFEM/BDC rates were 0.02 and 6.6 per cent, respectively, compared with 0.7 and 8.0 per cent in 2005. The reduction in premia was achieved through improved macroeconomic fundamentals, further liberalization of the market, increased availability of foreign exchange, greater public confidence, and improved surveillance on foreign exchange operations.

During the year under review, seven (7) additional counterparties for money market operations were engaged, bringing the total number to thirty (30). This was to allow for the diversification of investment and reduce the risk of concentration of deposits in a few banks, and thereby engender competition among the counterparties and enhance returns to the portfolio.



2.3.3 External Reserves Management

The management approved the appointment of a Global Custodian and fourteen (14) External Asset Managers to manage part of the country's external reserves. The Asset Managers have entered into partnership agreements with Nigerian banks with the aim of transforming them into significant operators in the global financial markets and improve their capacity to provide innovative financial services to the domestic market. It is gratifying to note that some local banks have started benefiting in terms of capacity building.

The management has also approved amendments to the CBN Investment Guidelines by adopting and including the Merrill Lynch Global Government Bond G7, the 1-3 years index hedged to the USD as benchmark for Global Asset Managers, in addition to the Merrill Lynch 1-3 years US Treasury Index earlier approved. The risk budget of 75 basis points is the maximum allowable under-performance of the portfolio relative to the benchmark that the Bank would tolerate from Asset Managers in a financial year.

2.4 SURVEILLANCE REPORT ON THE ACTIVITIES OF FINANCIAL INSTITUTIONS

2.4.1 Banking Supervision

The CBN further strengthened its supervisory and surveillance activities in the banking sector in 2006. It adopted various approaches, including regular appraisals and reviews of banks' periodic returns, spot checks, monitoring and special investigations, among others. The Bank also conducted post-consolidation due

diligence on the 25 deposit money banks to ensure the absence of “bubble” capital. The outcome of the exercise was largely satisfactory.

As at the end of December 2006, the web-enabled Credit Risk Management System (CRMS) database had an outstanding balance of N1,553.40 billion involving 48,494 borrowers, as against N1,388.14 billion and 34,366 borrowers in the preceding year. In absolute terms, both the naira value and the number of borrowers of the banking system credit portfolio grew, reflecting the growing confidence of the public in the banking system.

The CBN issued a number of circulars to the banks on their operations, as part of its efforts to promote a safe and sound financial system. These included:

- Code of Corporate Governance;
- Post-Consolidation Integration;
- Waiver of tax on interest earnings from agricultural lending;
- Reporting of suspicious or unusual transactions involving terrorism to the Nigerian Financial Intelligence Unit (NFIU); and
- Submission of Returns through the e-FASS.

Following the successful completion of the first phase of the consolidation programme in December 2005, the banks were directed to embark on a full-scale integration of their processes and operations. On-site verification of the banks' levels of integration, as at end-December 2006, revealed that out of the nineteen (19) banks that needed integration, only eleven (11) had made significant progress.

Out of the three hundred and twenty-two (322) BDCs in operation, only eighty (80) met the minimum paid-up capital of N10 million, while others were operating below the minimum paid-up capital. However, ninety-six (96) BDCs with unidentified addresses had their names published in three (3) widely read national newspapers. The surveillance efforts of a special taskforce that had been constituted to check malpractices among the BDCs led to the suspension of five (5) BDCs during the year.

2.4.2 Prudential Examination

During the period under review, income audits and the verification of capital and special investigations were conducted on some banks to check the authenticity of reports/returns to the CBN. The examination focused on the level of income and profits reported in their audited accounts, their liquid assets, as well as the legitimacy of funds used for recapitalisation.

Available data from the banks revealed that one (1) bank failed to meet the statutory minimum required capital adequacy ratio (CAR) of 10 per cent as at end-December 2006, compared with twelve (12) in 2005. Four (4) banks could not meet the minimum prescribed liquidity ratio of 40 per cent as at end-December, 2006, as against twenty-four (24) in 2005. The banks that failed to meet the minimum liquidity ratio requirement were penalized accordingly.

Prudential examination on the other financial institutions (OFIs) revealed that the number of PMIs that met the prescribed minimum paid-up capital requirement of N100 million rose to 74, compared with 45 in 2005. Also, 35 PMIs complied with the prescribed minimum mortgage assets to total assets ratio of 30 per cent, compared with 15 in 2005. In addition, 61 and 73 PMIs satisfied the prescribed minimum liquidity ratio of 20 per cent and capital adequacy ratio of 10 per cent, respectively, compared with 55 and 66 PMIs in 2005.

2.4.3 Compliance with the Code of Corporate Governance for Banks in Nigeria

During the year under review, a verification exercise on the compliance of banks with the provisions of the “Code of Corporate Governance for Banks in Nigeria” was conducted. The exercise revealed that many of

the banks complied with a number of the provisions, while some showed non-compliance. In the area of non-compliance, 8 banks had government equity holding above 10 per cent; 3 banks had two or more members of their families on the boards. No bank had complied with the requirement for the appointment of independent directors because of the absence of a clear definition. Seven (7) banks had Executive Directors as members of the Board Audit Committee (BAC), contrary to the provisions of the code.

2.4.4 Financial Crime Surveillance

In compliance with the requirements of the Financial Action Task Force (FATF), the CBN embarked on a number of measures on Anti-Money Laundering/Combating Financing Terrorism (AM/CFT). In that regard, the Bank organized various public enlightenment and training programmes on money laundering in collaboration with the other stakeholders. It also co-operated with and assisted local and foreign law enforcement agencies in the arrest and prosecution of persons involved in financial crimes.

2.4.5 Routine Examination

Maiden routine examinations were conducted in 2006 on the newly consolidated deposit money banks. Routine examinations were also conducted on the five (5) discount houses and offshore outfits of some Nigerian banks. The examinations covered prudential regulations, foreign exchange operations, anti-money laundering controls and know-your-customer (KYC) directives. The examination on the foreign exchange operations of the banks revealed various infractions, including poor record-keeping, non-compliance with the foreign exchange rules and regulations, excess charges by banks on foreign exchange transactions, among others. The errant banks were appropriately sanctioned for each of these offences.

2.4.6 Banking Sector Soundness

An assessment of the soundness of the banking system using the CAMEL parameters, revealed that as at end-December 2006, ten (10) banks were rated sound, twelve (12) were rated satisfactory and three (3) banks were rated marginal. The development indicated an improvement over the preceding year, reflecting the positive results of the bank consolidation exercise.

The non-performing loans of the banks declined by 40.9 per cent to N220 billion as at end-December 2006, reflecting partly improvements in the quality of credit facilities and increased recovery during the period under review. The ratio of non-performing loans to the industry total credit fell to 8.7 per cent from the 19.3 per cent recorded as at end-December 2005. The ratios were within the acceptable contingency threshold of 20.0 per cent for the industry.

Table 2.5
Rating of Banks Using the “CAMEL” Parameters

Category	Number				
	2002	2003	2004	2005 1/	2006**
Sound	13	11	10	5	10
Satisfactory	54	53	51	47	12
Marginal	13	14	16	16	3
Unsound	10	9	10	18	-

1/ As at September, 2005

** Following the conclusion of the Banking Sector consolidation exercise, the number of banks dropped from 89 to 25.

2.4.7 Examination of Other Financial Institutions

The CBN carried out on-site examinations on 291 Community Banks (CBs), 75 Primary Mortgage Institutions (PMIs), 56 Finance Companies (FCs), 293 Bureaux-de-Change (BDCs) and 3 Development Finance Institutions (DFIs).

The examination conducted on the PMIs, among other things, revealed the inactivity of four (4). Eighteen (18) PMIs were penalized for late and non-rendition of returns and submission of audited accounts. Of the fifty-six (56) finance companies examined in 2006, the major regulatory issues observed were under-capitalization, over-trading, a high incidence of loan default and poor loan recovery, low liquidity, a poor level of earnings and high expenditure profiles.

Routine examination on 293 BDCs revealed poor record-keeping, inadequate staffing, inadequate office infrastructure and non-rendition of prudential returns. Three hundred and sixty-one (361) audited financial statements of the OFIs were also approved during the period. Although the incidence of failure to render returns had substantially reduced, the problem still constituted an important impediment to the effectiveness of the supervisory process for OFIs, given that a total of N7.7 million was collected as penalty for various infractions, including late/non-rendition of statutory returns and submission of audited accounts.

2.5 DEVELOPMENTAL FUNCTIONS OF THE CBN

2.5.1 Agricultural Credit Guarantee Scheme (ACGS) Fund

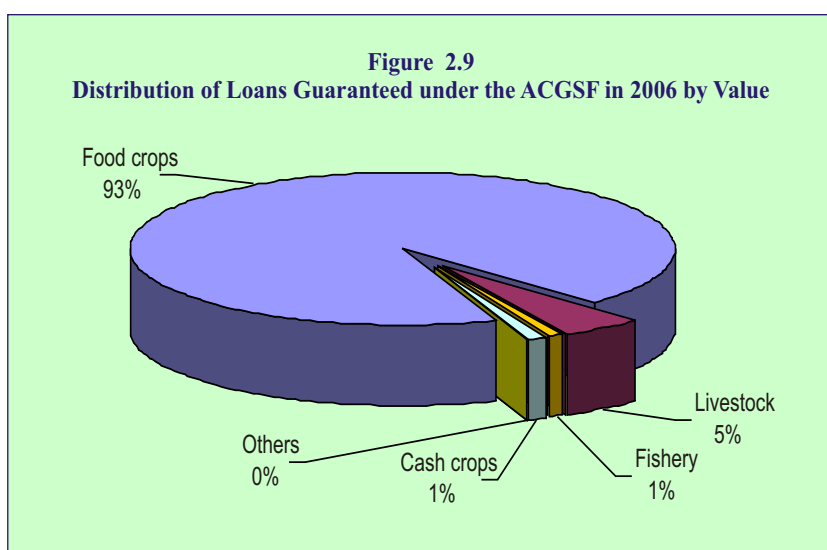
A total of 54,032 loans valued at N4.3 billion was guaranteed in 2006 under the Agricultural Credit Guarantee Scheme [ACGS]. The cumulative volume and value of loans guaranteed from its inception in 1978 to 2006 stood at 497,692 and N14.9 billion, respectively. Analysis of the guaranteed loans by State showed that Adamawa State received the highest, valued at N376.9 million (8.8 per cent), followed by Zamfara and Katsina States with N227.0 million (5.3 per cent) and N222.7 million (5.2 per cent), respectively. In terms of volume, Katsina State with 5,401 (10.0 per cent) had the highest number of benefiting farmers, followed by Jigawa and Kebbi States with 4,915 (9.1 per cent) and 4,018 (7.4 per cent) farmers. Ten DMBs and twenty three community banks participated in the Scheme in 2006.

Table 2.6
Distribution of loans under the ACGSF in 2006 by value

Category	Volume	Value in ₦'million
₦20,000 and below	9,464	168.5
₦20,001- ₦50,000	22,482	891.3
₦50,001 - ₦100,000	12,993	1,069.3
Above ₦ 100,000	9,093	2,134.0
Total	54,032	4,263.1

Analysis of loans guaranteed by purpose showed that food crops dominated with 50,168 projects (92.8 per cent) valued at N3.7billion (86.9). This was followed by livestock with 2,673 projects (5.0 per cent) valued at N0.4 billion (8.6 per cent). Cash crops had 480 projects (0.9 per cent) valued at N0.7 billion (15.9 per cent) while fishery registered 645 projects (1.2 per cent) valued at N0.01 billion (0.3 per cent). Other forms of agro-businesses, distributed among 65 projects (0.1 per cent) valued at N83,300.0 (0.01 per cent) made up the balance. A total of 35,595 loans valued at N2.2 billion was repaid during the year under review. The cumulative volume and value of total loans repaid from 1978 to 2006 stood at 343,248 and N8.6 billion, respectively. Analysis of loan repayments by category of borrowers showed that borrowers in the N20,001 – N50,000 bracket repaid the largest number of loans (12,227 or 37.51 per cent) while farmers who borrowed less than N5,000 accounted for the least with 830 (2.5 per cent). In terms of value, farmers who borrowed over N100,000 accounted for the highest repayment of N983.9 million (44.0 per cent) while borrowers of N5,000 or less accounted for the least value with N12.9 million (0.6 per cent).

A total of 2,245 claims amounting to N30.2 million were settled in 2006 under the ACGS while the sum of N48.7 million was paid to 15,796 deserving farmers as interest drawback claims under the Interest Drawback programme during the same period.



2.5.2 The Trust Fund Model

In 2006, the Bank signed a memorandum of understanding (MOU) with the Cross River State Government bringing the total number of signed MOUs and pledges under the model to seventeen. The Bank also monitored the compliance of stakeholders under the jointly signed MOUs on the Trust Fund Model in Katsina, Benue and Ondo States. The exercise afforded the Bank the opportunity to assess compliance by the stakeholders with the terms of the MOU, following which some challenges to the successful implementation of the model were identified. The militating factors identified included:

- Unwillingness on the part of the lending banks to disburse loans to farmers;
- The need for increased project monitoring and loan recovery drives in order to significantly improve repayment by Self-Help Groups (SHGs); and
- The need to identify/adopt better Self Help Groups, i.e., thorough assessment/search for good SHGs by the relevant state agricultural development agencies before recommendation to lending banks as a way of mitigating the high rate of loan default.

