

**THE GOVERNOR, PROF. CHUKWUMA C. SOLUDO'S
BRIEFING OF THE SENATE ON THE GLOBAL FINANCIAL
MELTDOWN
HELD AT
THE SENATE CHAMBERS
ON TUESDAY, OCTOBER 21, 2008**

Your Excellency, the president of the Senate,
Your Excellency, Deputy Senate President,
Distinguished Senators of the Federal Republic of
Nigeria,

It is indeed a great honour for me Mr. President and
the distinguished Senators to be here with my
colleagues to address you on the global financial crisis
and the possible impact on the Nigerian economy and
even more so on what Nigeria is doing and what Nigeria
should be doing in the context of the crisis.

Mr. President of the senate, I have come with my
colleagues and I also like to say it basically as it is and
I will tell you as it is. Four years ago, I did say to this
house but not as a group like this that our financial
system was in trouble and needed a fundamental
change but I don't think many believed this. But we
took the steps that were necessary, all be it unpopular
and today I am here in the wake of another, all being
the global one, therefore Mr. President, what I will
also tell you is also what you see because we examine
these banks, we supervise hem. The information I will
like to share with you are truly as they are.

I know in this time, particularly when there is some perceived crisis, various people have their own data bank and peddle all manner of information and some people have rolled out numbers which I don't know where they got them from. That is what you get when you have a crisis. But what I will share with you now, Mr. President, distinguished senators is simply as it is. And I want to thank the Senators for being responsible for organizing this kind of briefing because the financial system whatever it is, the level of poverty incidence in Nigeria by the last count is about 54 percent, whether we are going to fix the infrastructure decay, whether we are going to resume roads and reduce poverty, whatever it is we want to do, the financial system is at the heart of it.

Currently, this year alone the total credit by the banking sector to the private sector is more than the total expenditure of the federal government. So far, that is up to the end of September and in years to come, it will even be much more so. Everywhere in the world, it is basically the financial system that oils the economy and therefore, whatever happens to the financial system especially in Nigeria's case where the banking system account for more than 90 percent of the assets of the financial system, banking system is the de-facto driver of financial system in Nigeria. Whatever ails the financial system ails the economy. And therefore, I want to put it in context of this public presentation to the senate that there should be nothing more important in the discourse of the national

economy than to be able to be sure that our financial system is in a form that will not only see us through today but will also be able to see us through tomorrow and I want to thank you very much.

What are the stylized facts? My colleagues have elaborated on the nature of the crisis abroad, the financial derivatives, the unregulated market especially in Europe and OECD markets, the easy money and this has not even been emphasized, the low interest rate and the easy monetary policy in these economies that provided what economists call the **moral hazard** that is causing irresponsible behaviour in lending even to people that don't have the capacity to repay. What happened? This is what has now imploded and when it imploded, these people could not service the loans.

There is a fragmental regulatory regime in many of these markets. They tried to divorce the banks; I mean several of the banking activities were actually not within the ambit of the regulatory policy of their Central Banks. Now, we see in the US, several of them are coming back and have divorced. Now when the shock came, their banks began to make huge loses. Several of them were posting cumulatively 20, 40 billion dollars cumulatively as loses and as they wrote off these losses, that eroded their capital base, especially in the market that were so heavily connected with the US market. That led to credit crunch and with the credit crunch then reverberated around the world. A lot of the markets in the world have also borrowed

heavily because of these interdependencies; several of these markets became also affected.

One key point is the late response by many of the governments. There was loss of confidence in the market and the contagious across the financial markets around the world. I mention late response so as to underscore the point I will make later because here we tried to act in a most proactive manner in anticipating what will possibly go wrong and we have been acting, acting in anticipation of this.

What are the potential effects, what are the likely ways that the crisis could affect the Nigerian economy? Of course the first one is as crystallised and that is the commodity prices. Because of the down turn of economic activities globally, the oil price has come down significantly, the Minister of Finance has mentioned that from 50 percent, certainly in excess of 40 percent.

