FINANCIAL STABILITY REPORT

June 2014

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List of Abbreviations

ACL	Audit Command Language
AIPs	Approvals-in-Principle
AMCON	Asset Management Corporation of Nigeria
AML/CFT	Anti-Money Laundering and Combating the Financing of Terrorism
ASI	All Share Index (Nigerian Stock Exchange Index)
ATMs	Automated Teller Machines
BCEAO	Banque Centrale des Etats de l'Afrique de l'Ouest (Central Bank of West African States)
BDCs	Bureaux de Change
BOA	Bank of Agriculture
BOFIA	Banks and Other Financial Institutions Act 1991 (as amended)
BOI	Bank of Industry
BRICS	Brazil, Russia, India, China, and South Africa
CACS	Commercial Agriculture Credit Scheme
CAR	Capital Adequacy Ratio
CBN	Central Bank of Nigeria
CIBN	Chartered Institute of Bankers of Nigeria
CIFTS	CBN Inter-bank Fund Transfer System
CR6	Concentration Ratio (of the six largest banks)
CRMS	Credit Risk Management System
DFIs	Development Finance Institutions
DMBs	Deposit Money Banks
EBAs	Eligible Bank Assets
EDC	Entrepreneurship Development Centre
eFASS	Electronic Financial Analysis and Surveillance System
FATF	Financial Action Task Force
FCs	Finance Companies
FCT	Federal Capital Territory
FGN	Federal Government of Nigeria
FMBN	Federal Mortgage Bank of Nigeria
FMDQ-OTC	Financial Market Dealers Quotation – Over the Counter Plc
FMF	Federal Ministry of Finance
FRACE	Financial Regulation Advisory Council of Experts
FSIs	Financial Soundness Indicators
FSRCC	Financial Services Regulation Co-ordinating Committee
GDP	Gross Domestic Product
GIZ	Deutsche Gesellschaft fur Internationale Zusammenarbeit (German Society for International Cooperation)
HHI	Herfindahl-Hirschman Index
ICFA	Implied Cash Flow Analysis
IFRS	International Financial Reporting Standards
IFSB	Islamic Financial Services Board
IMF	International Monetary Fund
IOSCO	International Organisation of Securities Commission

KYC	Know Your Customer
L/C	Letter of Credit
M1	Narrow Money Supply
M2	Broad Money Supply
MCP	Microfinance Certification Programme
MENA	Middle East and North African Countries
MFBs	Microfinance Banks
MoUs	Memoranda of Understanding
MPR	Monetary Policy Rate
NAICOM	National Insurance Commission
NDIC	Nigeria Deposit Insurance Corporation
NERFUND	National Economic Reconstruction Fund
NEXIM	Nigerian Export-Import Bank
NFIU	Nigerian Financial Intelligence Unit
NGAAP	Nigerian Generally Accepted Accounting Principles
NIBSS	Nigerian Inter-bank Settlement System
NIRSAL	Nigerian Incentive-based Risk Sharing System for Agricultural Lending
NMRC	Nigeria Mortgage Re-finance Company Plc
NPLs	Non-Performing Loans
NSE	Nigerian Stock Exchange
OBB	Open Buy Back
OFIs	Other Financial Institutions
PAIF	Power and Aviation Infrastructure Fund
PCBs	Private Credit Bureaux
PENCOM	National Pension Commission of Nigeria
PFAs	Pension Fund Administrators
PFCs	Pension Fund Custodians
PMBs	Primary Mortgage Banks
PoS	Point of Sale
PSV 2020	Payments System Vision 2020
RDAS	Retail Dutch Auction System
ROA	Return on Assets
ROE	Return on Equity
RTGS	Real-Time Gross Settlement System
SEC	Securities and Exchange Commission
SMEs	Small and Medium Enterprises
SMECGS	Small and Medium Enterprises Credit Guarantee Scheme
SQL	Structured Query Language
WAMZ	West African Monetary Zone
WDAS	Wholesale Dutch Auction System
WEO	World Economic Outlook

Financial Stability

'Financial stability' is the resilience of the financial system to unanticipated adverse shocks, while enabling the continued smooth functioning of the financial system's intermediation process. A stable financial system contributes to broader economic growth and rising living standards. The financial system performs one of the most important functions in the welfare of citizens by supporting the ability of households and firms to hold or transfer financial assets with confidence. Thus, the stability of the financial system and its adequate analysis and reporting are important policy goals of the CBN.

Governor's Statement

I am delighted to present this statement on the *Financial Stability Report (FSR)* of the Central Bank of Nigeria (CBN) for the half year ended June 2014. Coming, as it does, at the commencement of my tenure as Governor of the CBN, I particularly welcome this opportunity to commend the exemplary efforts made over the years, by my predecessors, to initiate and sustain the various reform programmes that have resulted in the emergence of the vibrant financial system we have in Nigeria today.

The crucial role played by financial system stability in the optimal management and control of economic resources and the efficient performance of the financial system has become an accepted and incontrovertible fact. A fundamental imperative for sustained financial system stability is to have in place robust and efficient infrastructures, effective and timely supervision and a very resilient financial system. This should be complemented by the ability to undertake regular reviews, assessment and documentation of critical developments, with the aim of highlighting and resolving emergent vulnerabilities as well as consolidating on identified strengths. The *FSR* provides such a platform. I am pleased to note that this is the 9th edition in the series first published in 2010. I wish to commend the efforts that have continued to sustain the regular un-interrupted publication of the *FSR* since its maiden issue.

As with previous editions, this Report provides a comprehensive survey of the key developments in the Nigerian financial system during the review period: January–June, 2014 on the one hand, and the global economy on the other. These include developments in the international financial markets, domestic macroeconomic issues relating to money and credit, the foreign exchange and capital markets, as well as other financial institutions. Other developments covered include real sector intervention issues and the regulatory/supervisory activities of the CBN, as well as the reform of the payments system. Overall, this edition succeeds enormously in providing an authoritative source of information and critical insights into the current state of the financial system in Nigeria and the developments that have impacted its emergence.

The issues highlighted in each edition of the *FSR* invariably define the broad direction for the future course of action needed to promote the goals of financial system stability. In recognition of this, let me seize this opportunity of the publication of the June 2014 edition of the *FSR* to reiterate the Bank's resolve and commitment to sustain and build on the various laudable initiatives that have impacted positively in shaping the Nigerian financial system. In this regard, the CBN will continue to pursue, vigorously, the achievement of low interest rates, stable exchange rates, a reduction in the funding gap in infrastructure financing and also complement government's efforts in combating unemployment. Furthermore, the Bank will continue its financial inclusion drive designed to improve access to financial services by the unbanked. It will continue to collaborate with a broad spectrum of stakeholders, including fiscal and other regulatory and law enforcement authorities.

Going forward, the Bank plans to focus on issues connected with the management of expectations arising from Nigeria's new profile as Africa's biggest economy, following the rebasing of her GDP; and the need to continue with the core mandates of the CBN, complemented by the promotion of a vibrant development strategy. Though these issues constitute major challenges, as already indicated in this edition, the outlook for the near term is quite bright and I am confident that with the collective efforts of all the stakeholders, the goal of sustained financial system stability will be attained.

On this note, I wish to recommend the *FSR* June 2014 edition, to all who have a stake in the on-going drive to fully position the Nigerian financial system.

Godwin I. Emefiele
Governor
Central Bank of Nigeria

June 30, 2014.

Executive Summary

Global output growth was expected to accelerate in 2014 from the weakness experienced in 2013. It is forecast to average 3.7 per cent in 2014, up from 3.0 per cent in 2013. While growth is forecast for the US (2.0 per cent in May 2014), the Euro Area was forecast to grow by 1.0 per cent in 2014, an increase from the dip of 0.4 per cent in 2013. Growth in Germany, the biggest economy in the European Union, remained the key driver for the overall Euro Area growth in the first half of 2014.

Global inflation was projected at 2.71 per cent in 2014. However, favourable price movements of food and fuel would help contain the upward movement in the prices of major commodities. Thus, global inflation was expected to remain low, compared with historical averages.

The performance of international stock markets was positive in the first half of 2014, with the indices of the developed and some emerging markets rising substantially. At the foreign exchange markets, most of the currencies appreciated against the US Dollar during the period under review.

In Nigeria, the GDP grew by 6.38 per cent in the first half of 2014, compared with 4.94 and 5.98 recorded in the first and second halves of 2013, respectively. The non-oil sector was a key driver for the growth. The tight monetary policy stance of the CBN during the first half of 2014 continued to moderate inflationary pressures, although the year-on-year inflation rate rose marginally to 8.2 per cent. In the first half, banks' interest rates generally trended upwards, with the exception of the 7-day maturity deposit rate which declined marginally, owing to CBN's tight monetary policy stance. Provisional data showed that growth in broad money supply (M_2) was sluggish at the end of the first half of 2014. On the other hand, narrow money (M_1) fell by 6.07 per cent at end-June 2014, compared with the 5.50 per cent decline at the end of the second half of 2013.

Credit to the economy continued to increase, as total bank loans and advances to the various sectors grew by 7.86 per cent in the first half of 2014. However, the structure of bank credits indicated that credit of short-term maturities remained dominant. Furthermore, the banking industry remained dominated by a few major banks.

Towards the effective oversight of foreign subsidiaries of Nigerian banks, the CBN participated in supervisory college meetings. In the first half of 2014, two foreign subsidiaries of Nigerian banks were examined jointly by the CBN and the host supervisors. The purpose of the examination was to ascertain the state of health of the subsidiaries. Also, a joint CBN and NDIC risk assets assessment examination of all the domestic banks was conducted to ascertain the quality of their assets and the adequacy of loan loss provisioning for the purpose of considering their 2013 annual accounts.

Meanwhile, the CBN, in collaboration with other stakeholders, embarked on developing uniform underwriting standards to establish best practices in mortgage lending and prescribe eligibility criteria for access to Nigeria Mortgage Refinance Company (NMRC) refinancing. This followed the launching of the NMRC by the President and the subsequent issuance of an approval-in-principle to the company by the CBN.

In the money market, rates remained relatively stable as the MPR remained unchanged at 12.0 per cent and fiscal injections sustained a constant flow of liquidity into the system. Furthermore, authorised dealers were provided access to discount window operations, repurchase agreements, and Open Market Operations (OMO) for their liquidity management purposes. The country's external reserves at end-June 2014 stood at US$37.33 billion, which could finance about 8.7 months of imports and was higher than the international benchmark of 3 months.

At the foreign exchange inter-bank market, the Bank's intervention and fund flows from autonomous sources helped contain excessive volatility in the market, and kept foreign exchange rates within the target band at the official segment of the market. The capital market was bullish as the major indicators trended upwards, reflecting investors' expectation of favourable returns.