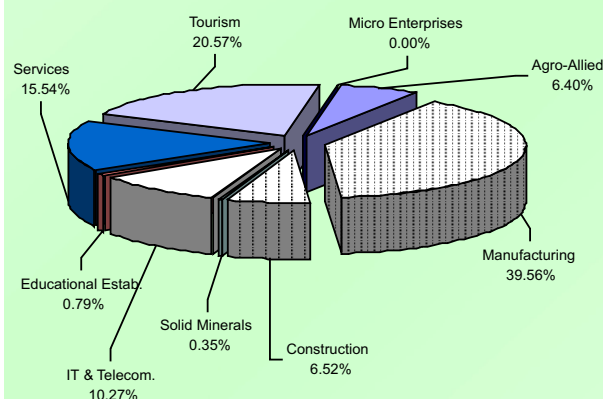
Table 2.7
Performance under the Trust Fund Model as at end December 2006

No	Name of Stakeholder	Amount Placed (N'm)	Partnering Bank	Date MOU was Signed	Other Remarks
1	SPDC MISCARD	5.00	FBN/CDB	2001	Nil
2	Jigawa State	50.00	FBN, PHB, & Unity Banks	2002	Nil
3	Agip Green Card	5.00	UBA	2003	Nil
4	Kogi State	180.00	FBN	27/11/03	Reviewed on 22/8/05
5	Nasarawa State	10.00	FBN	19/2/04	Nil
6	Katsina State	500.00	FBN, Unity, PHB, First-Inland Banks	1/6/04	To increase annually by N250m
7	Ondo State	100.00	Spring Bank	15/6/04	Nil
8	Total Card	20.00	UBA	2004	Nil
9	Benue State	15.00	PHB	27/6/05	Nil
10	Kaduna State	50.00	UBA	7/6/05	Nil
11	Kwara State	63.00	UBA	10/8/2005	Nil
12	Kebbi State	100.00	UBN	7/9/05	To increase to N250m by year end
13	Ogun State	50.00	FBN	2005	Nil
14	CASPAN	4.00	Fidelity, Zenith Banks	2005	Nil
15	Cross River State	100.00	UBA, UBN, FBN	12/1/2006	Pledged to increase to N250m
16	Osun State	40.00	UBA, CBN	3/8/2006	Yet to be placed
17	Oyo State	100.00	Spring Bank	21/09/2006	Nil
	Total	1,392.00	17 Stakeholders		

2.5.3 Small and Medium Enterprises Equity Investment Scheme (SMEEIS)

The performance of the SMEEIS improved in 2006. The cumulative sum set aside by banks, as at end-December 2006 stood at N38.2 billion, compared with N41.4 billion at end-December 2005. The difference resulted largely from the reclassification of banks during the year, following the conclusion of the consolidation exercise in December 2005. Thus, the sum of N2.5 billion and N25.3 million which were set aside by failed and liquidated banks, respectively, were netted out. In contrast, cumulative investment by banks increased phenomenally by 41.4 per cent to N17.0 billion or 44.6 per cent of the total sum set aside. The number of projects that benefited from the scheme also increased to 248 projects from 212 in 2005.

Figure 2.10
Sectoral Distribution of SMEEIS Investments by Banks as at December 2006



Analysis of investments showed that the real sector (manufacturing 39.6 per cent, construction 6.5 per cent, agro-allied 6.4 per cent and solid minerals 0.4 per cent) received N9.0 billion in 160 projects, up from N6.9 billion in 136 projects in 2005. Investments in the real sector thus represented 52.8 per cent of total sum invested by banks. The service sub-sector accounted for the balance, valued at N8.0 billion (47.2 per cent) in 88 projects.

2.5.4 The Microfinance Scheme

The Central Bank of Nigeria organized the Annual Entrepreneurship Award/International Microfinance Conference on 14th and 15th December 2006 to mark the one year anniversary of the launching of the Microfinance Policy, Regulatory and Supervisory Framework for Nigeria. The National Microfinance Policy Consultative Committee considered the proposal for the establishment of the National Microfinance Development Fund and the modalities for operating the linkage programme between microfinance and the universal banks. During the period, the proposal for the establishment of a certification programme for microfinance banks was also presented by the West African Institute for Financial and Economic Management (WAIFEM) and the Financial Institutions Training Centre (FITC).

2.5.5 Africa Finance Corporation (AFC)

The CBN took a major institutional initiative in 2006 to reposition Africa's private sector-led investment growth, through the promotion of the Africa Finance Corporation (AFC). The AFC is packaged to bridge the resource gap in the financing of infrastructure and other strategic sectors in Africa. Modest progress was made during the year with the constitution of a technical committee, under the auspices of the CBN, to fast-track the take-off of the Corporation.

Box 3: Africa Finance Corporation (AFC)

A major institutional initiative was taken by the CBN in 2006 to reposition Africa's private sector-led investment growth, through the promotion of the Africa Finance Corporation (AFC). The AFC is packaged to bridge the resource gap in the financing of infrastructure and other strategic sectors, including energy, telecommunications, roads and agriculture in Africa which has been noted to have the weakest physical infrastructural facilities. According to Global Monitoring Report (GMR), an investment of 9 per cent of GDP is required by Africa to achieve the MDG of 7 per cent growth rates over the next 10 years. Consequently, the market size for infrastructure financing has been estimated at US\$40 billion per annum, from 2005 to 2010. This presents a significant business opportunity that supports the market viability of the Corporation. As an investment bank, its intermediation process would help to mobilize and disburse funds towards driving the continent's economic development. Thus, its establishment would contribute positively to the reversal of the dependence on foreign financing by empowering key African institutions to build large private sector businesses into global players in key sectors. The AFC would be established to provide long-term funding and promote economic and social cohesion within African countries, through diversified business coverage in member countries

The funding of private sector-led projects by the AFC would cover financial products, such as loans, guarantees, risk management products, equity participation and venture capital, as well as investment banking services comprising corporate finance, mergers and acquisitions, capital market activities, equity research, asset management, and project/structured finance. In addition, it would provide technical assistance and advisory services.

Modest progress was made during the year as the President of the Federal Republic of Nigeria constituted a twelve (12)-member Technical Committee to fast-track the process, with the secretariat domiciled in the CBN which is mid-wifing the process. The AFC has an authorized share capital of US\$2.0 billion ordinary shares, of which at least US\$1.0 billion would be fully paid on commencement of business in 2007 with broad ownership expected to be African and beyond. The proposed minimum of 51.0 per cent shareholding in AFC from the private sector would be owned by financial institutions in Africa, multilateral and development financial institutions, pension funds, other institutional investors, and high net worth private investors. The CBN is committed to investing up to US\$490 million, subject to total public sector investment not exceeding 49.0 per cent.

The Corporation would be incorporated as a legal entity, through an international agreement to be executed by shareholders and one or more African countries, including Nigeria. The Agreement would be ratified and gazetted in accordance with the laws of the respective countries.

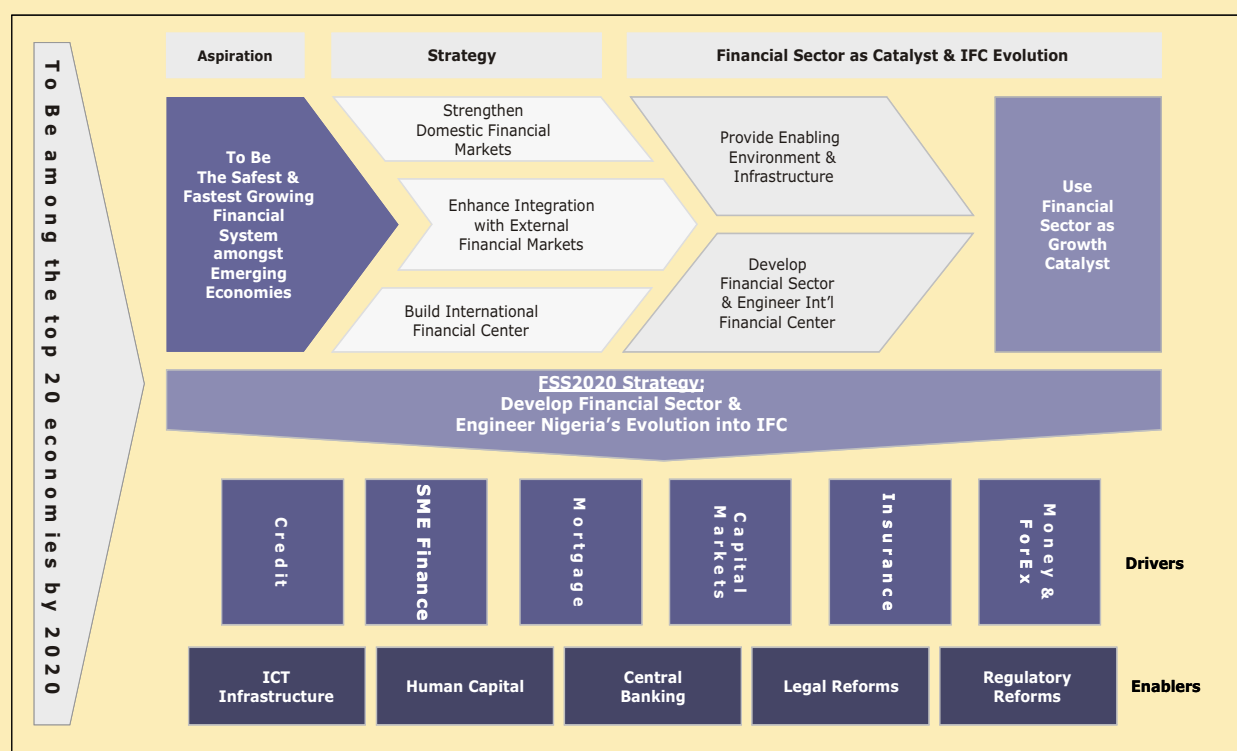
Box 4: FINANCIAL SYSTEM STRATEGY 2020

In line with Nigeria's goal to become one of the top 20 economies in the world by the year 2020, the CBN initiated a strategy to implement a financial system that would transform Nigeria into an international financial centre and provide the safest and the fastest-growing financial system amongst emerging economies. The strategy, known as the Financial System Strategy 2020 (FSS 2020) is the blueprint (illustrated in the figure below) for achieving the goals of developing and transforming Nigeria's financial sector into a growth catalyst, and propelling Nigeria into an international financial centre.

To accomplish these goals, it has been recognised that there is need for the concurrent strengthening of the domestic financial markets and enhancement of the sector's integration with external financial markets. The objective is to successfully develop the financial sector such that Nigeria would be the natural destination in West Africa for financial products and services, and also the ideal point for channelling investments to other parts of the continent. The strengthened financial sector would then serve as a driver to catalyze growth in other parts of the economy. The FSS 2020 is an outgrowth of the various reforms of the Federal Government and the financial sector of Nigeria.

Nigeria's large population makes the country one of the largest markets in the world and is one of the identified "Next 11" (N11) countries with the potential to become like Brazil, Russia, India and China (BRIC). In addition, Nigeria is centrally located in the middle of Africa and midway between the US and Asia. Nigeria's GDP is about 80% of the total GDP of the 16 countries that make up the Economic Community of West African States (ECOWAS).

Figure 2.11
THE FSS 2020



The FSS 2020 Project Committee commenced work in August 2006 with the constitution of a steering committee and the subsequent appointment of consultants to facilitate the development of the strategic plan.

In creating the blueprint, the CBN and other stakeholders have identified the following sectors as the “drivers” whose immediate development would enable the financial sector to catalyze growth:

- *Capital markets*
- *SME finance*
- *Consumer credit*
- *Mortgage*
- *Insurance*
- *Money markets*
- *Foreign exchange markets*

The blueprint also contains recommendations for developing the enabling environment that would transmit the improvements to the various sectors. Such “enablers” include:

- *Human capital necessary for the improved financial sector*
- *Conducive legal and regulatory environments*
- *Payments Systems*
- *ICT infrastructure*




PART TWO

ECONOMIC REPORT



CHAPTER 3

WORLD OUTPUT, PRICES AND TRADE

 Aggregate world output grew by 5.1 per cent in 2006. Capacity constraints and high oil prices drove up inflation in major industrialized countries, as well as in emerging and developing countries, including Africa. Global trade improved significantly over the level achieved in the preceding year. The high trade value was attributed to rising prices of oil, commodities and metallic minerals. Of the total world trade, advanced economies accounted for 67.7 per cent, while the balance of 32.3 per cent went to emerging and developing countries.

3.1 Output and Growth

World output growth was projected at 5.1 per cent, an increase of 0.2 percentage point above the level in the preceding year. The global expansion was broadly spread, with activity in most regions exceeding or meeting expectations. The United States (U.S.) economy experienced an initial strong growth which moderated later in the year. Higher interest rates, the decline in the housing market and high gasoline prices weakened private consumption. The US economy expanded by 3.4 per cent, 0.2 percentage point above the preceding year's level. The Japanese growth rate, at 2.7 per cent, remained strong owing to inventory decumulation. In the Euro area, the real growth averaged 2.4 per cent, up from 1.3 per cent in the previous year. The growth was driven by corporate investment which remained buoyant in the three largest economies of Germany, France and Italy.

In Asia, growth was strong at 8.7 per cent, as China and India recorded real output growth of 10.0 per cent and 8.3 per cent, respectively. In contrast, growth in most other Asian countries slowed down due to the effects of high oil prices and tight monetary policy. Among the economies in transition, Russia grew by 6.5 per cent, compared with 6.4 per cent in 2005. The growth was buoyed by high energy prices and substantial private and official capital flows. The economy of the Western Hemisphere grew by 4.8 per cent, supported by the high price of commodity exports.

Emerging Europe grew by 5.4 per cent. Among the Baltic countries, growth accelerated in the Czech Republic and Slovak Republic, but slowed in Hungary, Poland, Slovenia and Turkey. The varying growth momentum among these countries was largely driven by domestic demand, exchange rate developments and domestic rigidities.