The institutional investors, at about late March in Nigeria existed Nigeria's capital market or at least sold down. Faced with credit crunch in their markets, with some of them under pressure to repay some of their facilities; sold their holdings in some of the most profitable markets. When some of them sold, prices came down significantly in late March and what then followed was some bit of panic, panic on the part of the nascent investors. If you also recall, several of the investors in the capital market have gone in there for

speculation and not to invest and hold. One of the first rules you learn when investing in capital market is that you do not put in money you cannot forgo or you put in money for a long term. If you want short term, you go to the money market. But this was lost and a lot of people went for speculation and once the first shock came, prices came down; many people panicked and went to sell. Banks on their part for risk management purposes, wanted to cut their losses and they stopped giving facilities to people to go to the market and were recalling some of their existing facilities.

So, you have two things, first the liquidity that was flowing into the market dried up and many people wanted to sell. There was only one way the market could go, up and it is important to understand the context of why our own capital market and how it is linked to what is happening globally. Of course potentially, it could affect trade finance for the banks. But Mr. President it is good to know that on the aggregate, indeed trade finance to the banks has not actually gone down relative to where we were last year, it has actually increased.

Banks depending on credit lines from overseas for example in some countries abroad Asia, their credit to deposit ratio, some of their banks went as high as 350 percent, that means they were even lending out of the borrowed money from abroad. We don't have that here, that is why when it came, most of their own banks

started crumbling and this is the situation around most countries of the world.

This is not likely to happen in the case of Nigeria. Potentially if you have the currency crisis, in South Africa today, the currency depreciate by more than 40 percent and many other emerging markets have experienced that, we have not experienced such depreciation. The reason is by the time institutional investors portfolio exit your market, they are demanding for foreign exchange and therefore, a currency will depreciate. Many countries are having that we are not yet having that. Thank goodness, we have a buffer of foreign reserves to be able to shore up and deepen the currency. This has not happened.

Potentially, you could have counter party risks in the sense of where you put your reserves, are those banks safe and sound? And so far, I want to tell you Mr. President of the Senate and distinguished Senators that so far, the CBN is very , very vigilant. First of all, we insisted on putting our reserves in certain grades of banks- triple 'A's and so on, and the one when we noticed that it was beginning to fall, we moved out from there. I want to say Mr President and distinguished Senators that our foreign reserves are safe, very safe and will remain very safe in the sense that the institutions where they are, even though they are all triple 'A' rated but also these are now the countries where they have signalled that no bank should be allowed to fail by putting out resources if

necessary to recapitalize it. So our foreign reserves are safe.

There are second round effects, these are first round possible effects. The second round effects, the physical constraint have been mentioned because of our dependence on oil and oil revenue. Then the asset quality because of the exposure of banks to the capital markets, could potentially deteriorate, some of the assets could become non performing, that is when the borrowers borrowed money, invest in the capital markets and unable to service the loan or pay back, then some of those loans will go bad, this is a potential risk.

But I want to say Mr. President, distinguished Senators; there are various factors that provided what we might call a buffer or an insurance that are helping Nigeria to weather through the global crisis. The first I must say Mr President of the Senate, is because the banking sector, thank goodness, I said this at the beginning, what is going in much of the rest of the world in terms of recapitalising their banks, assurance for deposit and so on were completed in Nigeria three years ago. So, the banking sector consolidation, the recapitalization of our banks happen to provide the most important buffer that is helping to shield us from the full weight of the global financial crisis. Before the recapitalization of our banks, the non-performing total loan was about 23, 24 percent getting to about 25

percent, then it ought to trigger off financial systemic distress.

With the recapitalization of our banks three years ago, the capital ... ratio of our banks was about 23 percent today, the recommendation is about 8 percent, now being moved to 10 per cent. Indeed many of the banks abroad that have capital ... ratio up to 8 percent, one of the banks now has 9.7 percent ratio, 8.5 percent, 10 percent. It is not something they will show you that they are sound. Average for Nigerian banking system happens to be one of the most capitalised banking systems in the world today.