Following stress tests conducted on the industry at end-June 2014, banks were adjudged to be more sensitive to credit concentration and exchange rate risks than other risks. Liquidity and interest rate risks had tolerable effects, except in a few cases where volatility in interest rates produced a large impact on account of duration mismatches in the tenored buckets. Overall, the banking industry stress tests suggested that the industry is considerably resilient.

During the review period, the CBN analysed the report on the post-examination monitoring exercise earlier conducted to evaluate the level of compliance of MFBs with examiners' recommendations. Supervisory letters had been issued to erring institutions and penalties applied as appropriate, based on the outcome of the exercise.

The Bank continued to issue guidelines and implement policies and initiatives aimed at increasing the safety, reliability and efficiency of the payments system. The key initiatives pursued during the review period included the launching of an e-reference portal, introduction of the bank verification number scheme, and the extension of the cashless policy to the whole country.

It is expected that the services and manufacturing sectors would strengthen growth in Nigeria. Furthermore, it is envisaged that, despite inflationary pressures, CBN's proactive monetary policy measures would stem the liquidity surfeit arising from the accommodative fiscal policy anticipated in the second half of the year.

This edition of the *FSR* is divided into five sections. Section One reviews global and domestic economic and financial developments, highlighting key stability issues. Section

Two chronicles developments in the domestic economy, while Section Three covers regulatory and supervisory activities. Key developments in the payments system are highlighted in Section Four. Finally, Section Five provides the near-term outlook for financial stability.

1.0 MACROECONOMIC DEVELOPMENTS AND FINANCIAL SYSTEM STABILITY

1.1 Global Economic and Financial Developments

1.1.1 Global Output

Global output growth was revised downwards by 0.3 per cent to 3.4 per cent for 2014 (IMF July, 2014) and 4.0 per cent in 2015, compared with 3.2 per cent in 2013. This was due to the legacy of weak first quarter performance, particularly in the US, and the less optimistic outlook for several emerging markets as well as disruptions in the Middle East and North African (MENA) region and Eastern Europe. The US economy grew by 2.5 per cent in the second quarter 2014, compared with 1.8 per cent in the corresponding period of the previous year. However, output of the country contracted by 2.1 per cent in the first quarter 2014 partly due to a more-than-expected inventory overhang at the end of 2013. A depressed demand caused by a harsher winter and a sharp decline in exports reduced output in the first quarter.

Output growth in the Euro Area was projected at 1.1 per cent in 2014, from a contraction of 0.4 per cent in 2013. The economy grew by 0.7 per cent in the second quarter of 2014, compared with 0.6 per cent in the second quarter of 2013. Unemployment rate remained unchanged at 11.5 per cent in June 2014. In the UK, GDP growth was projected at 3.2 per cent for 2014, compared with 3.0 per cent in the preceding year.

Domestic demand considerably moderated in China, reflecting the determination of the authorities to rein-in credit growth and moderate real estate activities. Output growth was projected at 7.4 per cent in 2014, down from 7.7 per cent in 2013. Buoyed by a recent fiscal stimulus of US$81.4 billion, the economy grew by 7.5 per cent in the second quarter of 2014, compared with 7.4 per cent in the previous quarter.

In Russia, activities decelerated and demand weakened sharply, due to geopolitical tensions. Other emerging market economies also recorded less-than-expected growth, due to both weaker external demand, notably from the US and China, and, in many cases, softer domestic demand and low investment growth.

For the MENA region, GDP growth was projected at 3.1 per cent in 2014, compared with 2.5 per cent in the previous year, mainly driven by investment in infrastructure. However, the outcome continues to be threatened by the escalating regional tensions and the challenging external environment.

In Sub-Saharan Africa (SSA), output growth was projected to remain at 5.4 per cent in 2014, the same as in the previous year. The robust growth was attributable to strengthening global recovery, positive domestic supply-side developments and continuing fiscal consolidation in a number of key countries.

Global economic activity was projected to strengthen moderately in the medium-term amidst renewed market concerns about emerging market fundamentals. Cyclical adjustments, insufficient institutional reforms and prolonged soft growth in the Euro Area and emerging markets are among the medium term risks. Reversals of capital flows and external funding and currency depreciation on the back of the Quantitative Easing (QE) tapering by the US Federal Reserve are the additional risks. The main downside risks include the inappropriate policies in addressing external vulnerabilities, security threats and the impact of the Ebola Virus Disease (EVD) outbreak.

The prospects for global recovery gaining momentum remain good, particularly in the second half of 2014. This was anchored on the view that the unexpected weakness in the first quarter was transitory since the impact of the harsh weather and inventory correction would disappear with appropriate policy measures, including China's fiscal stimulus. Further, the key drivers supporting the recovery identified in the April 2014 WEO remained in place, including moderating fiscal consolidation and a highly accommodative monetary policy in many advanced economies.

Overall expectations are for global growth rates of 3.4 per cent in 2014 and 4.0 per cent in 2015. Recovery is gaining momentum in major advanced economies, notably in the US, as temporary factors wane. In the Euro Area, growth is expected to strengthen to 1.1 and 1.5 per cent in 2014 and 2015, respectively. Japan, with a stronger-than-expected performance in the first quarter, is set to grow higher at 1.6 per cent in 2014 before decelerating to 1.1 per cent in 2015, partly due to the planned tapering of its fiscal stimulus. In emerging markets and developing economies, growth has also been projected to decrease from 4.7% in 2013 to 4.6 per cent in 2014, before strengthening to 5.2 per cent in 2015.

China has turned to limited and targeted policy measures to boost activities, including tax relief for small and medium term enterprises, accelerated fiscal and infrastructure spending, and targeted cuts in bank required reserve ratios. Consequently, the country is projected to grow by 7.4 per cent in 2014 before moderating to 7.1 per cent in 2015. However, in India, Brazil, Mexico and Russia, currently burdened by domestic and regional tensions, projections are expected to still remain weak. South Africa is also expected to stay sluggish due to electricity constraints and labour conflicts.

Table 1. 1: Global Economic Growth (per cent)

Region/Country	**2013 (Q2)**	**2014 (Q2)**	**2013**	**2014**	**2015**
World	3.0	-	3.1	3.4	4.0
Advanced Economies			1.3	1.8	2.4
United States	1.8	2.5	1.9	1.7	3.0
Euro Area	0.6	0.7	(0.4)	1.1	1.5
Japan	-	3.6	1.5	1.6	1.1
United Kingdom	-	1.9	1.7	3.2	2.7
Canada	-	2.5	2.0	2.2	2.4
Emerging Markets + Developing Economies	-	-	4.7	4.6	5.2
China	7.4	7.5	7.7	7.4	7.1
MENA Region	-	-	2.5	3.1	4.8
Sub-Saharan Africa	-	-	5.4	5.4	5.8
Nigeria	5.4	6.54	5.49	6.21	-

Source: IMF WEO July 2014; Bloomberg 2014

1.1.2 Global Inflation

Global inflation remained benign, reflecting muted energy prices and abundant spare capacities, particularly in emerging market economies. Inflation was 3.4 per cent in June 2013 before inching to 3.6 per cent in December 2013. The position was expected to be lower at 3.2 per cent by end-2014. In the Euro Area and the United States, headline inflation is expected to remain below longer-term inflation expectations, largely owing to lower employment rates, with implications for adjustments in expectations and risks of a higher debt burden and rising real interest rates.

In advanced economies, inflation was 1.8 per cent in June 2014, compared with 1.5 per cent in the corresponding period of 2013, and is expected to end the year at 1.6 per cent. This partly reflects the reductions in the labour force, owing to demographic trends as well as discouraged workers dropping out of the labour force. The current performance, at about 1.0 percent on average, is lower than the target and longer-term inflation expectations.

Inflation in the US was 2.1 per cent in June 2014 compared with 1.8 per cent in the corresponding period of 2013. All relevant inflation measures declined in the US in 2013, with core inflation running at less than 1.0 percent, amidst continued fall in the unemployment rate. However, inflation was expected to decline to 1.4 per cent by end-2014.

The Euro Area recorded 1.6 per cent inflation in June 2013 before decelerating to 0.5 per cent in June 2014. Inflation is expected to be 0.9 per cent at end-2014, largely due to the recovery from the recent drag of the sovereign debt and banking sector crisis in some member peripheral economies. In the zone, inflation is on the decline and has moved closer to the lower end of the range forecast provided by the European Central Bank (ECB) in the last few years.

In Japan, inflation was 0.2 per cent in June 2013, compared with 3.6 per cent in June 2014, owing to increases in the consumption tax. Consequently, inflation which increased with stronger growth and the depreciation of the yen in 2013, has been projected to decelerate in 2014‑15.

Inflation in the emerging market and developing economies was 5.3 per cent in June 2014 compared with 6.5 per cent in the corresponding period of 2013. The rate is expected to remain at this level by end-2014 and 2015, owing to softer world commodity prices. Softer commodity prices and tight monetary policy have helped lower inflation in these economies.

Table 1. 2: Global Inflation (per cent)

Region/Country	June 2013	June 2014	2013	2014	2015
World	3.4	3.4	3.6	3.2	3.2
Advanced Economies	1.5	1.8	1.4	1.6	1.7
US	1.8	2.1	1.5	1.4	1.6
Euro Area	1.6	0.5	2.2	0.9	1.2
Japan	0.2	3.6	(0.1)	2.8	1.7
UK	2.9	1.9	2.7	1.9	1.9
Emerging and Developing Economies	6.5	5.3	5.9	5.4	5.3
MENA Region	11.5	12.3	10.5	8.4	8.3
Sub-Saharan Africa	7.1	6.5	6.3	6.1	5.9
Nigeria	8.4	8.2	8.0	7.3	7.0

Source: US Bureau of Labour Statistics; IMF Financial Statistics Data Report July 2014

1.1.3 Commodities

Energy prices were somewhat flat on account of increasing supply above demand in most markets. Crude oil prices were stagnant because of the continued supply surge in North America. Non – Organization of the Petroleum Exporting Countries (OPEC) supplies increased by 1.3 million barrels a day (mbd) in 2013, slightly faster than the 1.2 mbd growth in global demand. The net growth of 1.2 mbd from the United States was mainly out of shale oil and Canada's 0.2 mbd was mainly sands oil. Projections for growth in non-OPEC supply were raised to 1.8 mbd in 2014, well above the 1.4 mbd level of demand. Crude oil prices were held up because of mounting OPEC supply pressures, particularly from sanctions against the Islamic Republic of Iran and disruption of supplies from Libya, Nigeria, Syria, and Yemen. Oil demand was relatively weak in the fourth quarter of 2013. Thus, oil prices were marked down during the outlook period, owing to expanding oil supply and weak demand.