Sub-Saharan Africa sustained the economic expansion that started some years ago. Regional growth rate was 5.4 per cent. Oil-exporting countries in the region contributed significantly to the strong performance. Increased output and foreign exchange earnings boosted domestic incomes and spending. Growth in non-oil exporting countries, although lagging, was robust despite higher oil prices and the removal of international textile trade quotas which adversely affected some countries, such as Lesotho and Swaziland. Comparatively, countries such as Angola, Sudan, Morocco and Nigeria registered high growth rates of 14.3, 12.1, 7.3 and 5.6 per cent, respectively, while Cote d'Ivoire and Zimbabwe recorded the lowest growth rates of 1.9 per cent and -5.1 per cent respectively, due, largely to political uncertainties and armed conflicts.

3.2 World Prices

The global economy experienced inflationary pressure. Headline inflation in many advanced economies rose, due to high energy prices. For instance, in the United States, the headline inflation rate stood at 3.6 per cent, 0.2

percentage point above the preceding year's level. In Japan and the Euro Area, inflation rates also rose to 0.3 and 2.3 per cent, up from - 0.6 and 2.2 per cent, respectively in 2005. In the Western Hemisphere, with the exception of Argentina which recorded an inflation rate of 12.3 per cent, most countries in the region recorded low inflation, largely on account of fiscal restraint and increased private investment.

In Emerging Asia, headline inflation also rose on account of higher oil prices, but most countries succeeded in restraining core inflation. For example, India raised its market rates to resist inflationary pressure due to rising oil prices and strong domestic demand. The core inflation rate for India rose by 1.2 per cent, while China's core inflation rate declined by 0.3 per cent in the review period

In sub-Saharan Africa, despite the impact of higher oil prices, inflation was generally well contained, while fiscal positions deteriorated only modestly. The average inflation rate for the region was 9.9 per cent, 1.4 percentage points higher than the level in the preceding year. Nigeria recorded an inflation rate of 8.5 per cent, while in Ethiopia, Kenya and Angola inflation rate averaged 12.6 per cent. The inflation situation in Zimbabwe worsened further to 1,216.0 per cent from 237.8 in the preceding year.

3.3 World Trade

Total global trade amounted to US\$23,344.1 billion, representing a 14.6 per cent increase over the value in the preceding year. The expansion was due mainly to the high prices of commodities, especially petroleum and some metallic minerals.

A disgregation of the trade data showed that advanced economies accounted for US\$15,801.2 billion or 67.7 per cent of total world trade, while emerging markets and developing countries accounted for the balance of 32.3 per cent or US\$7,542.9 billion. The advanced countries accounted for US\$7,586 billion or 64.7 per cent of exports and US\$8,214.5 billion or 70 per cent of imports. Emerging market economies and developing countries accounted for US\$4,133.8 billion or 35.3 per cent of total exports and US\$3,409.1 billion or 30.0 per cent of total imports, respectively. Exports of primary products, namely, petroleum, coffee and metallic minerals benefited from high prices.

3.4 The International Foreign Exchange Market

In terms of the movements of other major currencies, the naira also exhibited relative appreciation during 2006. The naira appreciated significantly against the Japanese yen (8.9 per cent), the Swiss franc (3.6 per cent), the US dollar (3.4 per cent), the pound sterling (1.5 per cent), and the euro (0.6 per cent).

3.5 The Impact of International Economic and Political Developments on the Nigerian Economy

Global economic and political activities impacted positively on the Nigerian economy in 2006. The most significant economic event was the high demand for crude oil and petroleum products, especially from emerging markets, such as China, India, as well as the United States (US). These countries experienced rapid economic growth which resulted in increased demand for oil to fuel their productive activities. In the face of the high demand for oil vis-à-vis existing global capacity constraints and supply shortages, which also arose from production disruptions, an escalation of security concerns and uncertainties in the Middle East, the Niger Delta area of Nigeria and the Iran/US nuclear programme conflict, global oil prices rose sharply in 2006. For instance, the average price of Nigeria's reference crude, the Bonny Light, was US\$66.46 per barrel in 2006, up by 20.4 per cent from the average price recorded in 2005.

Nigeria's crude oil production output which, averaged 2.23 million barrels per day (lower than the 2.53 mbd produced in 2005), was compensated for by higher oil prices. Also, in the non-oil sector, agricultural produce prices for coffee, cocoa, palm oil and cotton rose in the world commodity market and, thus, recorded

positive terms of trade. While coffee and cocoa prices increased by 28.5 and 20.5 per cent, respectively, those of palm oil and cotton rose by 12.2 and 4.5 per cent, respectively. Consequently, the all-commodity world price index increased by 15.3 per cent. The country's earnings from oil and non-oil exports improved significantly, as evidenced by the quantum leap in external reserves by 49.6 per cent to US\$42.3 billion in 2006 from US\$28.28 billion in 2005. The foreign reserves could support 25.6 months of imports cover, compared with 19.7 in 2005. Also, the Federal Government's fiscal deficit compressed further from N161.4 billion or 1.1 per cent of GDP in 2005 to N101.35 billion or 0.6 per cent of GDP in 2006. In addition, foreign investment flows to Nigeria rose significantly in the wake of weakened investment fortunes in the former investment havens of transition and emerging market economies.

CHAPTER 4

THE FINANCIAL SECTOR

The reform of the financial sector continued to produce positive outcomes in 2006, as evidenced by the improvement in the major financial ratios. The financial sector deepened further with the increase in broad money supply/GDP ratio from 16.4 per cent at end 2005 to 16.9 per cent at end-2006. Banking system capacity to finance economic activity strengthened with a higher ratio of credit to private sector/GDP than in the preceding year. At 23.1 per cent at end-2006, the intermediation efficiency indicator (the ratio of currency outside banks/money supply) showed improvement over the outcome at end-2005. Furthermore, the money market deepened as the ratio of money market assets outstanding/GDP increased. The capital market performance also improved with a market capitalization/GDP ratio of 28.3 per cent, compared with 19.9 per cent at end-2005.

The monetary policy actions of the Bank delivered modest outcomes as broad money grew at 30.6 per cent, comparing favourably with the target of 27.8 per cent. However, reserve money was well above the target. The improvement of the payments system received a boost with the live run of the Bank's real time gross settlement facility. Public confidence in the use of e-payments grew with the increase in ATM and web-based transactions, which has curtailed the holding of cash by the public. At end-December 2006, the financial system comprised the CBN, the Nigeria Deposit Insurance Corporation (NDIC), the Securities and Exchange Commission (SEC), the National Insurance Commission (NAICOM), the National Pension Commission, 25 deposit money banks, 750 community banks (CBs), 7 microfinance banks (MFBs), 112 finance companies (FCs), 322 bureaux-de-change (BDCs), 1 stock exchange, 1 commodity exchange, 5 discount houses, 91 primary mortgage institutions, 5 development finance institutions, 103 insurance companies, and 581 brokers.

4.1 INSTITUTIONAL DEVELOPMENTS

4.1.1 Growth and Structural Changes

The number of deposit money banks in the country remained at the end-December 2005 level of twenty-five (25) as no new bank was licensed during the year in review. Also, there was no new application for a banking licence. The post-consolidation competition among the banks engendered the emergence of a variety of financial products and services. The credit market was enhanced with further reforms in the financial institutions, especially the conversion of some community banks into microfinance banks. The financial sector's infrastructure further improved as steps were taken to increase its efficiency. To improve financial reporting, all the banks and discount houses were effectively connected to the CBN extranet gateway and had started the rendition of various returns electronically.

The NDIC commenced the resolution of the fourteen (14) failed banks whose operating licences had been revoked by the CBN in January, 2006. The Corporation obtained final and provisional court orders to liquidate nine (9) and two (2) banks, respectively. The cases of the remaining three (3) banks were still pending in courts. Under the Purchase and Assumption (P&A) model of liquidation, the healthy banks were invited to assume the private sector liabilities and cherry pick the assets of those banks for which the NDIC had obtained the final court approval to liquidate. The CBN would issue Promissory Notes to cover the gap between the assumed deposit liabilities and the assets of the failed banks picked by the assuming banks. The P & A status, as at end-December 2006, is shown below:

Table 4.1: Purchase & Assumption of Failed Banks		
S/N	FAILED BANK	ASSUMED BY
1	Allstates Trust Bank	Ecobank Plc
2	Assurance Bank	Afribank Plc
3	Lead Bank	Afribank
4	Trade Bank	UBA Plc

As at end-December, 2006, a total of 1,287 OFIs, comprising seven hundred and fifty (750) Community Banks (CBs), seven (7) Microfinance Banks (MFBs), one hundred and twelve (112) Finance Companies (FCs), ninety one (91) Primary Mortgage Institutions (PMIs), three hundred and twenty-two (322) Bureaux De Change (BDCs), and five (5) Development Finance Institutions (DFIs) were operating in the country.

Self-regulation among the operating FCs, under the aegis of the Finance Houses Association of Nigeria (FHAN), was strengthened through the introduction of a code of ethics/professionalism guidelines.

During the year, 185 applications for MFB licences were received, while 381 existing CBs submitted their conversion plans. Out of the total applications received, 7 final licences and 9 approvals-in-principle (AIPs) were granted. Also, 4 provisional approvals were granted to convert to MFBs, while Two (2) CBs were formalising their exit procedures. In line with the consolidation of the insurance sub-sector which commenced in 2005, a number of measures to raise additional funds in the capital market were taken by the operators in 2006. These included private placements, public offers, rights issues and initial public offerings. In addition, a number of insurance companies signed Memoranda of Understanding (MoUs) to merge with other companies in order to meet the February 28, 2007 deadline.

4.1.2 Fraud and Forgery

The number of reported cases of attempted or successful fraud and/or forgery in the banking industry declined in 2006. There was a total of 1,193 reported cases of attempted fraud and forgery involving N4.6 billion, US\$1.8 million and £14,399.7, compared with 1,229 reported cases involving N10.4 billion, US\$1.4 million, £35,840.0 and €116,310.0 in 2005. Out of this number, 612 cases were successfully executed by the perpetrators and resulted in losses to the banks amounting to N2.6 billion, US\$1.3 million and £14,399.7, compared with N5.5 billion, US\$728,347.0, £30,085.0 and €10,255.0 in 2005.

4.1.3 Public Complaints Desk

The ethics and professionalism sub-committee of the Bankers' Committee handled complaints among banks, as well as between banks and their customers. As in the preceding years, most of the complaints concerned, among others, excess charges by banks, manipulation and fraudulent practices on customers' accounts, conversion of invested funds, irregular clearing of customers' cheques, and non-refund of wrong debit to customers' accounts.

4.1.4 Cheque-Clearing

The implementation of the Cheque Standard and Printer Accreditation Scheme during the year boosted public confidence in the retail payments segment. The volume and value of cheques cleared in the system rose by 1.8 and 18.5 per cent to 14.3 million and N16.5 trillion, respectively. Lagos, as a clearing zone, accounted for 52.0 per cent (7.8 million) and 44.5 per cent (N7.3 trillion), respectively, of the volume and value of cheques cleared through the system. Abuja followed with 7.6 per cent (1.1 million) and 16.7 per cent (N2.8 trillion) of total cheques cleared. Others accounted for the balance.

Table 4.2: Volume and Value of Cheques Cleared

	2005		2006	
	Volume	Value (N' Billion)	Volume	Value (N' Billion)
Clearing System	14,658,511	13,915.4	14,927,414	16,492.1
Lagos Clearing House	7,435,977 (50.7 %)	6,466.5 (46.5%)	7,759,599 (52.0%)	7,332.1 (44.5%)
Abuja Clearing House	1,115,973 (7.6%)	2,059.1 (14.8%)	1,130,175 (7.6%)	2,749.0 (16.7%)
Others	6,106,561 (41.7%)	5,389.5 (38.7%)	6,037,640.0 (40.4%)	6,411.0 (38.9 %)

Figure 4.1: Volume of Cheques Cleared

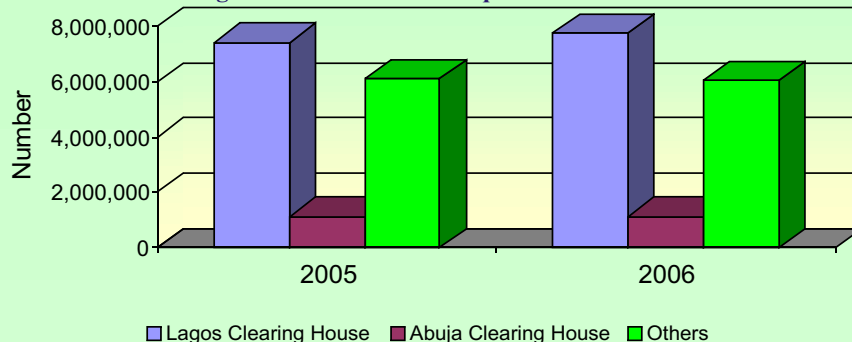
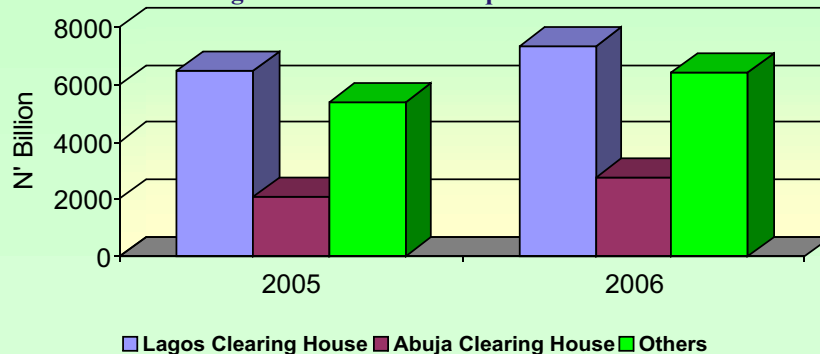


Figure 4.2: Value of Cheques Cleared



4.1.5 Inter-bank Funds Transfer (IFT)

Wholesale payments were effected during most of 2006 through the Nigeria Inter-Bank Settlement System (NIBSS). The volume of inter-bank funds transfers dropped by 32.4 per cent to 92,908, while its value rose by 4.4 per cent to N29.2 trillion. The volume of transactions relative to the preceding year reflected the decline in the number of deposit money banks, a fall-out of the bank consolidation exercise. The Temenos T24 banking application and the CBN Inter-Bank Funds Transfer System (CIFTS) became operational in 2006. With 25 DMBs and 5 Discount Houses as member institutions, the CIFTS, which became operational in mid-December 2006, recorded transactions valued at N1.1 trillion. In addition, the new monetary policy framework which commenced on December 11, 2006 boosted inter-bank transactions.