And this, Mr. President, means that our banks have the muscle to be able to take losses, it means even if some of their assets or loans they have given go bad, they have the muscle to write them off. It means as well that when they write them off, they will still have the capacity to extend more credit.

The second point is that unlike what is going on in most parts of the world, many of the companies quoted on the Nigerian Stock Exchange are making profit, declaring dividends. Secondly, most of the Nigerian banks if not all, have their resources formation since this year have all been declaring profit unlike what you find in most countries of the world where they were declaring losses and thereby writing off those losses. So, the contexts are different and it is those losses that actually eroded their capital and thereby provided

the basic for their government to inject money into the economy. We don't face that in Nigeria today, Mr. President, distinguished Senators.

On the capital market, as you could see, within this month of October alone because of the contagious effects a lot of the markets in the emerging market lost value, I think Taiwan or so lost 30 percent, several of them lost more than 60 percent of their capitalization.

But let me say something, this is something that affects a whole lot of Nigerians especially the middle class and I don't know the extent to which distinguished senators are also affected because wherever I go even at social functions, you hear people calling and saying you people must do something about this. I borrowed money to buy shares and it has gone down, you people should do something to prop it up. I can tell from the smile on people's faces that this is the question on everybody's mind. But one fact, Mr. President, that I want to stress is that in spite of the shock we have in the capital market, in spite of the capital market meltdown, compare to other exchanges, American Exchange went down to about 6 years loan by this October, the London Exchange went down about 5, 6 years loans and several other exchange went down 5, 6, 7 year loan. It is important to state Mr. President, Distinguished Senators, that the largest capitalization of the Nigerian stock exchange as at the date that this present administration took over, actually the eve

of the swearing in of Mr. President on the 28th of May was gross of total market capital of 8.14 trillion, the equity share which is what most people watch everyday was about 7.12 trillion, that was the total market capitalization. By the end of May last year, the total market count was 8.4 trillion, the equity part which was the bid we all watch everyday was 7.38trilion of the market capitalization. As at yesterday, the total market capitalization of the whole exchange, equities and bonds was 12.75 trillion and the equity's part was 9.365 trillion. In percentage terms, even on the equity part which has been the most volatile component of our stock market relative to where it was at the commencement of this administration, we still have a positive of about 27 percent. Relative to the eve of the commencement of this administration, it is about 31 per cent. This point is often lost in the discussion because probably we saw it balloon to about 12.6 trillion in March this year and then coming down but we have to put it in context in terms of where we are coming from.

What have others done and what have we done? Most of other markets have responded, you can put them in six bouquets. First, there is liquidity injection by their central banks; second cut in interest rate, bail-out plan of distressed institutions, banks and companies. I said bail out plan for distressed institutions. No government is going there to intervene in order to prop up prices in the markets. You can bail out distressed institutions; you don't bail out the market, deposit guarantees,

that's what we did in banking sector consolidation, guaranteeing deposits, they are also doing the same thing because of loss of confidence, purchase of ...assets, fiscal expansion.

What have we done? Almost each one of these, we have done something proactively. We did not wait for our banking system to collapse before we did our own capitalization. If you remember, I said part of the crisis today in many of these markets is that they reacted too late. We did not wait for our banking system to collapse before embarking on recapitalization. So we have finished our own recapitalization which is part of what they are doing today. On guarantee on private sector deposit, we did the same thing then. We restricted government ownership in our banks and restricted foreign ownership of our banks and this has proved, with the benefit of hindsight, to be beneficial because many of these were transmitted via Diaspora ownership of banks.

We proposed an asset management company during consolidation programme but it was not passed by National Assembly. This is the time, Mr. President of the Senate, Distinguished Senators; this is the time to pass the **Asset Management Company where banks and other financial institutions will go to sell some of their distressed assets.** We need it like yesterday.