Metal prices remained generally flat since 2013, at about 30 per cent below the highs of early 2011, as most markets recorded surpluses, owing to large and rising stocks as well as steady production gains. Global metal demand growth, especially in China, slowed in 2013, while supply grew strongly. Futures prices indicated declining metal prices, reflecting continuing diminishing surpluses in a number of markets.

Generally, softening commodity prices in the second half of 2013 may be a signal of the end of the commodity price super-cycle. This is based on the slowdown in emerging market economies, particularly China, and the increase in supplies, especially increased U.S. crude oil production, a supply overhang in most base metals, and increasing grain supplies. However, during the first quarter of 2014, some prices improved, with signs of strengthening global activity.

1.1.3.1 Oil

The OPEC Reference Basket spot price was US$107.88 per barrel in June 2014, inching up by US$2.03pb above the 2013 average. Similarly, the Bonny light spot price was US$107.89pb in June 2014, compared with US$110.95pb in 2013. Oil demand outside North America has slowed, particularly for diesel, partly owing to seasonal factors. OPEC expects its share of the world oil market to shrink in 2015 for the third consecutive year, adjusting to global demand. About 2.5 mb/d of OPEC output has been adjudged as output shortage from Libya, Iraq, Iran and Nigeria. Should this portion of oil return to the market, OPEC may need to restrain production further.

1.1.3.2 Food

Food markets recorded favourable production for most major crops. Global output for major grains and oilseeds was projected to surpass demand growth. China was projected to harvest increased production of wheat and corn, owing to favourable weather and increased global rice supplies. Stocks also continued to gradually recover, notably corn. In early 2014, concerns about the effects of adverse weather on South American harvests exerted some upward price pressure. The United Nations FAO Food Price Index averaged 206.0 points in June, 2014, down by 3.8 points or 1.8 per cent, from June 2013 (Table 1.3).

Table 1. 3: Global Food Price Index

	June 2013	June 2014	Dec. 2013	% Dec - June
Food price index	209.8	206.0	206.2	-0.10
Meat	201.1	194.6	185.6	4.85
Dairy	236.5	238.9	264.1	-9.54
Cereals	196.1	207	192.9	7.31
Vegetable oil	188.8	195.3	196.0	-0.36
Sugar	258	259.3	234.9	10.39
Source: Food and Agriculture Organisation of the United Nations				

While confirming the generally favourable crop production and supply outlook for 2014/15, the FAO Crop Prospects and Food Situation Report warned that many people around the world could face a situation of food insecurity. FAO estimates that globally, 33 countries, including 26 in Africa, were in need of external assistance, owing to a combination of conflicts, crop failures and high domestic food prices.

1.1.3.3 Gold

The spot price of gold on June 30, 2014 was US$1,327.33 per ounce, compared with the highest level of US$1,431.7 per ounce on August 28, 2013 and the lowest of US$1,192 per ounce on June 28, 2013[1]. The bullion price for August 2014 delivery rose by 0.57 per cent to US$1,334.90 an ounce on the Comex, the highest for the most-active contracts in 2014. Overall, gold gained about 6.2 per cent in price in the month of June 2014 and 10.0 per cent during the first half of the year, as the violence in Iraq and tensions between Ukraine and Russia boosted demand for haven assets.

[1]Sourced from Bloomberg.

Gold prices rose nearly 6 per cent in June, 2014 above the prices observed in May. Prices had risen by 11.0 per cent since January 2014, outpacing gains for indexes of commodities, equities and Treasuries. The recent slump in equities boosted demand for this precious metal as a safe haven. Investor holdings in exchange-traded products backed by the metal have rebounded. The jump in gold prices which came as turmoil in the Middle East and Eastern Europe put investors on edge. Equities performed below expectations on concerns about investments in Europe and the need for flight to safety. The latest was Portugal's Banco Espirito Santo SA bonds which plunged to a record low after a parent company delayed debt repayments on short-term notes, fuelling concerns that the Euro Area remained vulnerable to financial shocks. Gold futures for August delivery rose 1.1 per cent and settled at $1,339.20 an ounce on the Comex in New York. Earlier, the price reached $1,346.80, the highest for a most-active contract since March 19, 2014, according to data compiled by Bloomberg.

Prices of other metals fell by 2.9 per cent in May, 2014, partly due to concerns about slowing demand in China. The largest decline was for uranium prices, which plunged 13.0 per cent, following excess global supply and delays in restarting Japan's nuclear power plants. A Japanese court had ruled in May, 2014 against restarting two reactors, following safety checks on residential areas. Iron ore prices dropped by 12 per cent, as rapid increases in low-cost supplies from Australia and Brazil exceeded demand. Falling iron ore prices were threatening China's high cost producers, but the extent/timing of possible closures is uncertain. Aluminium prices fell by 3.0 per cent following continued oversupply conditions, although prices jumped in late-May and early-June on expectations that Indonesia's export ban might affect bauxite supplies. Partly offsetting these gains was a 12.0 per cent surge in nickel prices, mainly owing to Indonesia's January 12th export ban on unprocessed ore. However, nickel prices fell from their highs into early June as stocks were still at record levels and severe market tightening was not expected until 2015 (*IMF Commodity Market Monthly, June 2014*).

1.1.4 International Financial Markets

1.1.4.1 International Stock Markets

International stock markets recorded mixed results during the review period. While stock movements in North America and Africa were generally positive, markets in Europe remained weak. In North America, the Mexican Bolsa, S&P 500 and the Canadian S&P/TSX Composite indices increased month-on-month over the same period by 3.3, 1.9 and 3.7 per cent, respectively. In South America, the Argentine Merval index and Brazilian Bovespa increased by 2.9 and 3.8 per cent, respectively, while the Columbian IGBC General indices data were not available. Stock markets in Africa, notably the Nigerian ASI, South African JSE All-Share, Ghanaian GSE All Share, and the Kenyan Nairobi NSE 20 increased month-on-month between May and June by 2.4, 2.6, 2.3 and 0.1 per cent, respectively. However, the Egyptian EGX CASE 30 index decreased by 1.0 per cent.

In Europe, FTSE 100, CAC 40 and DAX indices decreased by 1.5, 2.1 and 1.1 per cent, respectively, while Russia's MCEX increased by 3.1 per cent. In Asia, India's BSE Sensex, Japan's Nikkei 225 and China's Shanghai Stock Exchange-A indices increased by 4.9, 3.6 and 0.5 per cent, respectively (see Table 1.4).

Table 1. 4: Indices of Selected International Stock Markets as at June 30, 2014

Country	Index	End-Dec, 2013	30-May-14	30-Jun-14	YTD % Change	May 30 - June 30 2014 % Change
AFRICA						
Nigeria	ASI	41,329.10	41,474.39	42,482.48	2.8	2.4
South Africa	JSE African AS	46,256.23	49,632.70	50,945.26	10.1	2.6
Kenya	Nairobi NSE 20	4,926.97	4,881.56	4,885.04	-0.9	0.1
Egypt	EGX CSE 30	6,782.84	8,242.94	8,162.20	20.3	-1.0
Ghana	GSE All Share	2,145.20	2,319.12	2,373.38	10.6	2.3
NORTH AMERICA						
US	S&P 500	1,848.36	1,923.57	1,960.23	6.1	1.9
Canada	S&P/TSX Composite	13,621.55	14,604.16	15,146.01	11.2	3.7
Mexico	Mexican Bolsa (IPC)	42,727.09	41,362.51	42,737.17	0.0	3.3
SOUTH AMERICA						
Brazil	Bovespa Stock	51,507.16	51,239.34	53,168.22	3.2	3.8
Argentina	Merval	4,275.98	6,351.65	6,537.61	52.9	2.9
Colombia	IGBC General	13,071.27	NA	NA	NA	NA
EUROPE						
UK	FTSE 100	6,749.09	6,844.51	6,743.94	-0.1	-1.5
France	CAC 40	4,295.95	4,519.57	4,422.84	3.0	-2.1
Germany	DAX	9,552.16	9,943.27	9,833.07	2.9	-1.1
Russia	MICEX	1,503.39	1,432.03	1,476.38	-1.8	3.1
ASIA						
Japan	NIKKEI 225	16,291.13	14,632.38	15,162.10	-6.9	3.6
China	Shanghai SE A	2,214.49	2,135.09	2,144.74	-3.1	0.5
India	BSE Sensex	21,170.68	24,217.34	25,413.78	20.0	4.9

Source: Bloomberg

1.1.4.2 Foreign Exchange Markets

Performance in the foreign exchange markets was generally mixed during the half year to June 30, 2014. Five out of the16currencies surveyed depreciated against the US dollar, reflecting continued investor appetite for dollar-denominated assets. In North America, the Canadian dollar recorded an appreciation of 0.98 per cent, while the Mexican peso depreciated against the U.S. dollar by 0.85 per cent. In South America, the Brazilian real and the Colombian peso appreciated against the US dollar by 1.36 and 1.05 per cent, respectively. However, the Argentine peso depreciated by 0.62 per cent on a month-to-month basis.

In Europe, the pound sterling and the Russian rubble appreciated by 3.45 and 2.71 per cent, respectively, against the US dollar. The euro-US dollar exchange rate remained flat over the May-June period. In the Asian market, the Japanese yen and the Chinese yuan appreciated month-on-month by 0.43 and 0.81per cent, respectively, while the Indian rupee depreciated by 1.81 per cent, against the US dollar.

Currencies in Africa, including the Nigerian naira and the Egyptian pound, remained unchanged. Kenyan shillings appreciated by 2.63 per cent between May and June, 2014 while the South African rand and the Ghanaian cedi depreciated month-on-month by 0.66 and 7.78 per cent, respectively, against the US dollar.

1.2 Domestic Developments

1.2.1 Output

The domestic economy remained strong in the first half of 2014. Real Gross Domestic Product (GDP) recorded a growth of 6.38 per cent in the first half of 2014, compared with 4.94 and 5.98 recorded in the first and second halves of 2013, respectively. The development was attributed to growth in the non-oil sector whose contribution increased from 88.27 per cent to 88.71 per cent. The sector recorded a growth of 7.44 per cent in real terms, compared with the growth of 8.18 and 8.62 per cent in the first and second halves of 2013, respectively. Growth in the non-oil sector was driven, mainly by activities in manufacturing (14.71%), construction (13.99%), services (7.22%) and trade (5.71%). In terms of sectoral contribution, the service sector accounted for the largest share (36.62%) of real GDP, followed by industry (21.85%) and agriculture (20.28%).

The oil sector recorded a decline of 1.23 per cent in the first half of 2014, compared with the decline of 13.77 and 12.34 per cent, respectively, in the first and second halves of 2013. The decline was attributed to low production levels. Further analysis indicated that the contribution of the oil sector to the GDP in the first half of 2014 stood at 11.29 per cent, compared with 12.16 and 10.43 per cent recorded in the first and second halves of 2013, respectively.