4.1.6 Use of e-Payment Products

The electronic payments market in Nigeria deepened further during the year in review with the introduction of new products, such as loyalty cards, naira-denominated credit cards and other on-line products. The development enhanced the efficiency of funds intermediation in the banking system. The volume and value of electronic card-based transactions in 2006 were 13.0 million and N86.2 billion, respectively. However, activities through off-line, point-of-sale terminals (POS) declined during the year due to public preference for on-line transactions. POS transactions in volume and value terms were 763,866 and N20.2 billion, down by 21.7 per cent and 51.7 per cent, respectively, relative to the levels in 2005.

In contrast, the volume and value of transactions in the foreign currency-denominated segment increased substantially by 240.4 and 237.8 per cent, respectively, owing to increased public awareness. Similarly, the automated teller machines (ATM) segment recorded significant patronage as its volume and value of transactions increased, relative to the 2005 levels, by 247.8 and 265.3 per cent respectively to 12.1 million and N63.2 billion. The substantial increase in activities in this segment reflected growing public confidence and access to ATMs, which increased to 776 from 425 in 2005. ATM transactions accounted for 93.1 and 73.4 per cent in volume and value of total card-based transactions, respectively, in 2006.

Figure 4.3: Volume of Electronic Card-based Transactions in 2006

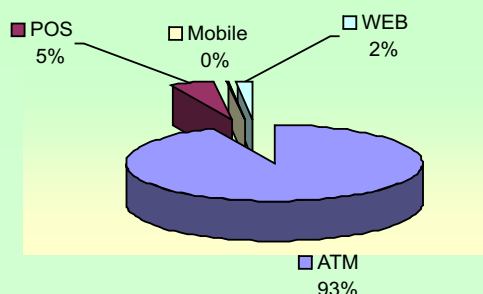
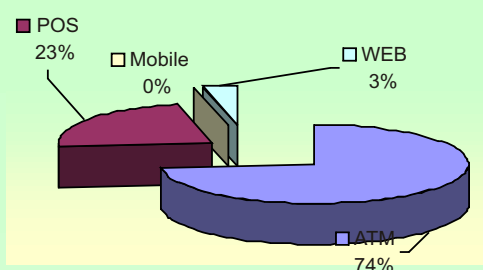


Figure 4.4: Value of Electronic Card-based Transactions in 2006

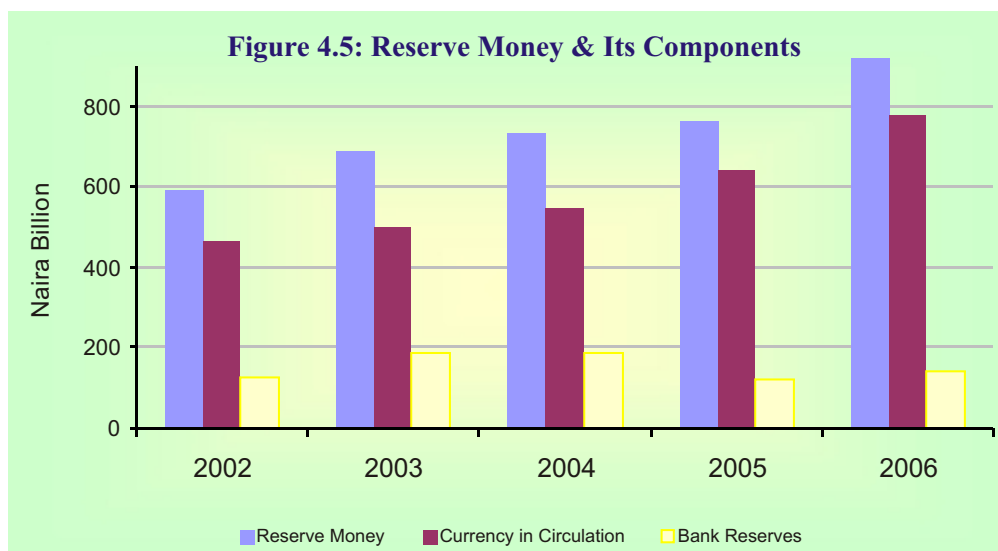


Internet and mobile phone banking has also become a feature of the Nigerian banking payments system. The volume and value of web-enabled transactions and mobile banking transactions through the GSM were 222,210 and N3.0 billion and 40,733 and N97.5 million, respectively.

During the first quarter of the year, the Nigerian Postal Service (NIPOST) made a re-entry into the payments arena with the introduction of PostCash, which enabled electronic funds transfers across all post offices nationwide. The total volume and value of PostCash transactions during the year stood at 5,125 and N65.5 million, respectively.

4.1.7 Institutional Savings

Aggregate financial savings rose by N667.7 billion or 56.0 per cent to N1,867.8 billion at end-December 2006, compared with N1,200.1 billion at the end of the preceding year. Relative to nominal GDP, the ratio of financial savings to GDP was 10.1 per cent, compared with 8.2 per cent in 2005. The development in 2006 reflected the faster growth of the former vis-à-vis the latter, which improved the ratio. The DMBs maintained their dominance as the major depository institutions within the financial sector. They accounted for 94.0 per cent of the total financial savings, compared with 90.8 per cent in the preceding year. Other sources of savings, including the PMIs, Life Insurance Funds, the Nigerian Social Insurance Trust Fund, and Community Banks held the balance of 6.0 per cent.

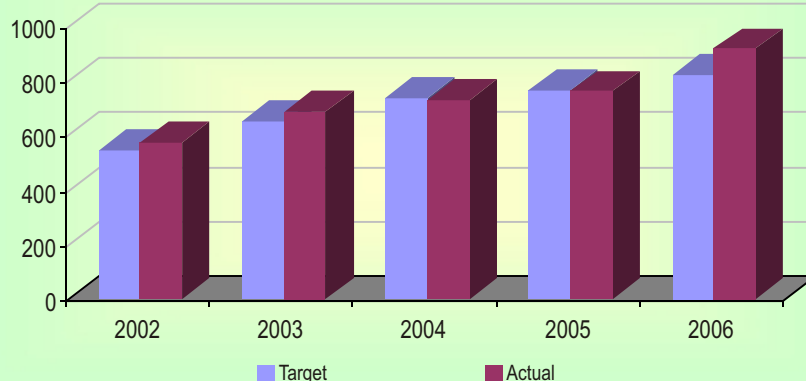


4.2 MONETARY AND CREDIT DEVELOPMENTS

4.2.1 Reserve Money

Despite the proactive monetary policy measures adopted by the CBN in 2006, the reserve money target was missed. The reserve money (RM) at end-December 2006 was N918.9 billion, compared with the target of N820.0 billion.

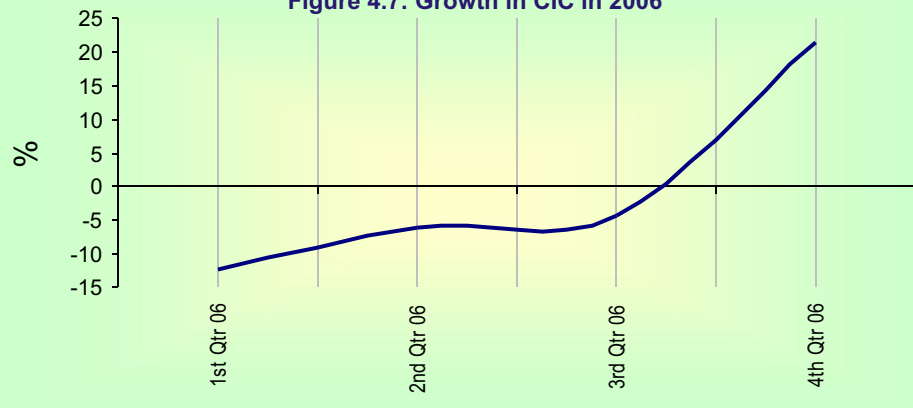
The non-attainment of the RM target at the end of 2006 largely reflected the effect of the unexpected rapid growth in currency in circulation (CIC) in the fourth quarter. Apart from the normal seasonal upward movement in CIC during that time of the year (in response to Christmas/New year and Muslim festivities) the pre-election activities of the various political parties in December 2006 contributed significantly to the observed trend.

Figure 4.6: Reserve Money Target & Outcome (₦b)

Relative to the end-2005 level, the currency component of reserve money declined by 12.3, 6.2 and 4.2 per cent respectively at the end of the first, second and third quarters of 2006. However, it rose sharply by 21.3 per cent at the end of the fourth quarter, due to the factors mentioned above. Similarly, DMBs' reserve balances at the CBN rose by 15.9 per cent as banks took advantage of the CBN deposit and lending facilities and the investment in special treasury bills.

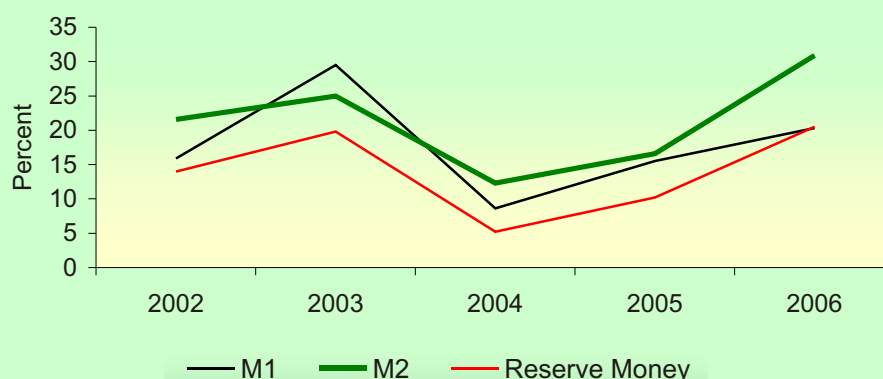
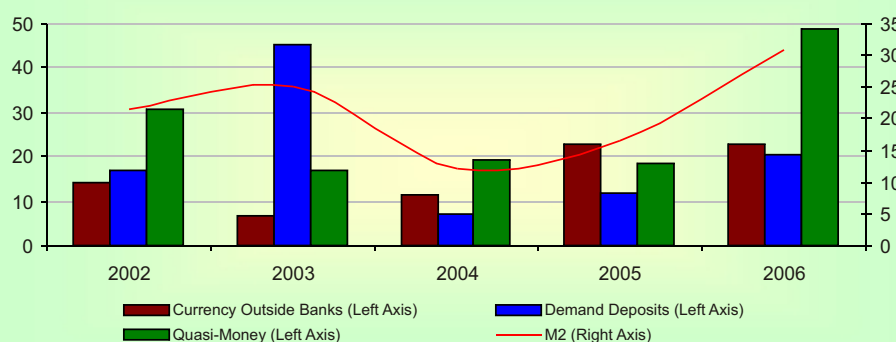
4.2.1 Narrow Money (M1)

The narrow money supply (M1), consisting of currency outside banks (COB) and demand deposits held by the public, grew by 20.3 per cent at end-2006, compared with the 15.5 per cent growth at end-2005. Currency held by the public increased by 22.7 per cent, while demand deposits grew by 19.0 per cent. As a proportion of M1, currency outside banks was 34.7 per cent at end 2005, compared with 37.3 per cent at end-2006. Relative to nominal GDP, the COB to GDP ratio fell marginally to 3.8 per cent at end-2006, from the 3.9 per cent at end-2005.

Figure 4.7: Growth in CIC in 2006

4.2.3 Broad Money (M2)

Broad money supply (M2) grew by 30.6 per cent at end-2006 to N3,190.9 billion, compared with the end-year target growth of 27.8 per cent. In addition to the expansion in the narrow money, quasi-money grew significantly during the year by 48.9 per cent. The growth in quasi-money was in response to the increase in time deposit rates in the continued efforts of banks to match increased competition in the deposit market following the consolidation, as well as the growing public confidence in the banking system.

