THE NEXT STAGE OF REFORM: INSTITUTIONALISING CHANGE IN NIGERIA

Economist Second Business Roundtable with the Government of Nigeria; Hilton Hotel, Abuja
31 JANUARY, 2006

BY
CHARLES C. SOLUDO
GOVERNOR
CENTRAL BANK OF NIGERIA

Outline

- *Background to the Reforms in Nigeria*

- *Macroeconomic Outlook and the Impact on business*

- *Banking Sector Reforms*
  - *Where we are*
  - *Where next?*

- *Towards Africa's Financial Centre*

- *Conclusion*

I. Background to the Reforms in Nigeria

- Reforms are embedded in the NEEDS document prepared in 2003

Key elements of NEEDS:

- Stable, Predictable and Sustainable Macroeconomic environment
- Non-inflationary, non-oil GDP growth (for poverty reduction);
- Low and Stable Price Level;
- Stable and Competitive Exchange Rate Regime; and
- Sound Monetary and Fiscal Policy regimes;

Macroeconomic Outlook and the Impact on business

<u>Growth Performance</u>

- GDP growth rate averaged 7.4% since the reforms (2003-2005)
- Growth being led by the non-oil sector; 8.5% in 2005
- Lending to private sector rose by 40% (unprecedented) in 2005; higher than the programme target of 30%

Macroeconomic Outlook and the Impact on business

Price Level

- Government committed to maintaining Sound Macroeconomic Environment– stable prices!

- Inflation rate of 10% in 2004.

- Despite food shortages in neighbouring countries that peaked non-core inflation at 38% in August, headline inflation was brought down to est.15.1% by November 2005 while core inflation was just at 6.8%; due to strong deflationary measures.

  – Growth of reserve money was reduced below the PSI target (N764 billion against the target of N770 billion)

  – Increase in the frequency of CBN's analytical balance sheet data from monthly to daily series helped to keep tract of the growth of monetary aggregates

Macroeconomic Outlook and the Impact on business

Exchange rate

- Maintained exchange rate stability around the pre-determined band of plus/minus 3%

- Exchange rate appreciated by 3% in 2005, reinforcing the 3.1% appreciation in 2004

- Confidence of investors reinforced by the stable exchange rate

Macroeconomic Outlook and the Impact on business

External debt reduction

- Sound economic reform programme under NEEDS and its successful implementation led to the external debt relief of US$18 billion

External reserves

- External reserves position of over US$30 billion, the highest in Africa

Macroeconomic Outlook and the Impact on business

Growth Prospects

- President and stakeholders committed to achieving 10% growth rate in 2006
- Determined to improve infrastructure
  - POWER
  - TRANSPORT and COMMUNICATION
  - WATER
- Developing efficient Institutions for enforcement of contracts--- property rights; and facilitation of businesses--- NIPC; NEPC; EPZ; CAC; customs; etc.
- Fight Against Corruption--- value for money spending!

Macroeconomic Outlook and the Impact on business

Growth Prospects

- About 32% of GDP in total investment spending in 2006 through Government, private sector and FDI.

- Challenge of VALUE-FOR-MONEY SPENDING BY ALL AGENTS---- can generate more than 10% growth!!

- Which SECTORS have implications for non-inflationary growth?

  – Heavy investment in agriculture will dampen inflation
  – Externalize spending: more on Power plants and Transportation

Macroeconomic Outlook and the Impact on business

Role of Partners

- Development partners are welcome for continued policy discussions on the strategies to achieve the growth targets

Specific Efforts by CBN to Promote Growth

- CBN and the Universal Banks to work hard:
  - Mainstreaming Microfinance Banks (MFBs) which can jump-start SMEs and create millions of jobs.
  - Encourage states to devote 1% of budget to micro credit--- about N20 billion in 2006
  - LGAs to devote 1% of budget to micro credit == N5 billion

Macroeconomic Outlook and the Impact on business

- Establishment of African Investment Bank to finance export-oriented Industries and infrastructure.

- REVIEW of SMEEIS; ACGS; and Interest Draw-back Scheme to facilitate easier access and maximum impact especially on Agriculture and Manufacturing

- Special SME Windows in Commercial Banks?

Banking Sector Reforms

- *Where we are*
- What is Unique about the Banking Sector Revolution in Nigeria?

- First time a fundamental policy reform is announced in Nigeria, with clear timelines and milestones and implemented fully to the letter as designed without reversals and modifications, despite monumental opposition by strong vested interest groups.

- More than doubled the capital base of Nigerian banks from about US$2.5 billion in June 2004 to about US$5.8 billion end December 2005. No non-oil sector of the economy has attracted such magnitude of investment within such a short period of time in Nigeria and no policy has had such a phenomenal impact on the capital market as the banking sector reforms.