Figure 1.1: Gross Domestic Product by Sector (₦ billion)

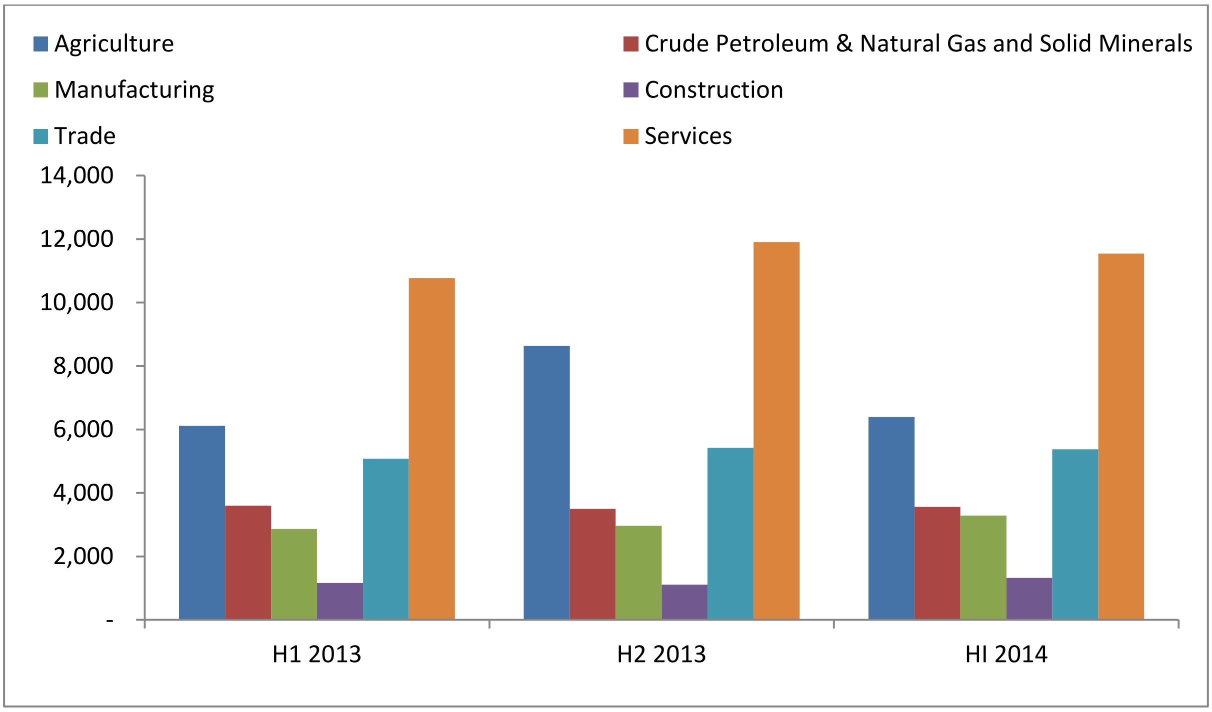


Table 1.5: Changes in Real GDP by Sector (per cent)

Sector	H1 2013	H2 2013	H1 2014
Manufacturing	21.89	21.71	14.71
Construction	13.96	14.49	13.99
Services	8.82	9.89	7.22
Trade	5.91	7.33	5.71
Agriculture	2.52	3.24	4.54
Crude Petroleum, Nat. Res. and Solid Min.	-13.53	-12.06	-1.04

Figure 1. 2: Share of Oil and Non-oil Sectors in Real GDP (%)

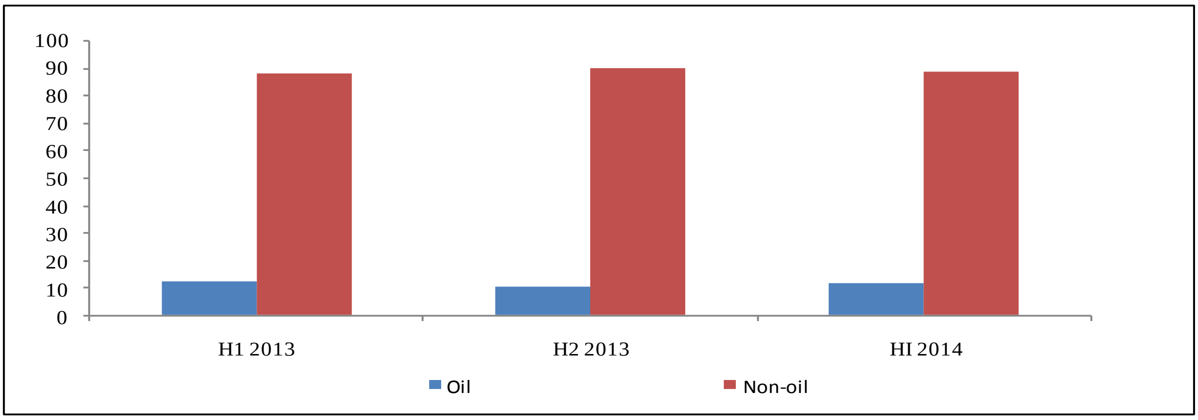
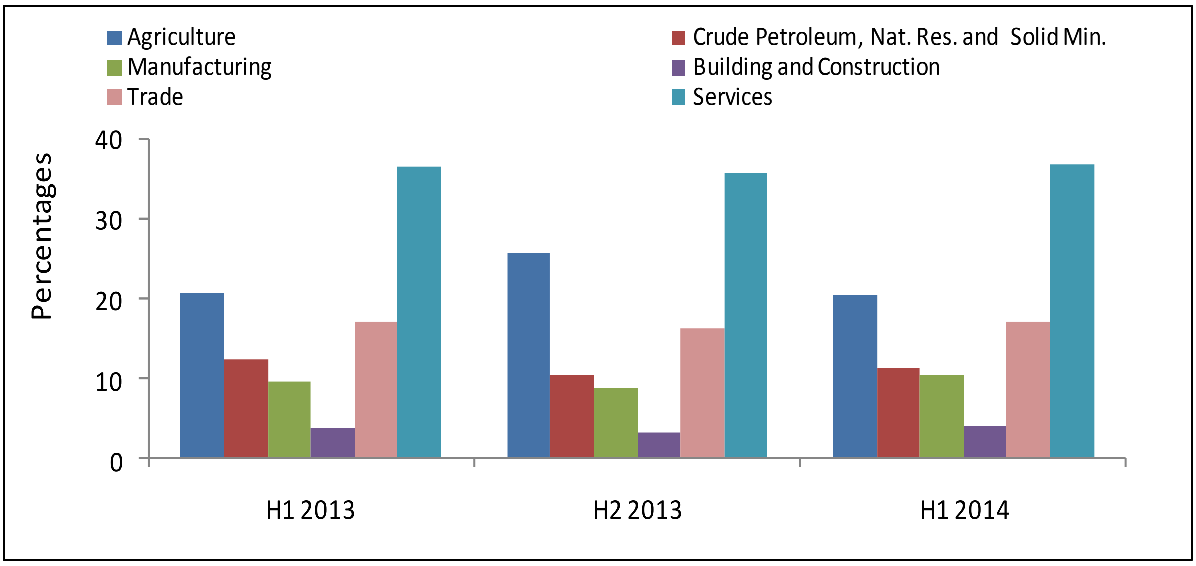


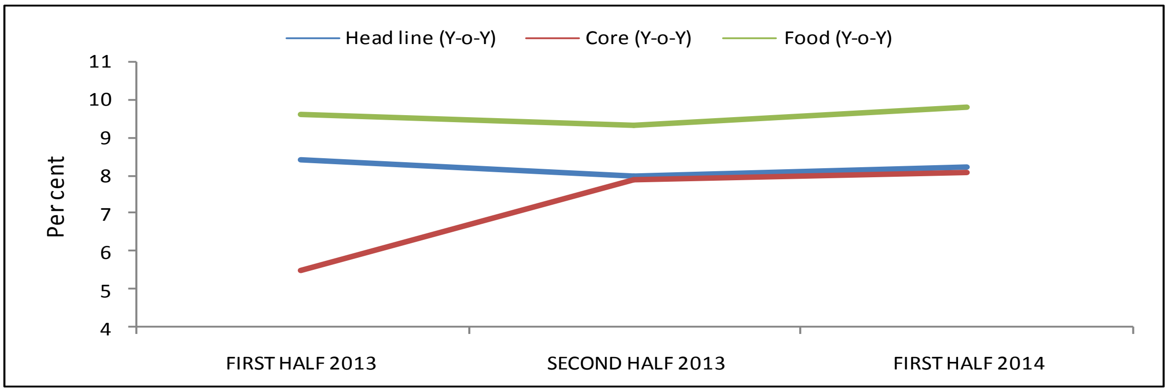
Figure 1.3: Sectoral Share in Total GDP (%)



1.2.2 Inflation

The domestic general price level continued to be moderated by the tight monetary policy stance of the CBN during the first half of 2014. Inflation rose marginally, but remained at single digit during the period. Year-on-year headline inflation rose to 8.2 per cent in June 2014, from 8.0 per cent at end-December 2013. Also, core and food inflation rose to 8.1 and 9.8 per cent, respectively, at end-June 2014, from their respective levels of 7.9 and 9.3 per cent at end-December 2013 (Figure 1.4).

Figure 1. 4: Inflationary Trend (Year-on-Year)



1.2.3 Interest Rates

Banks' interest rates generally trended upwards in the first half of 2014, with the exception of the 7-day deposit rate which declined marginally to 4.81 per cent from 4.82 per cent. This reflected, largely, the continued monetary tightening stance of the CBN as the Bank maintained its policy rate at 12.00 per cent. The average term deposit rate rose to 8.57 per cent, from 6.42 per cent in the second half of 2013. Similarly, the average savings rate rose to 3.35 per cent from 2.46 per cent, while the rates for other deposits of various maturities rose to a range of 8.31–9.98 per cent in the first half of 2014, from a range of 4.82–7.73 per cent in the second half of 2013 (Figure 1.5).

The average inter-bank call and open-buy-back (OBB) rates stood at 10.44 and 10.99 per cent, respectively, in the first half of 2014, down from 12.87 and 13.01 per cent in the second half of 2013, respectively. Similarly, the average prime lending rate fell by 0.09 percentage point to 16.73 per cent, while the average maximum lending rate rose by 1.24 percentage points to 25.76 per cent in the review period, from 24.52 per cent in the second half of 2013. Thus, the spread between the average maximum lending and the average term deposit rates stood at 17.19 percentage points, indicating a 0.91 percentage point below the level in the second half of 2013. With inflation at 8.20 per cent in June 2014, most deposit rates and all lending rates were positive in real terms. The positive real rate of return on deposits is an incentive to save, providing an opportunity for capital accumulation and enhancing the ability for banks to build a sustainable long-term loanable funds base.