Figure 4.8: Growth in Monetary Aggregates**Figure 4.9: Growth in the Components of Broad Money (M2) (%)**

Factors Influencing Broad Money Growth

4.2.3.1 Net Foreign Assets (NFA)

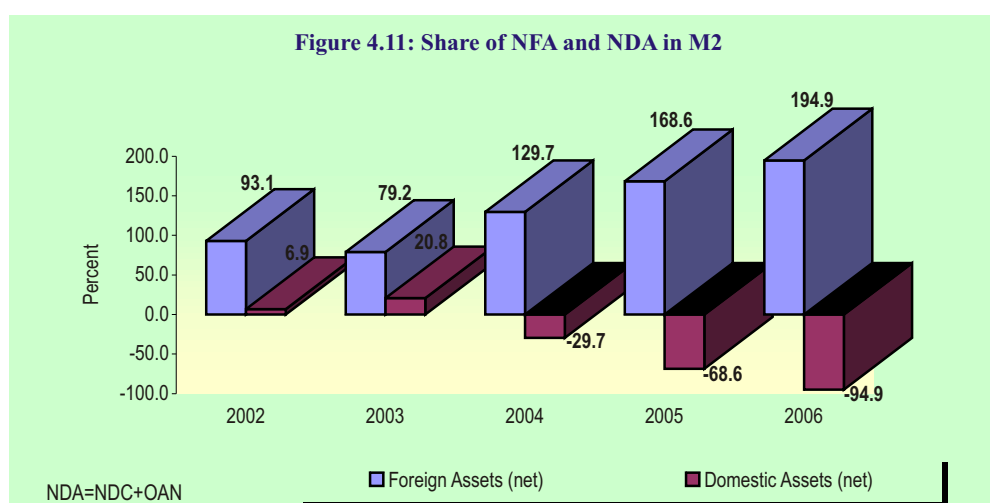
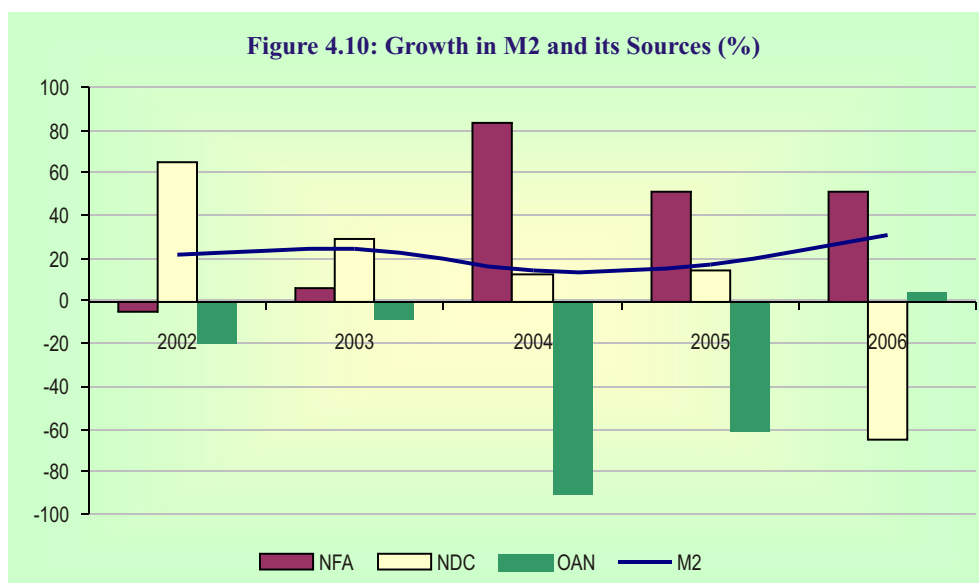
The increase in the components of monetary liabilities was accounted for largely by the substantial increase in the Net Foreign Assets (NFA) of the banking system. NFA rose by 51.3 per cent over its level at end-2005, owing to the favourable crude oil prices in the international oil market. As a share of M2, NFA, at 194.9 percent at end-2006, continued to surge, maintaining the dominance observed in the last five years, compared with 168.9 percent in 2005 and an average of 100.7 percent during the previous three years, 2002-2004.

4.2.3.2 Net Domestic Credit (NDC)

Credit to the domestic economy fell by 65.0 per cent at end-2006, in contrast to the increase of 14.5 per cent at end-2005, thus moderating the growth in M2. The development reflected, entirely, the significant decline in net credit to the Federal Government, as a result of the huge earnings from crude oil exports, which enhanced government's revenue profile and buoyed its deposits with the banking system. Thus, the Federal Government was a net creditor to the banking system as a whole during 2006.

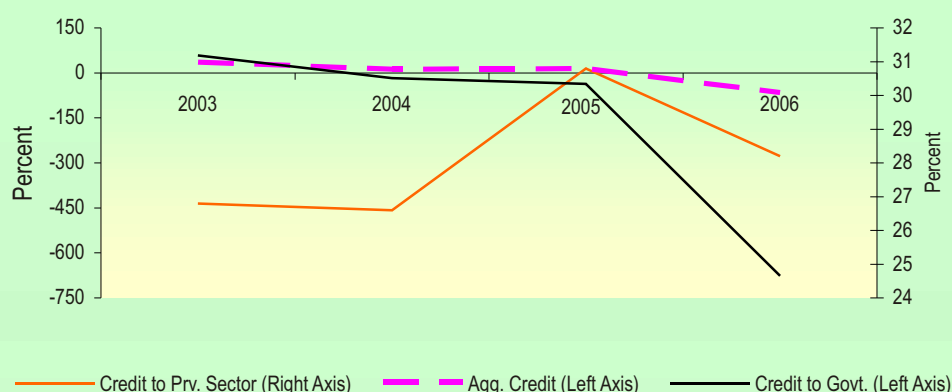
4.2.3.3 Credit to the Government

Net credit to the Federal Government (Cg) fell dramatically by 676.2 per cent, compared with the decline of 40.0 per cent programmed for fiscal 2006 reflecting, largely, the increase in Federal Government deposits with the banking system, especially with the CBN.



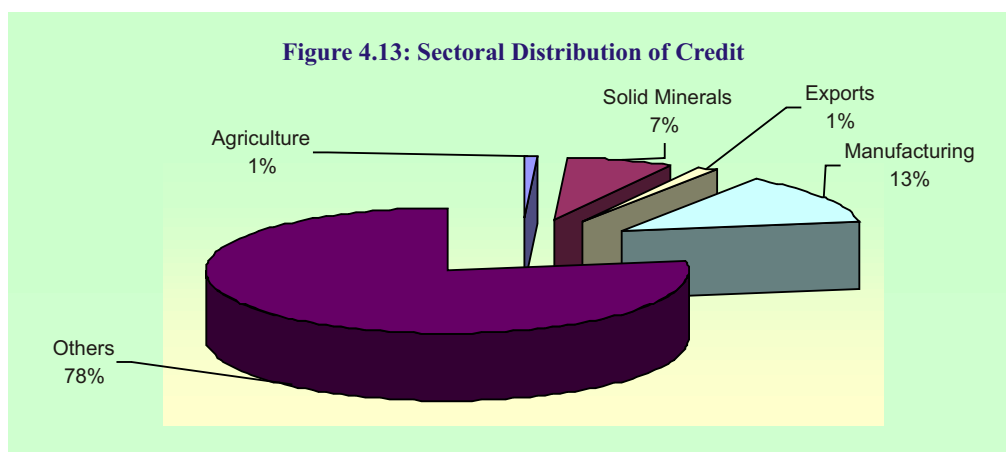
4.2.3.4 Credit to the Private Sector

Credit to the private sector (including the State and Local Governments, non-financial public enterprises and the core private sector) over-shot its target of 14.5 per cent for the year, as it grew by 28.2 per cent over the level at end-2005. The impact of this on NDC was more than offset by the decline in credit to the Federal Government (net). The major share of the increase in credit to the private sector was absorbed by the core private sector.

Figure 4.12: Growth in Domestic Credit

4.2.4 Sectoral Distribution

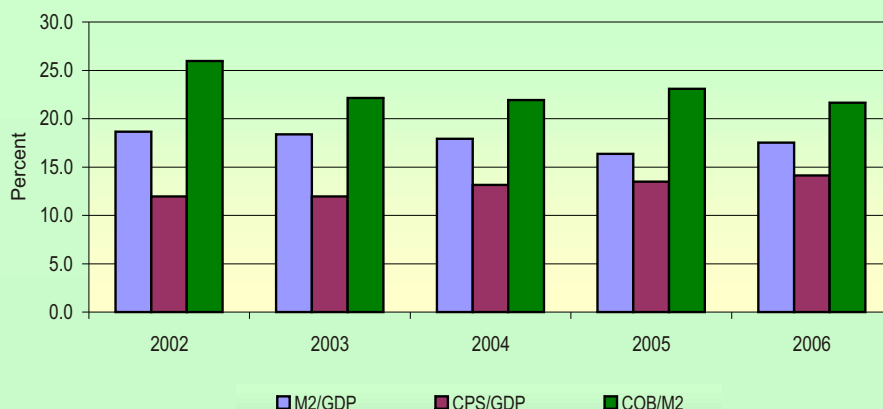
Credit to the core private sector by the DMBs grew by 27.1 per cent or N525.5 billion. Of the N2,462.1 billion outstanding DMBs credit to the core private sector, credit to priority sectors constituted 22.5 per cent. Specifically, 0.9, 7.2, 1.3 and 13.1 per cent of outstanding credit went to agriculture, solid minerals, exports and manufacturing, respectively. Unclassified sectors accounted for the balance of 77.5 per cent.

Figure 4.13: Sectoral Distribution of Credit

4.2.5 Financial/Banking System Ratios

The depth of the financial sector, as measured by the ratio of M2 to GDP, stood at 17.5 per cent at end-2006, indicating a slight improvement when compared with the pre-consolidation outcome of 16.4 at end-December 2005, reflecting a marginal increase in financial deepening of the economy. Thus, the banking system showed a greater capacity to provide liquidity for the exchange of goods and services during the year relative to the pre-consolidation period. Bank financing of the economy, measured by the ratio of banking system credit to the core private sector (Cp) to GDP stood at 14.1 per cent at end-2006, a slight improvement when compared with 13.5 per cent at end-2005. Furthermore, the intermediation efficiency indicator, as measured by the ratio of currency outside banks to broad money supply, improved modestly to 21.7 per cent at end-2006 from 23.1 per cent at end-2005. The development reflected, partly, the impact of the increase in electronic forms of payments, particularly the use of ATM and other card products.

Figure 4.14: Ratio of Broad Money (M2) and Credit to Private Sector (CPS) to GDP and Currency Outside Banks (COB) to M2

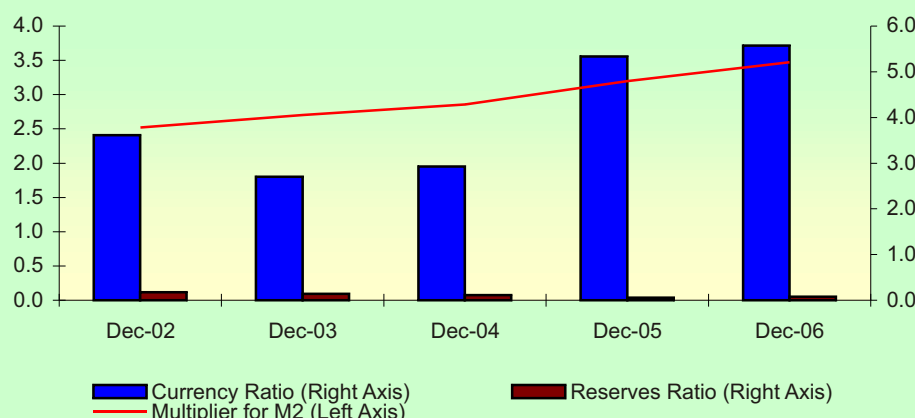


The size of the banking system, relative to the size of the economy, showed an improvement in 2006. The ratio of the CBN assets to GDP increased from 30.2 per cent in 2005 to 56.7 per cent in 2006. Similarly, the ratio of DMBs assets to GDP increased from 31.0 per cent at end-2005 to 35.4 per cent at end-2006.

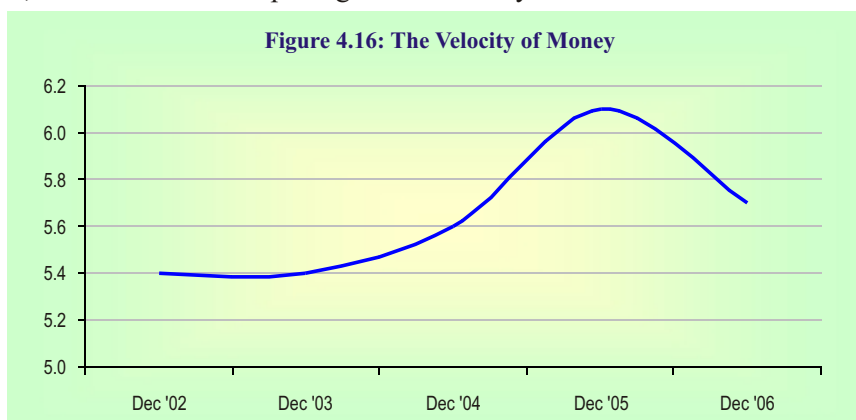
4.2.6 Money Multiplier

The broad money multiplier at end-December 2006 was 3.5, compared with 4.1 programmed for the year and the 3.2 at the end of 2005. The rise in the multiplier, relative to end-2005, was due to a number of factors including: the reduction in the cash reserve requirement from 5.0 per cent to 3.0 per cent in December 2006, and the increase in the use of electronic money which contracted the currency-deposit ratio. The currency-deposit ratio, which stood at 30.5 per cent at end-2005, fell to 28.2 per cent at end-2006, reflecting the substantial increase in total deposit liabilities of DMBs. However, the reserve-to-deposit ratio declined from 0.8 per cent at end-2005 to 0.6 per cent at end-2006 owing, largely, to the impact of the new monetary policy framework on banks' excess reserve balances and the reduction in CRR towards the end of the year.

Figure 4.15: Money Multiplier, Currency Ratio and Reserves Ratio



The income velocity of circulation of broad money remained unstable at end-2006. The M2 income velocity, which stood at 6.1 at end 2005, fell slightly to 5.7 at end-2006. This development may be reflecting the role of institutional factors, such as financial deepening in the economy.



4.3 OTHER FINANCIAL INSTITUTIONS

4.3.1 Development Finance Institutions (DFIs)

Five DFIs rendered returns to the Bank, compared with four in the preceding year. The reporting DFIs were: the Bank of Industry (BOI), the Federal Mortgage Bank of Nigeria (FMBN), the Nigerian Export Import Bank (NEXIM), the Nigerian Agricultural, Co-operative and Rural Development Bank (NACRDB) and the Urban Development Bank (UDB). Aggregate assets of the DFIs indicated an increase of 45.1 per cent over the level in the preceding year. Analysis of the assets base of the five institutions also indicated that the NACRDB accounted for 37.2 per cent of the total, while the FMBN, NEXIM, BOI and the UDB accounted for 34.8, 16.0, 11.0, and 1.0 per cent of the total, respectively.

Cumulative loan disbursements by the five institutions increased marginally by 0.9 per cent to N169.7 billion. The composition of the loan disbursements indicated that the UDB had the highest of N128.24 billion (75.6 per cent), while the NACRDB, the FMBN, NEXIM and BOI accounted for N17.23 billion (10.2 per cent), N9.80 billion (5.8 per cent), N7.97 billion (4.7 per cent) and N6.44 billion (3.8 per cent), respectively.