Banking Sector Reforms

- Reforms accomplished seamlessly without any systemic crisis even though the system was on the verge of a crisis before the reforms

- Broadened ownership structure---- with the presence of government in the ownership of banks being wiped out, and one-man or family banks almost eliminated as virtually all the banks have been listed in the Nigerian stock exchange.

- Zero tolerance towards infractions, and improved corporate governance: greater transparency is being enforced and deployment of IT infrastructure (eFASS and RTGS) help to ensure improved processes and procedures.

- Reforms bound to be the least cost banking sector restructuring anywhere in the world---- cost of 100% blanket guarantee to depositors --- <u>will be much less than 1% of GDP</u>

Banking Sector Reforms

- *Further stylized outcome*
  - ALL 4 foreign banks recapitalized despite initial hesitation
  - Share of NSE doubled from 24% to almost 50%
  - Deepening of capital market; consciousness about capital market among population
  - Capital market becomes more liquid and capitalized
  - Increased potential to finance big transactions---(higher single obligor limits)

Banking Sector Reforms

– Dilution of ownership--- as most banks become PLCs; and more regulators oversee them---- SEC and NSE.

– More effective supervision---- focus on fewer (25) banks rather than 89 mostly sick banks

Banking Sector Reforms

- *Where next?*
- Other Reforms?
- Refocusing CBN back to basics as monetary authority --- effective liquidity management framework; movement towards Inflation-targeting, etc.
- Fundamental institutional reforms and capacity building.
- Nigerian Security Printing and Minting reforms--- self-sufficiency in currency production by end of 2006.
- Currency restructuring and currency exchange in 2006
  - to determine the appropriate mix and sizes of notes and coins to ensure cost-effectiveness, positive seigniorage and meet the needs of currency users.

Banking Sector Reforms

- Micro finance policy---- new dawn for SME funding.
  - Total Credit by SA banks to the economy is more than 100% of GDP, and Nigeria’s is about 20% of GDP
  - Mortgage loans in Nigeria is less than 0.5% of GDP, whereas it is about 18% in South Africa
  - SME loans are more than 22% of total loans in SA but about 0.9% in Nigeria
  - Market for Debentures and bonds largely non-existent

Banking Sector Reforms

- Second Phase of Consolidation:----for bigger, more transparent and efficient banks!

- Partnership of foreign banks with domestic financial institutions in Foreign Reserve Management/ Custody---- JV as preferred form of partnership.

- Due Diligence on ALL Banks in the system---(re-verification of capital) to prevent ‘Bubble capital’.

- IT and New Ways of Doing Business
  eFASS; RTGS; --- no place to hide– for banks to lie about their state of affairs

- CBN and BOFIA amendments to strengthen CBN in enforcement

Banking Sector Reforms

- Restructuring/Strengthening Banking Supervision Department (risk-focused; skills)
  - New robust Code of Ethics and Conduct
  - Incentive and Sanctions Regime--- supervisors who fail to find what they should, would be penalized; and those who succeed are rewarded!
- Managing the next phase of consolidation--- market driven
  - Bank(s) with US$1 billion in capital base to receive at least US$500 million reserves to manage

Banking Sector Reforms

- ***NSPM PLC—the Mint***: to conclude the reform of the company and stop printing currency abroad by end 2006.

- ***Payments System Reform***: to ensure transparency, processing speed and security of financial instruments.

Towards Africa's Financial Centre

- Context and Vision for Financial Sector Reforms?
  - Nigeria as Africa's financial hub; and most effective and efficient Central Bank in Africa!
  - In 10 years, one or more of banks to be in the top 50—100 banks in the world.

- National Legal and institutional reforms– creditor rights; mortgages; land tenure, etc (Designate special 'Federal Commercial Courts' in 2006?)

Towards Africa's Financial Centre

- Attracting a reasonably stable deposit base as opposed to volatile, short-tem--- savings certificate; pension funds
- Liquidity and risk management tools
- Benchmarking capital market fees/charges to best practices
- Creative product developments--- bond, debentures, housing finance; consumer credit; etc
- Establishing a yield curve….
- Overall improvement in business environment
- NOTE: Without Stable Macroeconomic Environment, sustainable development of Money and Capital Markets Will NOT HAPPEN!---- First priority: Low inflation and Exchange Rate Stability

Towards Africa's Financial Centre

<u>Our Concerns</u>

- We take strong exception to the practice where Letters of Credit opened for Nigerian banks have to be 100% cash-backed. This needs to change with the new 25 strong, and reliable banks in Nigeria.

- Furthermore, we wish to use this forum to observe that the continued listing of Nigeria as non-compliant nation in the FATF list is, to say the least, unfair and without basis.

Conclusion

- The President and the entire government machinery remain committed to the implementation of the reform programme
- A stable and healthy macroeconomic environment has emerged from the reforms
- The financial sector has been repositioned to lead and sustain investments for further economic growth.
- All stakeholders to enlist their support and carve a niche in the economic boom