Figure 1. 5: Money Market Interest Rates and MPR

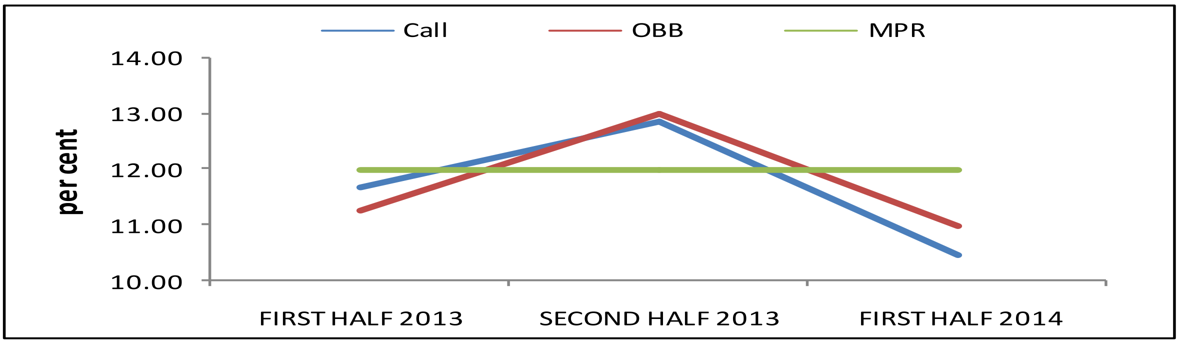
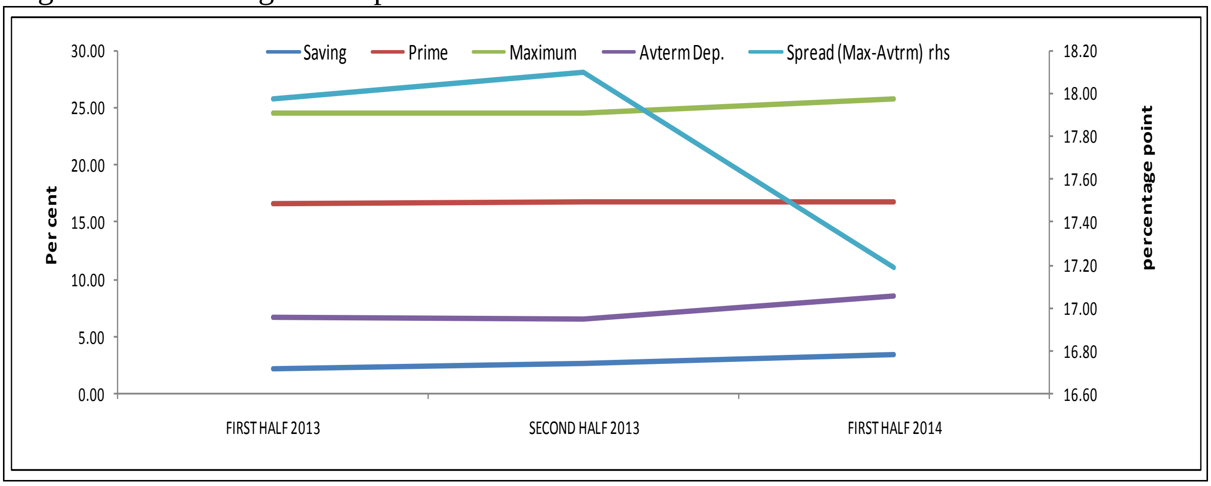


Figure 1. 6: Lending and Deposit Rates

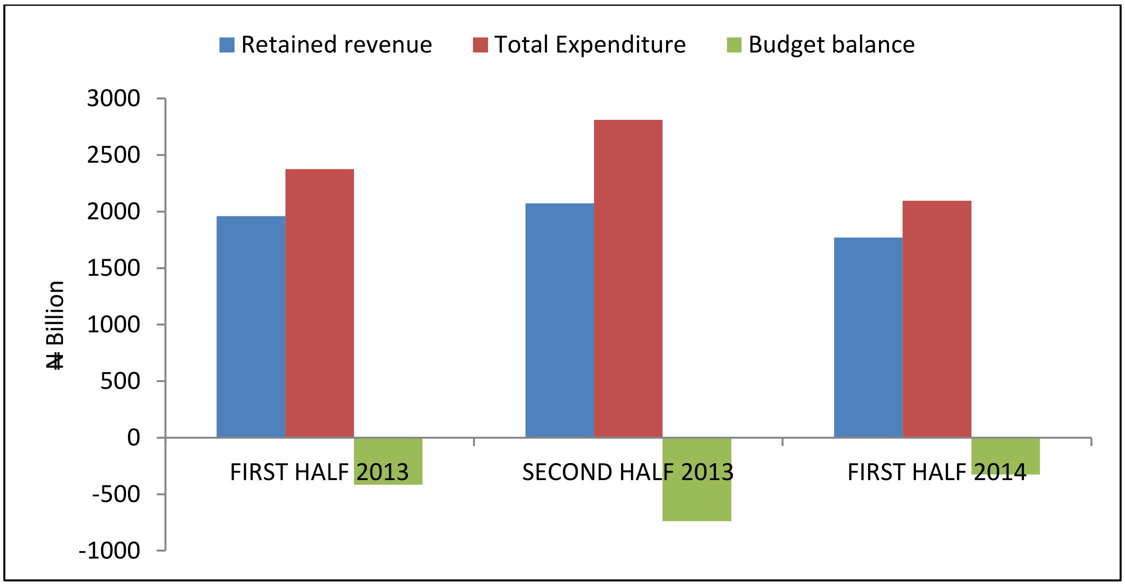


1.2.4 Fiscal Operations

Federal Government's retained revenue stood at ₦1,771.27 billion in the first half of 2014, against the budget estimate of ₦2,134.0 billion, while expenditure was estimated at ₦2,096.37 billion, compared with ₦2,616.1 billion budgeted for in the first half of 2014.

Consequently, the fiscal operations of the Federal Government resulted in an overall deficit of ₦325.10 billion or 0.8 per cent of GDP, as against the proportionate budget deficit of ₦482.1 billion for the first half of 2014 and ₦443.53 billion for the corresponding period of 2013. The deficit was financed mostly through domestic borrowings (Figure 1.7).

Figure 1. 7: Federal Government Fiscal Operations



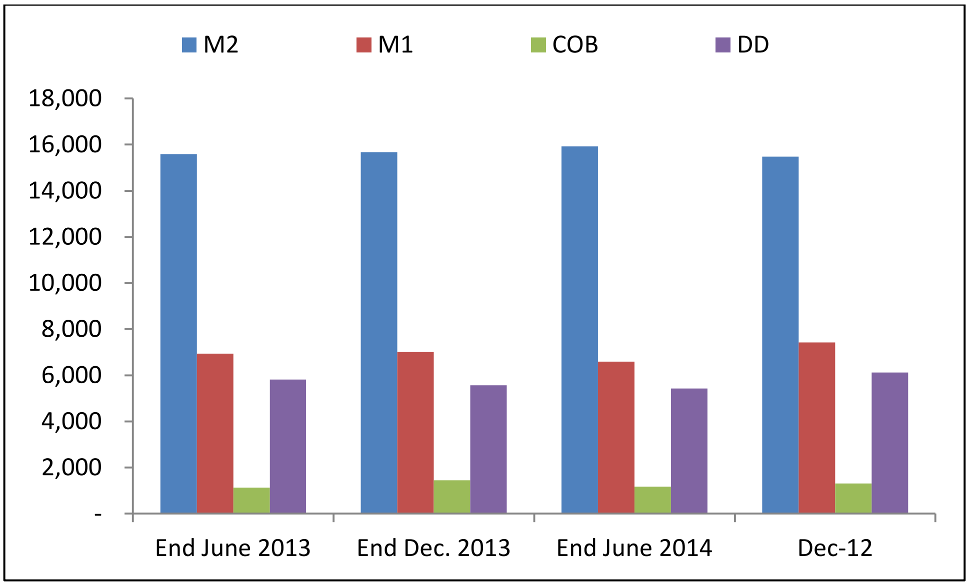
2.0 DEVELOPMENTS IN THE FINANCIAL SYSTEM

2.1 Monetary and Credit Developments[2]

Provisional data showed that growth in broad money supply (M_2) was sluggish at the end of the first half of 2014. Over the level at end-December 2013, M_2 grew by 1.66 per cent to ₦15,928.4 billion at end-June 2014, compared with 0.7 per cent at the end of the corresponding period of 2013. This increase reflected, largely, the 0.88 per cent rise in net domestic credit of the banking system, which more than offset the decline in net foreign assets and other assets (net) of the banking system during the review period.

Narrow money (M_1) fell by 6.07 per cent at end-June 2014, compared with the 6.49 per cent decline at end-June 2013.The decline was attributed, largely, to the 19.67 and 2.53 per cent fall in currency outside banks (COB) and demand deposits, respectively. As a ratio of total monetary assets, COB stood at 7.29 per cent, compared with the 7.20 per cent recorded at the end of the corresponding half of 2013.

Figure 2. 1: Trend in Monetary Aggregates



2.1.1 Aggregate Credit to the Economy

Net domestic credit (NDC) to the economy grew marginally by 0.88 per cent to ₦15,173.6 billion at end-June 2014, compared with ₦15,040.7 billion at the end of the second half of 2013. This reflected the 2.75 per cent growth in claims on the private sector (CP), which more than off-set the 21.89 per cent fall in claims on the Federal Government (CG) (Figure 2.2).

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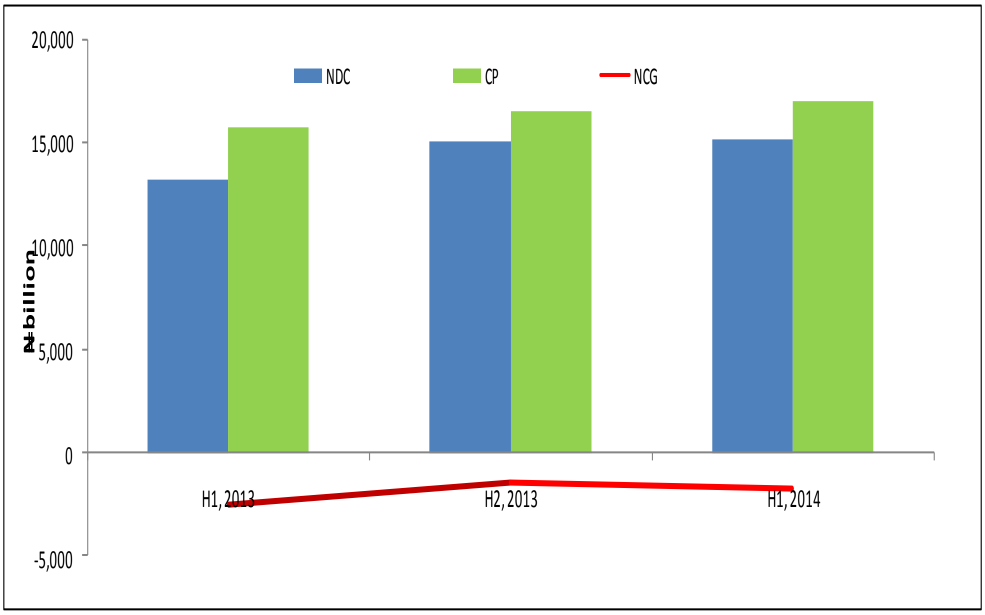
[2] The analysis is based on the revised CBN Monetary Survey.