Analysis of the assets portfolio of the DFIs indicated a general deterioration in quality with the exception of BOI. The total capitalization for the five DFIs stood at N21.82 billion as at end-December 2006, a far cry from what is required for these institutions to play their expected role of financing development projects in the economy. The paid-up share capital of NEXIM, however, increased by N3.76 billion from N6.69 billion in 2005, to N10.46 billion in 2006, through additional capital injection by both the Federal Ministry of Finance and the CBN.

4.3.2 Microfinance Banks (MFBs)

Forty (40) applications for MFB licences from new investors, 1 application for the transformation of an existing NGO-MFI and 144 applications for conversion from existing CBs were received, while 381 other existing CBs submitted their conversion plans.

To further facilitate the conversion process and reduce the cost, the Bank granted a waiver of the application for change of name and licensing fees for all existing CBs. Following an appeal by the CBN, the Corporate Affairs Commission (CAC) also granted a 50 per cent reduction in the filing fees payable by all converting CBs. In order to ensure the sound corporate governance and risk management practices of the MFBs, a certification programme was initiated in 2006.

4.3.3 Community Banks (CBs)

The total assets/liabilities of the reporting CBs rose by 19.5 per cent to N55.06 billion in 2006, from N46.06 billion in 2005. The paid-up capital increased by 43.7 per cent from N5.78 billion in 2005 to N8.30 billion in 2006, while the shareholders' fund increased by 23.9 per cent from N10.28 billion in 2005 to N12.74 billion in 2006. Loans and advances granted by the reporting banks rose from N14.55 billion in 2005 to N16.50 billion, in 2006, representing a growth of 13.4 per cent.

4.3.4 Discount Houses

Analysis of the activities of the five Discount Houses indicated a significant improvement in 2006. Their total assets/liabilities rose by 87.8 per cent to N185.5 billion, while the total funds sourced amounted to N91.9 billion, compared with N37.3 billion in 2005. The funds were sourced mainly from non-bank customers (N41.9 billion) and money-at-call (N42.0 billion), among others. The funds were utilized mainly in the purchase of Federal Government securities of less than 91-days maturity (N36.2 billion), loans to banks (N31.6 billion) and loans to non-bank customers (N13.4 billion). Discount houses' investments in Federal Government securities of less than 91 days maturity amounted to N70.2 billion as at end-December 2006, representing 44.8 per cent of their total deposit liabilities. This was 15.2 percentage points below the prescribed minimum of 60.0 per cent for fiscal 2006.

4.3.5 Finance Companies (FCs)

The total number of licensed FCs remained unchanged at 112 as no new licence was granted in 2006. Total capitalization stood at N11.4 billion as at end-December 2006, compared with N9.5 billion as at end-December 2005.

The total assets/ liabilities of the FCs increased from N37.5 billion in 2005 to N54.3 billion in 2006, representing a growth of 44.8 per cent. Loans and advances increased by 46.0 per cent, from N16.3 billion in 2005 to N23.8 billion in 2006. Placements with other FCs increased by 25.6 per cent, from N7.4 billion in 2005 to N9.3 billion in 2006. Total borrowings increased by 51.7 per cent, from N22.8 billion in 2005 to N34.6 billion in 2006, while the shareholders' funds rose by 20.0 per cent from N9.5 billion in 2005 to N11.4 billion in 2006. Investible funds accruing to the sub-sector in the year under review increased by N13.9 billion, from N32.2 billion in 2005 to N46.1 billion in 2006. The funds were sourced mainly from increases in borrowings (N11.8 billion) and reserves (N2.1 billion), amongst others, and were used mainly to increase loans and advances (N7.5 billion).

4.3.6 Primary Mortgage Institutions (PMIs)

The total number of licensed PMIs remained at 91 as no new PMI was licensed in 2006. However, approval was given to five (5) PMIs to restructure their capital base, while another PMI increased its capital through a rights issue. Total capitalization rose from N11.60 billion in 2005 to N15.55 billion in 2006, representing an increase of 34.1 per cent.

The total assets of the PMIs, which stood at N99.9 billion as at end-December 2005, rose by 14.5 per cent to N114.39 billion as at end December 2006. Investible funds available to the PMIs totalled N94.34 billion and comprised deposit liabilities (N74.21 billion), long-term loans/NHF (N7.56 billion) and paid-up capital (N12.57 billion).

4.3.7 Bureaux-de-Change (BDCs)

Following the liberalization of the operations of the BDC sub-sector in 2006, one hundred and ninety-six (196) fresh applications for BDC licences were received, out of which sixty operating licences were approved; eighty-six Approvals-In-Principle were granted; and 50 others were at various stages of processing. Consequently, the number of BDCs licensed (excluding those granted AIPs) rose to 352 as at end-December, 2006, compared with 292 in 2005, an increase of 20.5 per cent while the number of BDCs in operation stood at

312 as at end of the review period. Out of the 312 BDCs, 68.9 percent or 215 were located in Lagos. During the reporting period, 9 BDCs were suspended for various offences against the guidelines.

4.4 MONEY MARKET DEVELOPMENTS

Activities in the money market during the year were influenced by the monetary conditions and the various policy actions by the CBN, including the adjustment of its policy and prudential rates. With the exception of the NTBs segment, activities increased in all other segments, evidenced by the higher value and volume of transactions and an increase in the outstanding assets. Moreover, the newly introduced CBN standing facilities boosted activities in the market, while the restructuring of the NTBs to longer maturities led to an improved yield curve and attracted foreign investments.

Government remained the dominant player in the Nigerian money market, as treasury securities constituted 82.5 per cent of money market assets outstanding as at end-2006, while private sector-issued securities (certificates of deposits, commercial papers and bankers' acceptances) accounted for 17.5 per cent. The depth of the money market, as measured by the ratio of value of money market assets outstanding to GDP, improved slightly from 7.9 per cent in 2005 to 8.8 per cent in 2006, reflecting the effect of the issuance of the 3rd FGN Bonds. However, the size of this ratio in relation to bank financing of the economy (credit to core private sector/GDP 13.5 per cent) underscores the short-term feature of financial markets in Nigeria. The size of private sector securities to GDP, at 1.5 per cent, was relatively small.

4.4.1 Inter-Bank Funds Market

Activities at the inter-bank funds market (inter-bank placements and securities trading) indicated a marked improvement in 2006. The turnover of transactions rose substantially by 113.2 per cent to N11,942.60 billion, from N5,600.60 billion in 2005.

The volume of transactions at the inter-bank funds market rose by 8.9 per cent to 12,319 deals in 2006, from 11,309 deals in 2005. The substantial increase reflected the huge transactions at the open-buy-back segment. The development was attributed to the standardization of cost-of-transactions at N500.00 per transaction, instead of the 0.01 per cent commission charged hitherto.

Table 4.3: Composition of Money Market Assets Outstanding in 2006

Asset	Share in Total (%) in 2005	Share in Total (%) in 2006
Treasury Bills	63.7	43.1
Treasury Certificates	0.0	0.0
Development stocks	0.1	0.0
Certificate of Deposit	0.0	0.0
Commercial papers	14.5	12.6
Bankers' Acceptances	3.1	4.8
FGN Bonds	18.7	39.5

Figure 4.17: Value of Inter-bank Funds Market Transactions

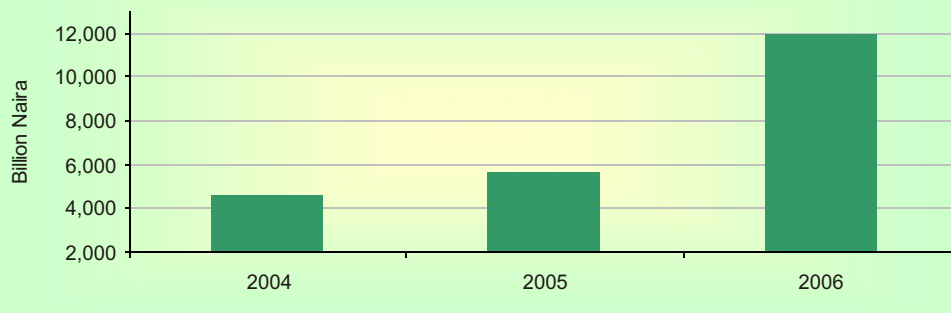
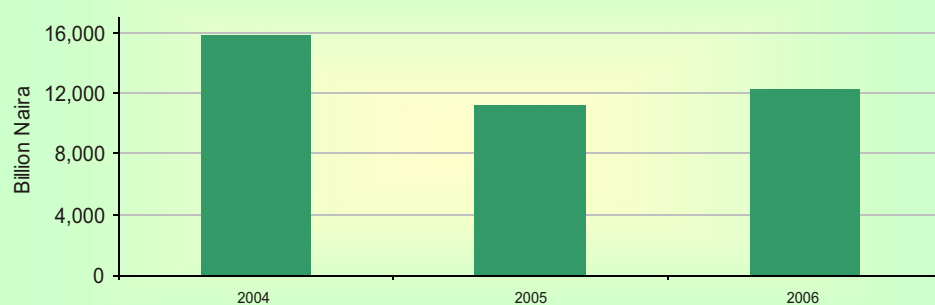
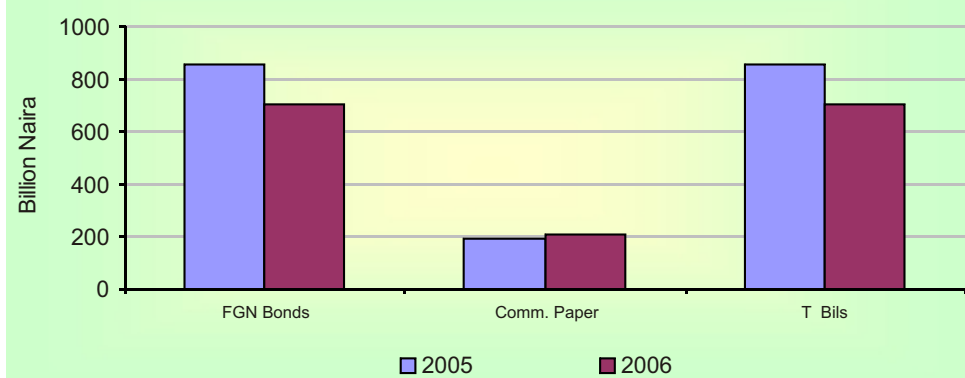


Figure 4.18: Volume of Inter-bank Transactions



The value of transactions at the inter-bank call placement segment fell by 27.1 per cent to N3,788.8 billion in 2006, relative to the level in 2005. At the open-buy-back segment, investment shot up to N8,151.2 billion, from N382.6 billion in 2005. As a proportion of the total value of transactions, the inter-bank call and the open-buy-back segments accounted for 31.7 and 68.3 per cent, respectively, compared with 92.7 per cent and 9.8 per cent, respectively, in 2005.

Figure 4.19: Money Market Assets Outstanding

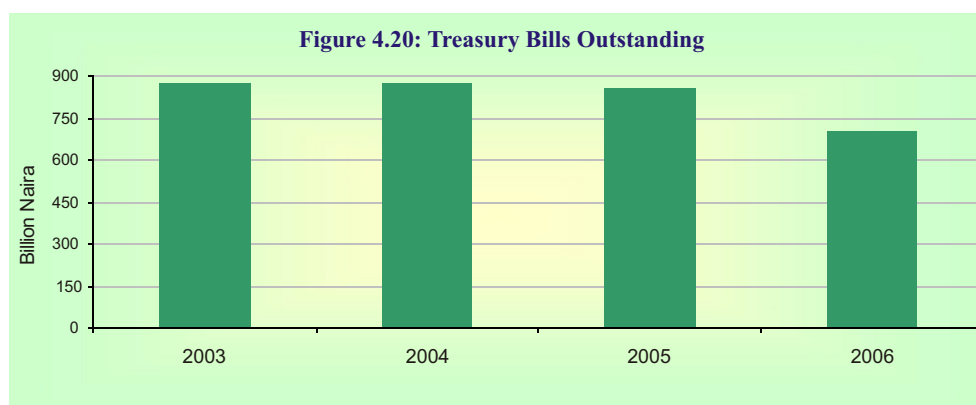


4.4.2 Money Market Assets Outstanding

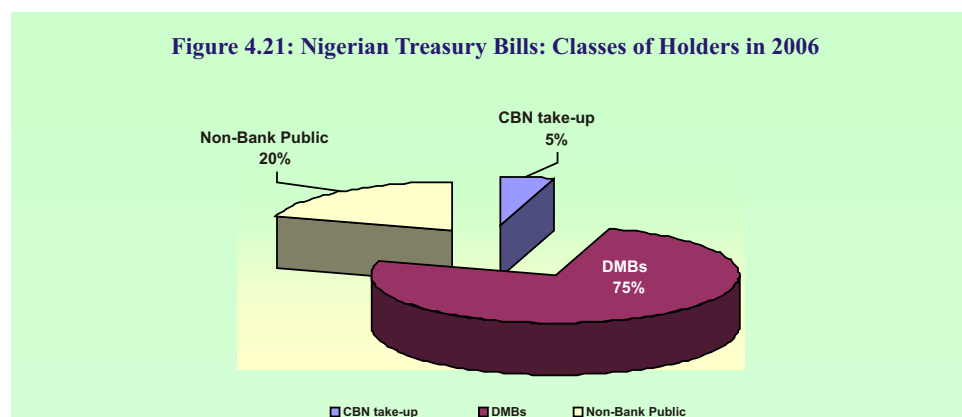
Total money market assets outstanding as at end-December 2006, stood at N1,622.8 billion, an increase of 21.4 per cent when compared with the 34.0 per cent increase at end-2005. The development was traceable to the increase in the value of commercial papers (CPs), Banker's Acceptances (BAs) and FGN bonds outstanding.