There is liquidity surge in the banking system, we suspended mop up operations, extended our discount window and ready for long term lending to the banks. We have allowed our banks to restructure some of their exposure to the capital market for up to the end of next year. We have taken steps to safe guide Nigeria's foreign reserves and the SEC has also reduced transactions cost of the exchange.

What are the other measures, the summary of what I have said so far distinguished Senators is that the circumstances of our banking and financial system happens to be different from what is happening in the rest of the world. Much of what they are doing today as a reaction is actually what we have done two years ago. But in order to pre-empt and make sure that the contagion does not wipe out our own system, we have also taken proactive measures by making sure that the system is as liquid as possible and we have opened our lending window to be able to extend credits to any bank as much as we can. And that is why the inter bank rate is still slightly less than ten per cent today. Confidence is taking a while to restore everywhere.

There are other measures we took, we said it to our banks and I want to say this to Distinguished Senators, that distance from where we see our banks, where they are today and with the contingency plan that we have in place, no Nigerian bank will be allowed to fail. At the extreme we have opened our window to be the lender of last resort. That is part of our function as the Central Bank to be able to extend credit and as the

lender of last resort; no Nigerian bank will be allowed to fail.

Second is that, in the limit of it, let us even assume that the banks exposure to the capital market gets bad, at most we could also have arrangements to take off some of those assets from their balance sheet and free them off from those assets. We need to recapitalise, *this bit should be a discussion within the executive about the development banks to recapitalize*, the development banks to make them much more vibrant,

Today, the market is failing; we are trying to expand that even further to make it more liquid. Credit to the private sector as I mentioned up to the end of September was about 2.3 trillion actually. The banks exposure to the capital market is barely about 9.6 percents of their aggregate rate.

On annualized basis, I did say that credit to the private sector as at end of September have grown to about 71 percent from the end of December last year, this is against the target growth rate of 30 percent which was set. So even if they don't extend any credit again for the rest of the year, they have already exceeded the target for the year. The total non performing loan of our bank is miniscule, at about 5.9 percent. The stage it gets and you begin to think of distress is about 20 -25 per cent. US dollar is much stronger; this is the good news of the global financial

crisis that it has not metamorphosed into currency crisis. To be frank, the dollar has in recent weeks strengthened against other major currencies in the world.

And one of the buffer that we have as insurance in Nigerian economy is that our productive sector is still dominated by the non-oil sector. It is still dominated by agriculture at about 40 percent and this is not so much responsive to the global financial crisis and this is why output is still expected, we are not likely to get into a recession. Second quarter GDP growth rate was about 8.5 percent for this year and I don't think it will be greatly dampened by next year.

Foreign reserves, as at end of August, the total foreign direct investment was 8.5 billion dollars compared to last year, it is expected that every year will exceed the total for this year and trade finance has not fallen

In conclusion, I have tried to lay in details the difference between the two regimes, what is happening, where we are and why we would likely survive. But there are challenges going forward and that is the responsibility for this Hallowed Chamber, the Senate. I think there are several bills before the National Assembly that should have been passed like yesterday that are needed to strengthen the financial system. The banks and other financial institutions Acts has been here since early 2006. It still requires

amendment to strengthen the regulatory capacity. There is a bill for consumer credit, it is before the National Assembly, and mortgage reform is before the National Assembly.

Mr. President, Distinguished Senators, these bills need to be passed urgently because they are required to unleash the boom in Nigeria's financial system and also useful for moving the economy forward. There are several other legislations pending here that I think my own recommendation is that we could treat them like the way the US Congress treated their own stabilization Act and emergency. We could say within the next 100 days let us pass ten most critical legislations required to strengthen the financial system and move the economy forward. We can select those ten major legislations and several of them have been pending here for years now. This is the time to have that as an emergency and that's what we do at the executive and I think I will leave that, I just want to focus essentially on the agenda of the National Assembly.

Thank you, Mr. President of the Senate.