Figure 2.2: Credit to the Economy



2.1.1.1 Claims on the Federal Government

Net claims on the Federal Government declined by 21.89 per cent to negative ₦1,790.2 billion at end-June 2014, in contrast to the growth of 40.14 per cent recorded at the end of the second half of 2013. This development, relative to the preceding half year reflected, mainly, the decline in the banking system's holdings of government securities. The fall in net claims on the Federal Government tended to enhance private sector credit availability. This development is expected to further promote the emergence of a vibrant private sector.

2.1.1.2 Claims on the Private Sector

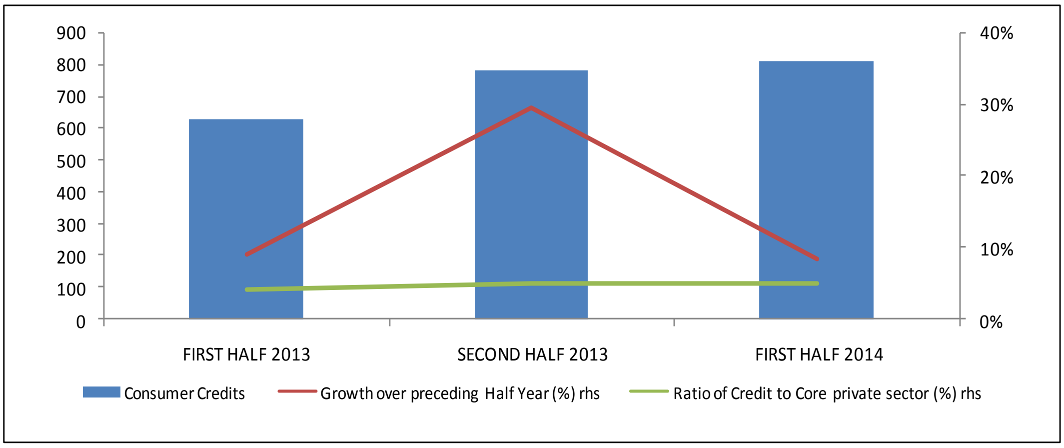
Credit to the private sector increased by 2.75 per cent to ₦16,963.8 billion at end-June 2014, compared with the growth of 8.96 per cent recorded at the end of the second half of 2013. The growth in private sector credit reflected, largely, the 3.18 per cent rise in claims on the core private sector[3].

2.1.1.3 Consumer Credit

Consumer credit grew marginally by 3.49 per cent to ₦809.8 billion in the first half of 2014, compared with the growth of 0.8 and 24.50 per cent in the first and second halves of 2013, respectively. As a ratio of credit to the core private sector, consumer credit constituted 4.49 per cent, the same as in the second half of 2013 (Figure 2.3).

[3]Excludes the state and local governments

Figure 2.3: Consumer Credit



2.1.2 Sectoral Classification of Private Sector Credit

Total bank loans and advances to the various sectors of the economy grew by 7.86 per cent to ₦10,830.1 billion in the first half of 2014, compared with 13.88 per cent growth in the second half of 2013. Credit to the oil and gas sector accounted for the highest share of 24.33 per cent, followed by manufacturing (13.15%). The agriculture, forestry and fishing category absorbed 3.84 per cent of total bank credit in the first half of 2014, indicating a 0.6 percentage point increase over the 3.23 per cent recorded in the second half of 2013 (Table 2.1).

Figure 2.4: Sectoral Allocation of Credit

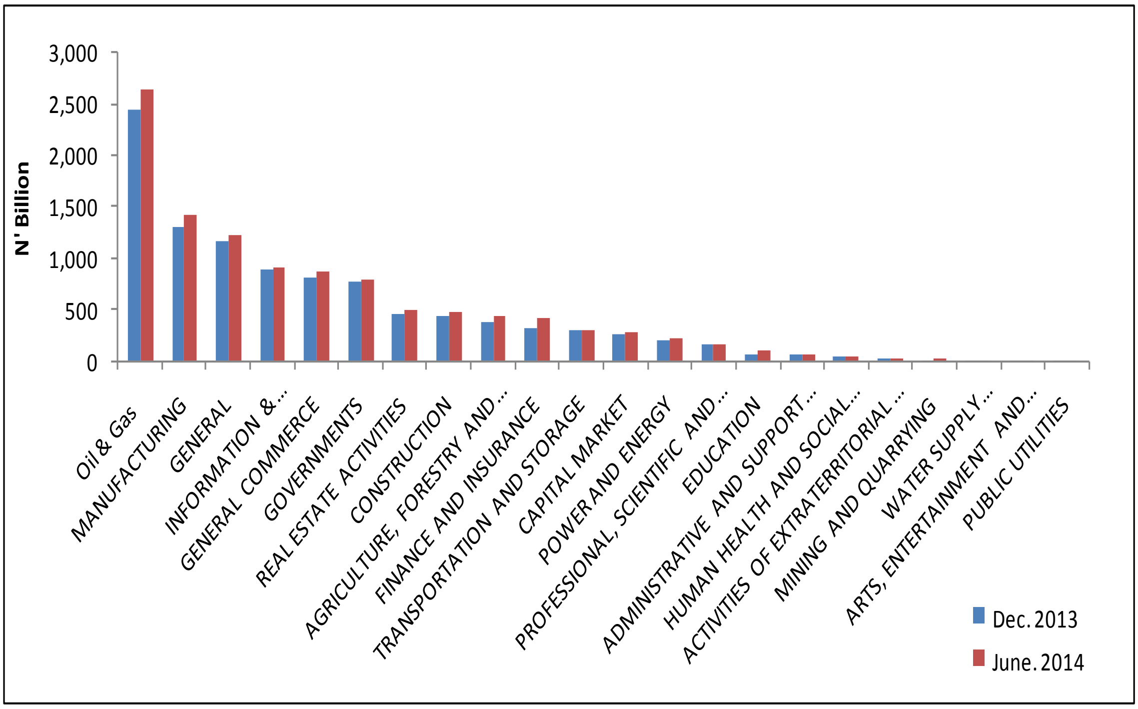


Table 2. 1: Sectoral Distribution of Credit

Sector	Dec. 2013		June 2014	
	₦' Billion	Per cent	₦ 'Billion	Per cent
Oil and gas	2,450.48	24.40	2,635.12	24.33
Manufacturing	1,295.41	12.90	1,424.11	13.15
General: Household Consumer Goods (Personal)	782.59	7.79	809.78	7.48
General: Hospitality/Leisure and Religious	381.83	3.80	410.39	3.79
Information and communication	881.22	8.77	917.46	8.47
General commerce	807.51	8.04	872.32	8.05
Governments	764.91	7.62	795.40	7.34
Real estate	431.27	4.29	479.35	4.43
Construction	450.1	4.48	498.67	4.60
Agriculture, forestry and fishing	324.21	3.23	415.88	3.84
Finance and insurance	291.44	2.90	289.46	2.67
Transportation and storage	255.79	2.55	272.02	2.51
Capital market	193.98	1.93	213.73	1.97
Power and energy	370.63	3.67	427.75	3.95
Professional, scientific and technical activities	159.13	1.58	150.40	1.39
Education	70.99	0.71	89.04	0.82
Administrative and support service activities	58.67	0.58	56.94	0.53
Human health and social work activities	32.38	0.32	30.32	0.28
Activities of extra-territorial organizations and bodies	14.66	0.15	14.53	0.13
Mining and quarrying	11.35	0.11	13.26	0.12
Water supply, sewerage, waste mgt. & remediation activities	8.22	0.08	9.51	0.09
Arts, entertainment and recreation	3.98	0.04	4.53	0.04
Public utilities	1.96	0.02	0.10	0.00
Total	**10,040.75**	**100.00**	**10,830.07**	**100.00**

2.1.3 Reserve Money

Reserve money (RM) declined by 15.04 per cent to ₦4,723.1 billion at end-June 2014, from the level of ₦5,558.9 billion at end-December 2013, in contrast to the growth of 12.6 per cent recorded at the end of the first half of 2013.This was, however, lower than the indicative benchmark of ₦5,106.90 billion. This development relative to the level at end-December 2013, reflected the 10.1 and 33.1 per cent decline in net foreign and net domestic assets, respectively, of the CBN. The corresponding decline in the uses of reserve money was attributed to the fall in both currency-in-circulation and bank deposits with the CBN which recorded 15.7 and 14.7 per cent, respectively.

2.1.4 Maturity Structure of Bank Deposits and Credits

The structure of bank credits in the first half of 2014 indicated that credit of short-term maturities remained dominant. Credits maturing within one year accounted for 56.6 per cent, compared with 52.6 per cent at the end of the second half of 2013. The medium-term (≥1yr and < 3yrs) and long-term (3yrs and above) maturities stood at 16.8 and 26.6 per cent, compared with 19.1 and 28.3 per cent, respectively, at the end of the second half of 2013 (Figure 2.5).

Similarly, deposits of below one-year maturity constituted 95.6 per cent (of which 72.7 per cent had maturity of less than 30 days), compared with 97.2 per cent at end-December 2013. Further analysis showed that the medium and long-term deposits constituted 3.4 and 1.1 per cent, compared with 2.8 and 0.003 per cent recorded at end-December 2013, respectively (Figure 2.6).