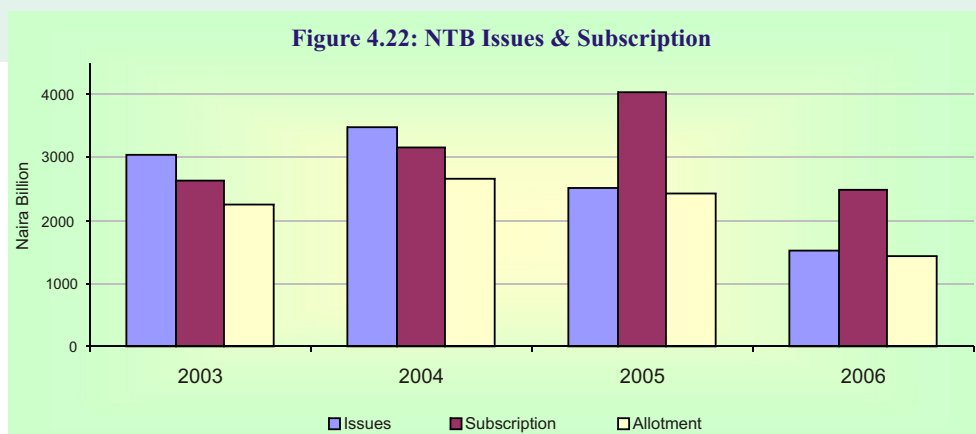
4.4.2.1 Nigerian Treasury Bills (NTBs)

Nigerian Treasury Bills worth N1,509.1 billion were issued during 2006, compared with N2,521.7 billion in 2005, a decrease of 40.4 per cent. The significant decrease resulted from the restructuring of the 91-day NTBs to longer tenors of 182 and 364 days. Consequently, the total outstanding Nigerian Treasury Bills fell from N854.8 billion as at end-December 2005 to N701.4 billion (made up of N695.0 billion NTBs and N6.39 special NTBs) as at end-December 2006, owing to the repayments of matured bills of 91-day tenor.



Public subscription and allotment of the securities stood at N2,486.0 billion and N1,445.3 billion, respectively. The subscription and allotment represented a decrease of 38.4 per cent and 39.8 per cent, when compared with the levels of N4,033.2 billion and N2,434.0 billion, respectively, in 2005. The total CBN take-up stood at N63.8 billion, representing 4.2 per cent of the total issue. Patronage remained appreciable owing to the combined effects of the varying levels of repayments, roll-overs and the smoothening of issue amounts.





4.4.2.2 Commercial Papers (CPs)

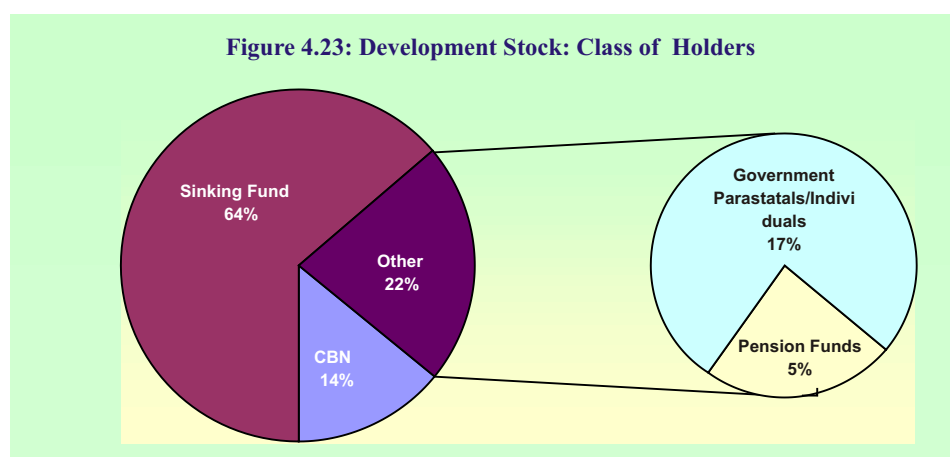
Investment in Commercial Papers (CPs), as a supplement to bank credit to the private sector, maintained an upward trend. The value of CPs held by DMBs rose by N10.0 billion to N204.6 billion at end-December 2006, compared with an increase of N105.8 billion at end-December 2005. Thus, CPs constituted 12.6 per cent of the total value of money market assets outstanding as at end-2006, compared with 14.5 per cent at the end of the preceding year.

4.4.2.3 Bankers' Acceptances (BAs)

Holdings of BAs by DMBs rose by 90.9 per cent to N78.5 billion as at end-December 2006, as against the decline of 1.0 per cent in 2005. The rise reflected increased investments by deposit money banks and discount houses. Consequently, BAs accounted for 4.8 per cent of the total value of money market assets outstanding at end-2006, compared with 3.1 per cent in 2005.

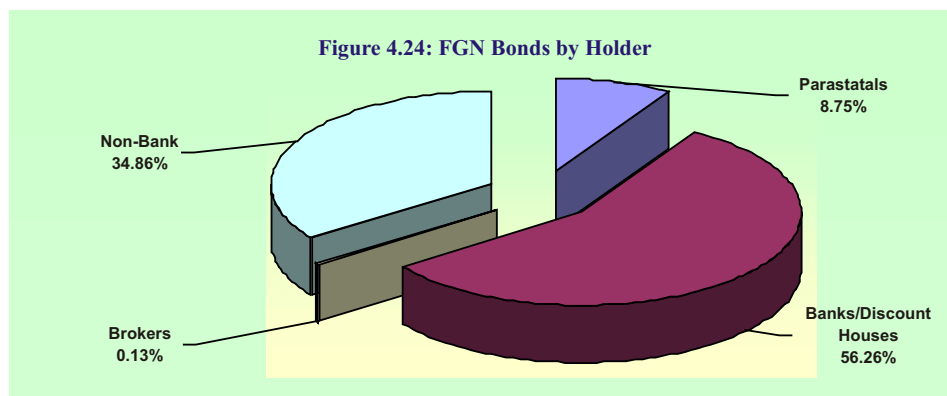
4.4.2.4 Development Stock (DS)

A total of N0.72 billion DS was outstanding by end-December 2006, down by 26.5 per cent from the level recorded in 2005. The decrease was accounted for by the redemption of the 11.75 per cent FRN 24DS and 8.0 per cent FRN 20DS that matured in the year. Of the amount outstanding at end-2006, the CBN held a total of N0.10 billion, compared with the N0.16 billion held in 2005. Holdings on the account of sinking funds stood at N0.46 billion, down from N0.62 billion in the preceding year. Holdings by other institutions amounted to N0.15 billion, down from N0.20 billion in the preceding year.

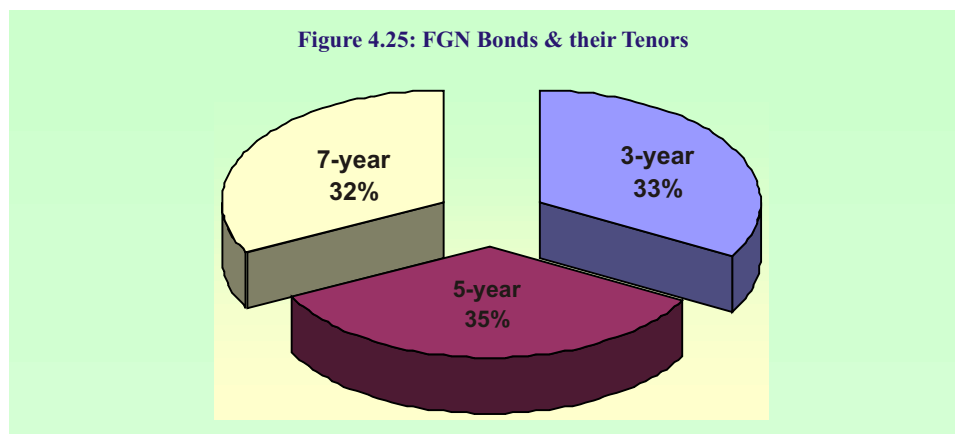


4.4.2.5 FGN Bonds

In line with the efforts of the Federal Government to restructure its domestic debt profile, develop a virile bonds market and promote economic development, the Debt Management Office (DMO), in collaboration with the CBN, issued the 3rd FGN Bonds Series 116, with tenors of three (3), five(5) and seven(7) years. The CBN acted as the issuing house and registrar to all the series.



The total issue of all three series was N282.10 billion, indicating an increase of N103.83 billion over the N178.27 billion issued in 2005. Public subscription for the bonds was remarkable at N613.4 billion, representing an over-subscription of N332.8 billion or 118.6 per cent. Out of the total sale of N282.1 billion, 32.9 per cent was for the 3-year tenor, 34.7 per cent for the 5-year, while the balance of 32.4 per cent was for the 7-year tenor. Special bonds of 3-year tenor worth N75.0 billion and 5-year tenor worth N91.8 billion were also issued during the year to settle outstanding pension arrears as well as offset local contractors' debt. The coupon rates for all the issues in 2006 ranged between 10.98 and 16.00 per cent, compared with 8.0-17.0 per cent in 2005. In 2006, total foreign investment in FGN Bonds was N51.91 billion.



4.4.3 Open Market Operations (OMOs)

Open Market Operations (OMOs) were conducted throughout the year on a daily basis with the aim of effectively managing liquidity in the system. The instruments used for the conduct of OMOs were the NTBs, Treasury Bonds, CBN bills and the recently approved non-rediscountable special NTBs which helped to bridge the supply shortages that were experienced following the dearth of NTBs. Total subscription and sales of the intervention securities was N2,270.20 billion and N1,808.40 billion respectively, compared with N1,247.3 billion and N989.9 billion in 2005. The breakdown of sales in 2006 showed that special NTBs and regular NTBs accounted for N1,423.32 billion and N145.2 billion, respectively, while Nigerian Treasury Bonds and CBN

Bills accounted for N136.8 billion and N103.12 billion, respectively. The total value of sales also included roll-overs of matured investment of excess reserves from the reduction of the CRR totalling N145.7 billion in the months of April, July and October 2006, respectively.

The increased sales could be attributed to a number of factors, amongst which were: (i) the rollover of the N145.7 billion in 91-day, non-rediscountable special NTBs, (ii) the attractive rates offered at the open market, (iii) the supply shortage of long tenored instruments offered at the primary market, and (iv) the distribution and injection into the economy of N570.0 billion excess crude oil proceeds.

4.4.4 Discount Window Operations

4.4.4.1 Reverse Repo Transactions

Reverse repo transactions amounted to N10,301.8 billion, indicating an increase of 96.2 per cent, compared with N5,249.9 billion in 2005. The development was largely influenced by the liquidity surfeit in the system. The CBN ensured that DMBs did not close with huge reserve balances in their accounts at the end of each business day. The applicable rate for the normal reverse repo remained at 0.4 per cent, while it was 0.1 per cent for the special reverse repo.

4.4.4.2 Repo Transactions

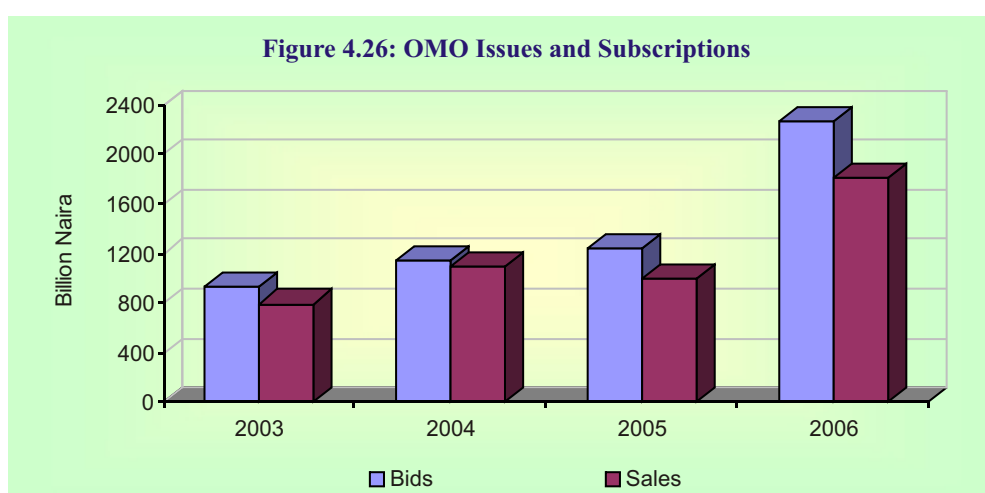
Total value of repo transactions amounted to N411.04 billion, down from N902.0 billion in 2005. Repo transactions were quite low, owing to the liquidity surfeit during much of the year. However, in November 2006, the repo window which had been temporarily closed was re-opened in order to stem the rise in interest rates at the inter-bank market. The tenor for the repo deals remained one to seven days.

4.4.4.3 Bills Rediscounting

In 2006, rediscounts totalled N261.0 billion, a decline of 61.1 per cent, when compared with N671.3 billion in 2005. The fall reflected the liquidity surfeit experienced during the year. However, in the absence of the initial recourse to the CBN for repo facilities, customers had to re-discount their bills.

4.4.4.4 Open-Buy-Back

Open Buy-Back transactions in 2006 fell by 20.3 per cent, compared with N13,914.01 billion rediscounted in 2005. The decline was partly due to the repo investments made available to the DMBs and the introduction of CBN standing facilities.



4.4.5 CBN Standing Facilities

The CBN standing facilities was introduced in December 2006 and constitutes the hub of the new framework for monetary policy implementation designed to stabilize money market rates. The lending and deposit facilities provide the rates corridor within which market players with securities are expected to trade. The facilities became operational on December 11, 2006. The Monetary Policy Rate (MPR), which replaced the erstwhile Minimum Rediscount Rate (MRR) as the nominal anchor for interest rates, was fixed at 10.00 per cent with an interest rate corridor operated at a 600 basis point band, 300 basis points above and 300 basis points below (7.00 to 13.00 per cent). These facilities provide banks with investment windows (deposit facilities) that enable them to invest their excess reserves or borrow funds (lending facilities) at reasonable interest rates when they are short overnight.