Figure 2.5: Distribution of Bank Loans and Advances by Maturity

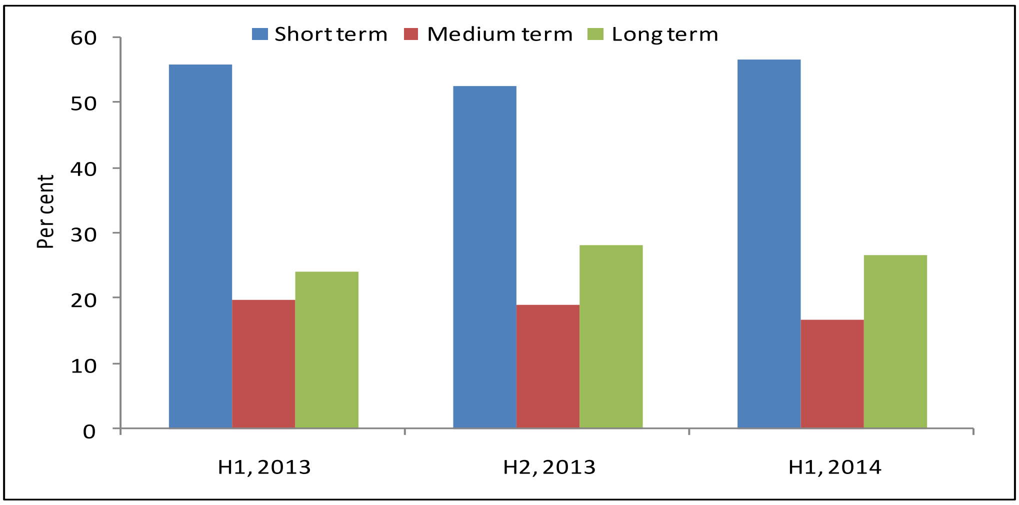
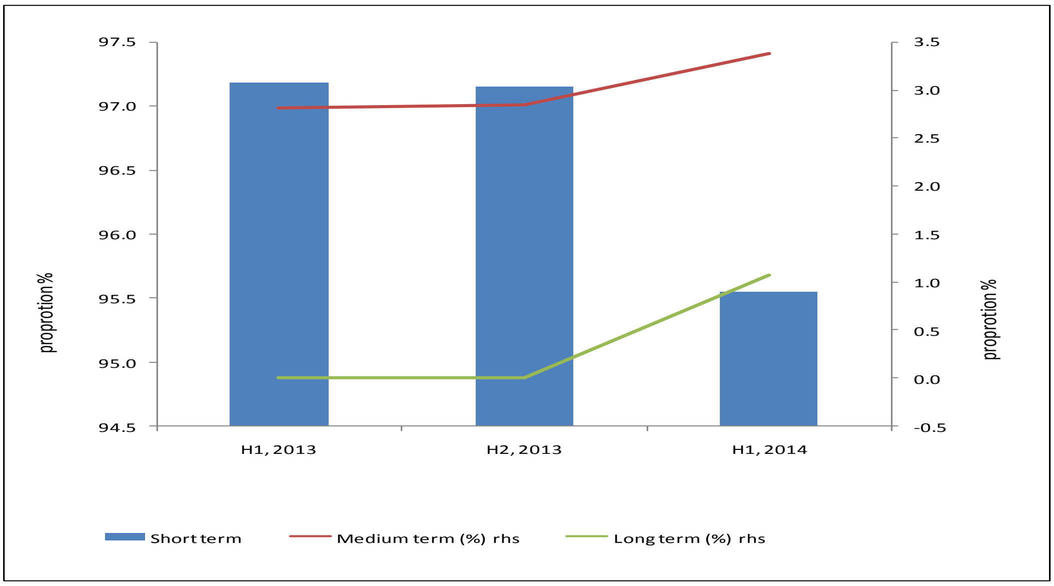


Figure 2.6: Maturity Structure of Bank Deposits

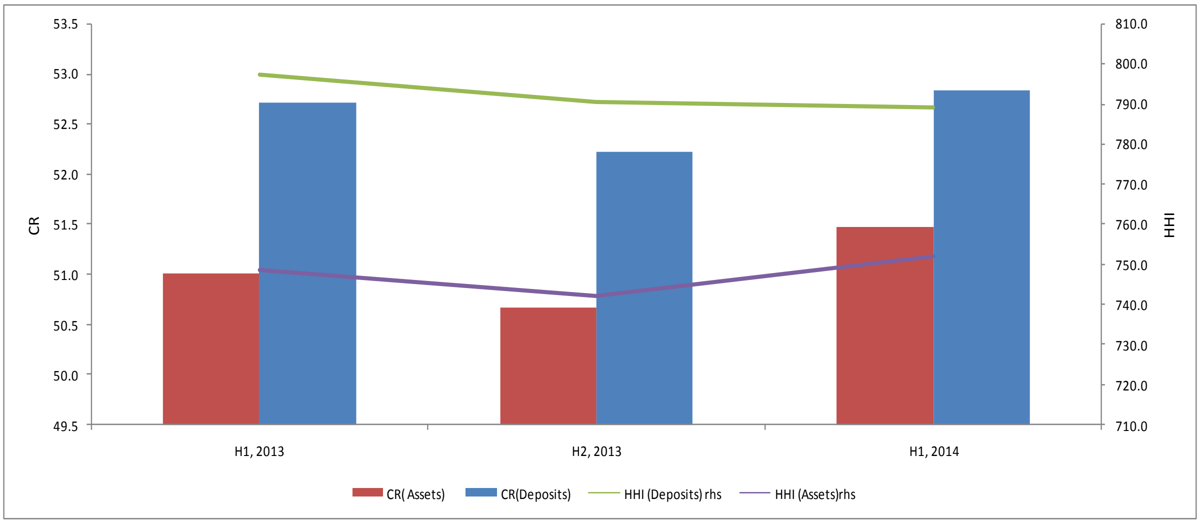


Apart from the consequences of a maturity mismatch, such as illiquidity, the continued dominance of short-term maturities remains a constraint to the ability of banks to create long-tenored risk assets and limits lending to the real sector which is crucial for economic development. This also portends refinancing and re-pricing risks for the system.

2.1.5 Market Structure of the Banking Industry

The banking industry, in the first half of 2014, remained dominated by a few major banks. The average market share of deposits and assets of the six largest banks (concentration ratio–CR6) stood at 52.85 and 51.48 per cent, compared with 52.23 and 50.68 per cent, respectively, in the second half of 2013. Similarly, during the review period, the average market share of the largest bank, in terms of deposits and assets, stood at 14.80 and 13.69 per cent, compared with 15.13 and 13.71 per cent, respectively, in the second half of 2013. However, the banking industry remained competitive in both deposits and assets as revealed by their average Herfindahl-Hirschman Index (HHI) of 789.21 and 752.06, respectively, (on a scale of 10,000), compared with 790.57 and 742.06 in the second half of 2013 (Figure 2.7).

Figure 2.7: Market Concentration Ratios of Banks (Assets and Deposits)



2.2 Cross-border Collaboration

The CBN provided technical assistance to supervisors from other jurisdictions on the regulation and supervision of development finance institutions, during the review period. It also participated in Supervisory College meetings aimed at enhancing effective oversight of cross-border operations of the banking groups.

During the review period, two banks divested from their subsidiaries in West and East Africa, while one, which had been given approval to operate in Southern Africa, was yet to commence operations. Two other subsidiaries were subjected to regulatory actions and were taken over by the regulator in one jurisdiction. However, one subsidiary had been returned to its parent, while the other remained under the direct control of the host supervisor.

Table 2. 2: Distribution of Offshore Subsidiaries of Nigerian Banks

Region	Subsidiaries		Representative Offices & Branches	
	Dec 2013	Jun 2014	Dec 2013	Jun 2014
West Africa	35	34	-	-
The Rest of Africa	20	18	4	4
Europe, N/ America& Asia	9	9	5	5
Total	64	61	9	9

In their quest for profit maximization, risk diversification, increasing business opportunities, among other reasons, Nigerian banks sustained their cross-border operations. However, these operations exposed the Nigerian financial system to regional contagion risk. The major supervisory thrust in managing the contagion risk is the timely exchange of information amongst home and host regulatory authorities. This is facilitated through the execution of memoranda of understanding, the activities of the College of Supervisors and cross-border examinations. In addition, the CBN is developing a framework for cross-border crisis management.

2.2.1 The College of Supervisors

During the review period, the 15th and 16th Meetings of the College of Supervisors were held in The Gambia and Ghana, respectively. The CBN also hosted the maiden College of Supervisors for the parent and the banking subsidiaries of a Nigerian bank, in Abuja. The meeting gave all supervisors an opportunity to exchange information and engage the top management of the bank on their strategies and commitments to the jurisdictions in which they operated.

2.2.2 Cross-border Examination

The maiden examination of two foreign subsidiaries of Nigerian banks was undertaken by the CBN and host supervisors during the review period.

The College of Supervisors of the West African Monetary Zone (CSWAMZ) adopted a resolution specifying a maximum period of two (2) months for finalization and issuance of supervisory reports.

2.3 Non-Interest (Islamic) Banking (NIB)

The CBN, in conjunction with the Islamic Financial Services Board (IFSB), conducted a workshop in Abuja for capacity building, on the following IFSB Standards:

- Fundamentals of Islamic Banking,
- Takaful (Islamic Insurance) Principles,
- Guiding Principles on Risk Management for Takaful Undertakings,
- Guiding Principles on Liquidity Risk Management, and
- Guiding Principles on Stress Testing.

The workshop was attended by regulatory agencies including: the CBN, the Nigeria Deposit Insurance Corporation (NDIC), the National Insurance Commission (NAICOM), the National Pension Commission (PENCOM), and the Securities and Exchange Commission (SEC).

In the same vein, the CBN, in conjunction with the Islamic Council of the United Kingdom and Enhancing Financial Innovation and Access (EFInA) - a non-Governmental organization-sponsored by the British Government through the Department for International Development (DFID) and Bill and Melinda Gates Foundation, organized a training session for the CBN Financial Regulation Advisory Council of Experts (FRACE) members as well as the Advisory Council of Experts (ACE) of the non-interest financial institutions. The training covered some aspects of Islamic and conventional finance.

2.4 Other Financial Institutions (OFIs)

There were 4,291 OFIs in Nigeria at end-June 2014, compared with 3,858 at end-December 2013. This number comprised six (6) Development Finance Institutions (DFIs), 40 Primary Mortgage Banks (PMBs), 925 Microfinance Banks (MFBs),64 Finance Companies (FCs) and 3,256 Bureaux de Change (BDCs).

Table 2. 3: Other Financial Institutions Licensed by the CBN

Institution-Type	**Number**	
	Dec 2013	**June 2014**
Development Finance Institutions	6	6
Primary Mortgage Banks	82	40
Microfinance Banks	820	925
Finance Companies	61	64
Bureaux de Change	2,889	3,256
Total	**3,858**	**4,291**

Total assets of the sub-sector fell to ₦1,372.2 billion at end-June 2014, from ₦1,444.6 billion at end-December 2013, reflecting a decrease of 5.0 per cent. Similarly, the paid-up capital and net loans/advances decreased by 3.65 and 4.02 per cent to ₦446.4 billion and ₦663.5 billion, respectively, at end-June 2014, from ₦463.3 billion and ₦691.3 billion at end-December 2013. Total deposits decreased by 2.1 per cent to ₦462.5 billion at end-June 2014, from ₦472.4 billion at end-December 2013.