4.4.5.1 Deposit Facilities

The cumulative deposits made, as at end-December 2006, amounted to N82.44 billion. The low level of deposits could be attributed to the fact that the market was short during the period under review.

4.4.5.2 Lending Facilities

The lending facility was actively utilized by banks and discount houses that were short, during the year. The cumulative amount lent in the period under review was N1,350.46 billion, thereby resulting in a net lending of N1,267.02 billion by end-2006.

4.5 CAPITAL MARKET DEVELOPMENTS

4.5.1 The Nigerian Stock Exchange

Activities on the floor of the Nigerian Stock Exchange in 2006 indicated improved performance. The aggregate volume and value, as well as the total number of transactions in the secondary market rose. Market capitalization of the 288 listed securities increased by 76.6 per cent to close at N5.12 trillion, compared with N2.9 trillion or an increase of 50.6 per cent recorded in the preceding year. The development was attributable to the listing of new securities and improved corporate results which led to a rise in stock prices. The banking sub-sector accounted for 41.8 per cent of the market capitalization at the end of the year. The major capital market development indicators showed substantial improvements. Market capitalization was 28.1 per cent of GDP in 2006, compared with 19.5 per cent in 2005. The ratio of the value of stocks being traded to GDP stood at 2.6 per cent in 2006, compared with 1.8 per cent in 2005, while the turnover (measured as the ratio of the total value of stocks being traded to the total value of stocks listed on the domestic market) was 9.2 per cent, compared with 9.1 per cent in 2005. Twelve additional stocks were listed during the period under review.

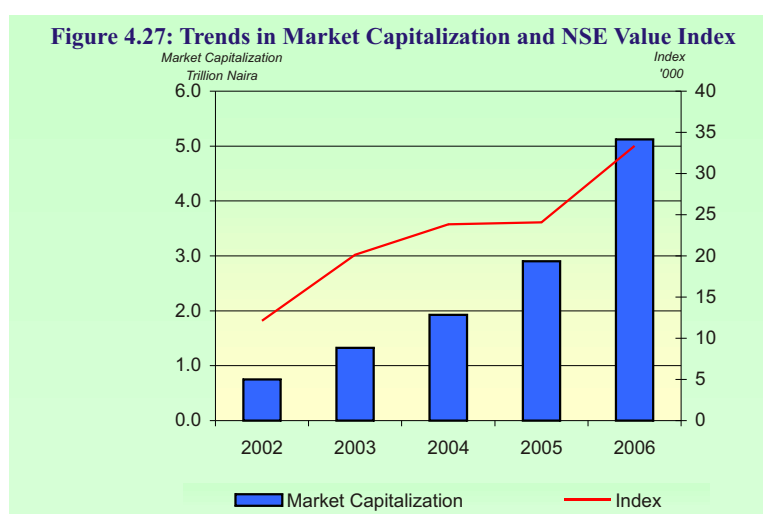


Table 4.4: Indicators of Capital Market Developments (NSE)

	2002	2003	2004	2005	2006
Number of Listed Securities	258	265	277	288	288
Volume of Stocks Traded (Turnover Volume) (Billion)	6.6	13.3	19.2	26.7	36.5
Value of Stocks Traded (Turnover Value) (Billion Naira)	59.4	120.4	225.8	262.9	470.3
Value of Stocks/GDP (%)	0.7	1.2	1.9	1.8	2.6
Market Capitalization (Billion Naira)	747.6	1324.9	1925.9	2900.1	5120.9
<i>Of which: Banking Sector (Billion Naira)</i>	<i>233.5</i>	<i>354.1</i>	<i>662.7</i>	<i>1212.1</i>	<i>2142.7</i>
Market Capitalization/GDP (%)	9.4	13.1	16.5	19.5	28.1
<i>Of which: Banking Sector/GDP (%)</i>	<i>2.9</i>	<i>3.5</i>	<i>5.7</i>	<i>8.1</i>	<i>11.8</i>
Banking Sec. Cap./Market Cap. (%)	31.2	26.7	34.4	41.8	41.8
Annual Turnover Volume/Value of Stock (%)	11.1	11.0	8.5	10.1	7.8
Annual Turnover Value/Market Capitalization (%)	7.9	9.1	11.7	9.1	9.2
NSE Value Index of Equities(1984=100)	12,137.7	20,128.9	23,844.5	24,085.8	33,358.3
Growth (In percent)					
Number of Listed Securities	1.2	2.7	4.5	4.0	0.0
Volume of Stocks	11.5	101.2	44.4	38.8	36.8
Value of Stocks (Annual Turnover Value)	3.0	102.7	87.6	16.4	78.9
Market Capitalization	15.3	77.2	45.4	50.6	76.6
<i>Of which: Banking Sector</i>	<i>13.2</i>	<i>51.7</i>	<i>87.1</i>	<i>82.9</i>	<i>76.8</i>
NSE Value Index of Equities	10.7	65.8	18.5	1.0	38.5

Source: Nigerian Stock Exchange (NSE)

4.5.1.1 The Secondary Market

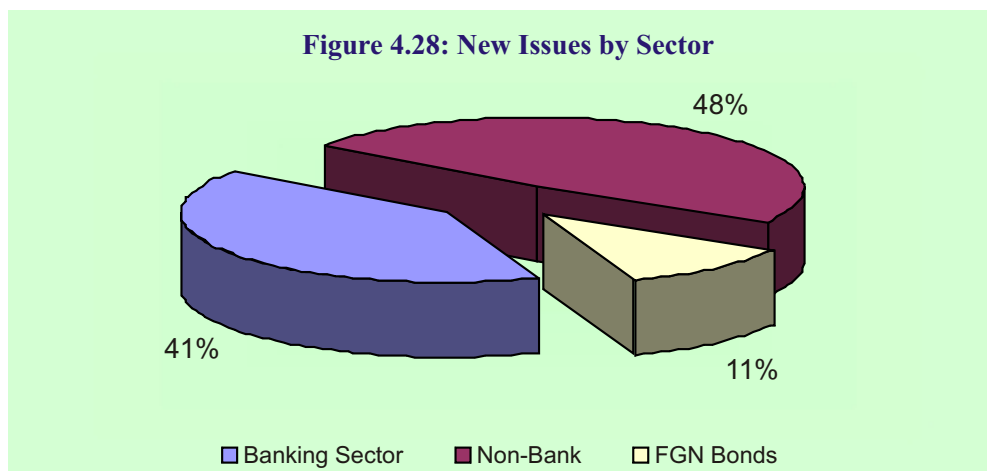
The secondary market segment of the Nigerian Stock Exchange recorded a significant increase in activity. The performance of the market was enhanced by the increased awareness of the opportunities in the stock market, improved operating results of some quoted companies, available large float, especially in the banking sector, as a result of the conclusion of the recapitalization exercise in the sector, as well as the investment of 25.0 per cent of pension funds in the market. Improvements in the macroeconomic environment in the country also attracted foreign investors into the market and, thus, increased the level of activity. The total turnover for the year under review was 36.5 billion shares, indicating an increase of 36.8 per cent over the 26.7 billion shares recorded in 2005. The year closed with a market turnover of N470.3 billion or an increase of 78.9 per cent over the preceding year. The banking sub-sector accounted for 72.8 per cent of the total volume of transactions as investors re-aligned their portfolios after the consolidation exercise.

4.5.1.2 Value Index of Equities

The Nigerian Stock Exchange's all-share index rose by 37.8 per cent to close at 33,358.30, the highest in the last three years. However, the index attained its all-time high of 35,085.84 on August 18, 2006, reflecting an improvement in the share prices of some quoted companies.

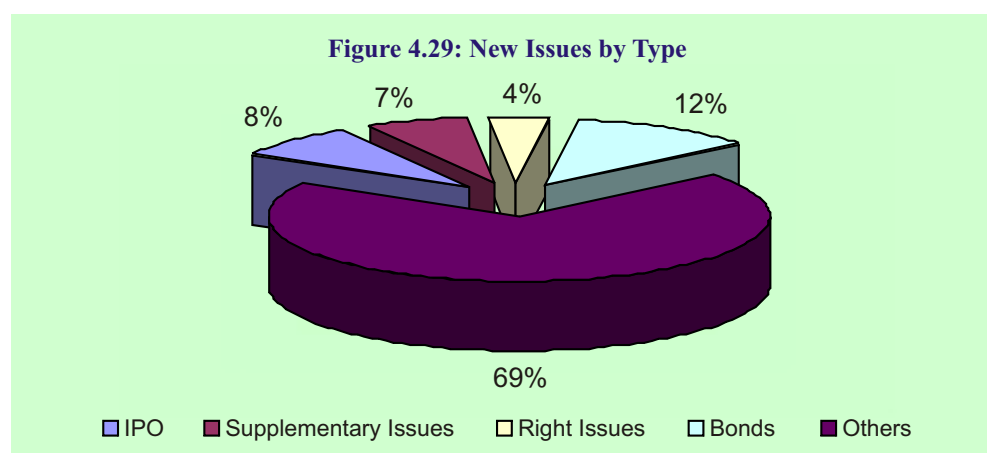
4.5.1.3 New Issues Market

There was improved activity in the new issues market, reflecting an increased recourse to the stock market by companies and the Federal Government. The Exchange approved 62 applications for both new issues and mergers/acquisitions, valued at N1.4 trillion, compared with 52 applications valued at N730.5 billion in 2005. The non-bank corporate issues accounted for 48 per cent of the new issues approved in 2006, with 40 applications valued at N678.54 billion, while the banking sector accounted for 41 per cent with 21 applications valued at N577 billion. The FGN Bonds issue amounted to N155.0 billion and accounted for 11.0 per cent of the total.



In its effort to create and develop a vibrant and liquid bond market in Nigeria, the DMO granted licences to 15 Primary Dealers and Market Makers (PDMMs) in FGN Bonds. The operators, which comprised ten (10) banks and five (5) discount houses in Nigeria, were expected to provide an active and liquid market for government bonds. The new FGN bond issues received a high level of subscription from domestic, institutional and foreign investors. The breakdown showed that a total of N402.7 billion worth of bonds was issued; N775.6 billion was subscribed, representing a 192.6 per cent over-subscription, and N444.7 billion was allotted. The highest coupon rate was 16.0 per cent, while the lowest coupon rate was 10.96 per cent.

Further analysis of new issues showed that the sum of N117.4 billion was raised through initial public offerings (IPOs); N95.7 billion through supplementary issues; N53.8 billion through rights issues; and N168.5 billion through bonds issue, including the FGN bonds issue. Other issues accounted for the balance.



The number of securities listed on the Exchange remained at 288, the same as in 2005. However, 28 new securities were listed, while the same number of securities was de-listed during the year. Also, four new sub-sectors were created on the daily official list (mortgage companies, road transportation, leasing and the foreign listings), thus raising the number of sub-sectors in the equity sector of the daily official list to 31.

Box 5: NIGERIAN PAYMENTS SYSTEM INITIATIVES AND ACTIVITIES IN 2006

Over the years, it has been recognized that modern payments and settlement systems have far-reaching economic and social implications for an economy. On the microeconomic level, a safe and efficient payments and settlement system reduces transaction costs, improves operational efficiency of trade and commerce and is supportive of the internationalisation of an economy. Modern payments and settlement systems also help in the inclusion of a significant proportion of the population in participating in the financial systems, thereby improving the quality of their lives. This financial inclusion further benefits the economy as money kept outside the financial system is brought in and used by banks in stimulating business growth and consumption.

Due to the perceived benefits of a safe and efficient payments system, the Central Bank of Nigeria has been active its promotion. This has been reinforced by the need to improve the effectiveness of monetary policy implementation and ensure the overall financial stability of the economy. In 2006, notable achievements in infrastructure and institutional reforms of the payments system were recorded, as highlighted below:

INSTITUTIONAL REFORMS:

National Payments System Committee (NPSC):

Reconstituted and inaugurated in 2005, the National Payments System Committee (NPSC) is at the apex of the Nigerian payments and settlement systems, with the Governor of the Central Bank of Nigeria as its chairman. The Committee met thrice in 2006 and considered various papers and memoranda from its technical sub-committees, including the following:

- Guidelines on Transaction Switching Competition
- Guidelines on Transaction Switching and Card Issuance
- Modalities on Linking the Central Securities Clearing System (CSCS) to the CFTS
- Memorandum on Pathway to Electronic Payments System
- Draft Cards and Electronic Payments Standard
- Modalities for Electronic Bill Presentment and Collection of Government Revenue

The recommendations made by the sub-committees were being fine-tuned prior to their implementation.

Payments Systems Vision 2020

In 2006, the National Payments System Committee (NPSC) constituted and inaugurated a National Payments System Strategy Team to prepare a payments and settlement system vision document to guide the orderly development of the nation's payments system. The vision document was approved during the year as a key component of the broader reform programme, known as the Financial System Strategy 2020 (FSS 2020). The document identified seven user initiatives and core infrastructure that would drive the electronification of payments and settlement systems in Nigeria. It is envisaged that government supplier payments, person-to-person trade, salary payments, bill payments, taxes, etc, would be settled electronically, using the various standard systems available now and in the future.

Nigerian Cheque Standards and Cheque Printers Accreditation Scheme

The Nigerian Cheque Standard was established to reduce the high reject rates in the clearing system and deter cheque fraud. Cheques printed for the Nigerian market must conform to certain standard specifications in order to significantly reduce the high reject rate and thus promote greater efficiency in the cheque clearing process. In addition, the standard was designed to ease progression to cheque imaging, truncation and archiving in the future.