2.4.1 Microfinance Banks (MFBs)

The total assets of MFBs rose to ₦280.76 billion at end-June 2014, from ₦270.90 billion at end-December 2013, representing a 3.64 per cent increase. Similarly, the paid-up capital and shareholders' funds of MFBs increased by 7.79 and 16.17 per cent to ₦72.65 billion and ₦84.76 billion at end-June 2014, from ₦67.40 billion and ₦72.96 billion, respectively, at end-December 2013. The increase in capital was due largely to the recapitalization of some MFBs in compliance with regulatory directives.

Total deposit liabilities and net loans &advances also increased by 6.3 and 0.4 per cent to ₦144.4 billion and ₦129.5 billion at end-June 2014, compared with ₦135.9 billion and ₦129.0 billion, respectively, at end-December 2013. The rise in deposit liabilities was indicative of increased public confidence in the operations of the MFBs, while the marginal growth in net loans and advances showed an improvement in mission-focus on the part of the operators. Reserves also increased to ₦12.1 billion at end-June 2014, from ₦5.6 billion at end-December 2013, due mainly to share premium arising from new issues and retention of profits by the MFBs.

2.4.1.1 Microfinance Certification Programme (MCP)

The MCP entered its third phase of implementation during the review period. During this phase the subsidy on tuition paid by the CBN and the NDIC was withdrawn, while the CBN continued the coordination of the programme. Candidates for the certification programme were hence expected to be responsible for full payment of their tuition and examination fees. Meanwhile, the Chartered Institute of Bankers of Nigeria (CIBN) had examined and certified 391 operators, bringing the total certified operators to 2,593.

2.4.2 Primary Mortgage Banks (PMBs)

The number of PMBs in operation remained at forty (40) at end-June 2014, although their composition had changed. Following the approval of the application for upgrade of three (3) State PMBs to National status, the number of National PMBs increased to ten (10) at end-June 2014, from seven (7) at end-December 2013, while the State PMBs decreased from thirty-three (33) to thirty (30).

The total assets of PMBs decreased by 14.5 per cent to ₦413.7 billion at end-June 2014, from ₦484.0 billion at end-December 2013. This was due to the non-inclusion of the assets of the 16 PMBs that had applied for conversion to other forms of financial institutions. Accordingly, the paid-up capital, deposit liabilities and loans and advances of PMBs decreased by 14.1, 11.2 and 12.5 per cent to ₦129.0 billion, ₦146.3 billion and ₦137.8 billion, respectively, at end-June 2014. However, aggregate reserves improved by 570.18 per cent, from negative ₦5.7 billion at end-December 2013 to ₦26.8 billion at end-June, 2014 and shareholders' funds rose to ₦155.8 billion at end-June 2014, reflecting an increase of 7.7 per cent.

2.4.2.2 The Nigeria Mortgage Re-finance Company (NMRC)

Following an approval-in-principle (AIP) granted to the NMRC in 2013, the company was launched on January 16, 2014, as a public-private partnership arrangement. The company is expected to provide second-tier mortgage liquidity refinancing for mortgage operators. Twenty-two (22) shareholders had invested **₦7.**05 billion as deposits for shares. Furthermore, an additional sum of ₦2.88 billion is expected to be called up as the second tranche of the investment from both domestic and multilateral investors. This would increase the company's total equity contribution to ₦9.93 billion.

2.4.2.3 Uniform Underwriting Standards

The CBN, in collaboration with other stakeholders, is developing uniform underwriting standards to provide best practices in mortgage lending and prescribe eligibility criteria for access to NMRC refinancing. The standards would also promote efficiency and mitigate the legal and operational risks in the sector.

2.4.3 Finance Companies (FCs)

The CBN licensed three (3) finance companies (FCs), bringing the total number to 64, from the 61 at end-December 2013.

As part of the reform initiatives in the FC sub-sector, new guidelines were issued for the industry in the first half of 2014 to reposition it to meet the financial needs of the public, and deliver credit to the informal sector and small scale borrowers. The significant changes introduced by the guidelines included:

- Increase in the minimum capital from ₦20 million to ₦100 million;
- Increase in the size of their boards of directors from a minimum of three (3) to five (5) and a maximum of seven (7) to nine (9). Furthermore, FCs are required to have a minimum of one (1) and a maximum of two (2) independent directors and a majority of non-executive directors;
- Identification of non-permissible activities comprising deposit taking; non-financial activities, such as trading, construction and project management, capital market activities, and foreign exchange transactions, except through their correspondent banks/authorized dealers; and
- Expansion of the supervisory purview of the CBN to include all companies rendering finance lease services, which shall hence be required to apply for FCs licence.

All existing operators are expected to comply with the new requirements before end-September 2015.

The total assets of FCs decreased to ₦102.73 billion at end-June 2014, from ₦103.05 billion at end-December 2013, representing a decline of 0.31 per cent. Similarly, total borrowings decreased by 2.43 per cent to ₦57.78 billion at end-June 2014, from ₦59.22 billion at end-December, 2013. Their paid-up capital increased by 7.62 per cent to ₦15.81 billion at end-June 2014, from ₦14.69 billion at end-December 2013. Furthermore, loans and advances, and reserves increased by 8.29 and 20.34 per cent to ₦50.55 billion and ₦4.32 billion, respectively, at end-June 2014, reflecting improved operational performance of the institutions.

2.4.4 Bureaux de Change (BDCs)

The number of licensed Bureaux De Change (BDCs) at end-June 30, 2014 was 3,256 as against 2,889 recorded at end-December 2013, an increase of 12.70 percent which resulted from the issuance of 367 new licences.

2.4.5 Development Finance Institutions (DFIs)

In its efforts to reposition the DFIs for effective contribution to real sector and economic development, the CBN, in collaboration with the World Bank, developed draft regulatory and supervisory guidelines to facilitate the entrenchment of best practices to enable the institutions to achieve their mandates. The guidelines, which provide a framework for the regulation and supervision of the operations of Wholesale DFIs (WDFIs) and Retail DFIs (RDFIs), were exposed to stakeholders for comments during the review period. The guidelines also provide incentives for private investors to operate DFIs.

2.5 Financial Inclusion

The CBN continued to implement measures aimed at increasing access of the under-banked to basic banking and other financial services during the period under review. In particular, the Bank conducted on-site verification of the status of compliance of banks and OFIs with the financial inclusion provisions in the *CBN AML/CFT Regulation*. The verification exercise was conducted on 22 banks and 57 microfinance banks. The key findings were as follows:

- Seventeen banks and 12 MFBs had commenced the implementation of the KYC requirements;
- Banks that implemented the policy had, so far, opened over 102,537 new tier one and 119,846 tier two accounts; and
- Based on the overall analysis of the compliance status of the financial institutions, seven banks and three MFBs were categorized as fully compliant, seven banks and nine MFBs as partially compliant, while eight banks and 45 MFBs were non-compliant with the requirements.

The Bank will continue to monitor the implementation of the measures to enhance financial inclusion in Nigeria.

2.5.1 Financial Literacy

Financial Literacy and Consumer Protection Sensitization Campaign

The Bank conducted a Financial Literacy and Consumer Protection Sensitization campaigns, using the mass media and organised workshops in seven states spread across the six geopolitical zones. The Bank also engaged six tertiary institutions on a workshop entitled, *"Financial Literacy: A Tool for Economic Empowerment"*.

National Baseline Survey

The CBN conducted the data collection phase of the Baseline Survey on Financial Literacy. A total of 13,320 randomly selected respondents were interviewed.

2014 Global Money Week

During the review period, the CBN and the Bankers Committee, in collaboration with other stakeholders, observed the 2014 Global Money Week which aimed at raising awareness on Financial Literacy.

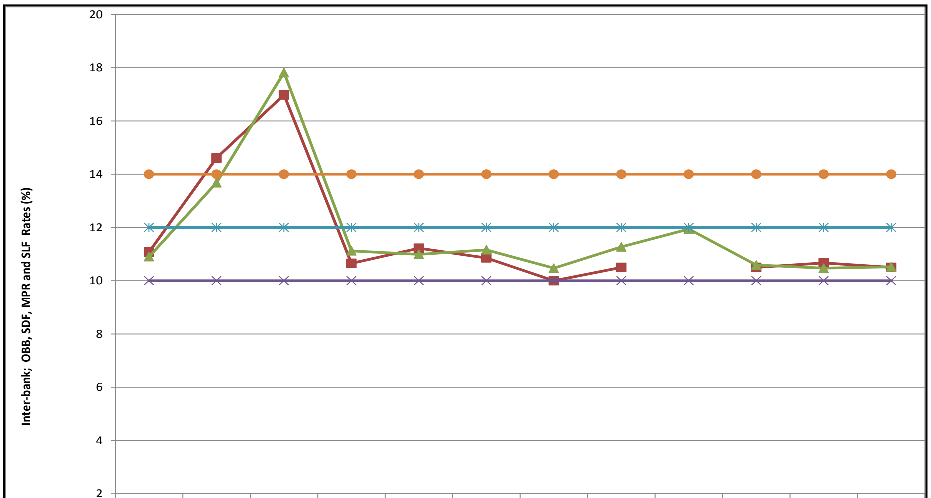
2.6 Financial Markets

2.6.1 The Money Market

In the first half of 2014, activities in the money market reflected the liquidity surfeit in the banking system, with authorised dealers indicating preference for collateralized transactions. Money market rates remained relatively stable, with the MPR remaining unchanged at 12.00 per cent, while fiscal injections sustained a constant flow of liquidity into the system. Money market operators continued to access discount window operations, repurchase agreements and Open Market Operations for their liquidity management.

The monthly weighted average inter-bank call rate ranged from 10.00 to 10.67 per cent. In March 2014, no activity was recorded at the call segment of the inter-bank market, due to liquidity surfeit in the system and the risk aversion of operators. The open-buy-back (OBB) rate ranged from 10.47 to 11.94 per cent during the review period. The OBB and inter-bank call rates closed at 10.50 and 10.52 per cent, respectively, at end-June 2014, compared with 11.16 and 10.86 per cent at end-December 2013.

Figure 2. 8: Movements of Money Market Rates



	July 2013	August 2013	September 2013	October 2013	November 2013	December 2013	January 2014	February 2014	March 2014	April 2014	May 2014	June 2014
Inter-bank	11.08	14.61	16.98	10.65	11.22	10.86	10.00	10.50		10.50	10.67	10.50
OBB	10.90	13.68	17.82	11.12	10.99	11.16	10.47	11.27	11.94	10.59	10.47	10.52
SDF	10.00	10.00	10.00	10.00	10.00	10.00	10.00	10.00	10.00	10.00	10.00	10.00
MPR	12.00	12.00	12.00	12.00	12.00	12.00	12.00	12.00	12.00	12.00	12.00	12.00
SLF	14.00	14.00	14.00	14.00	14.00	14.00	14.00	14.00	14.00	14.00	14.00	14.00

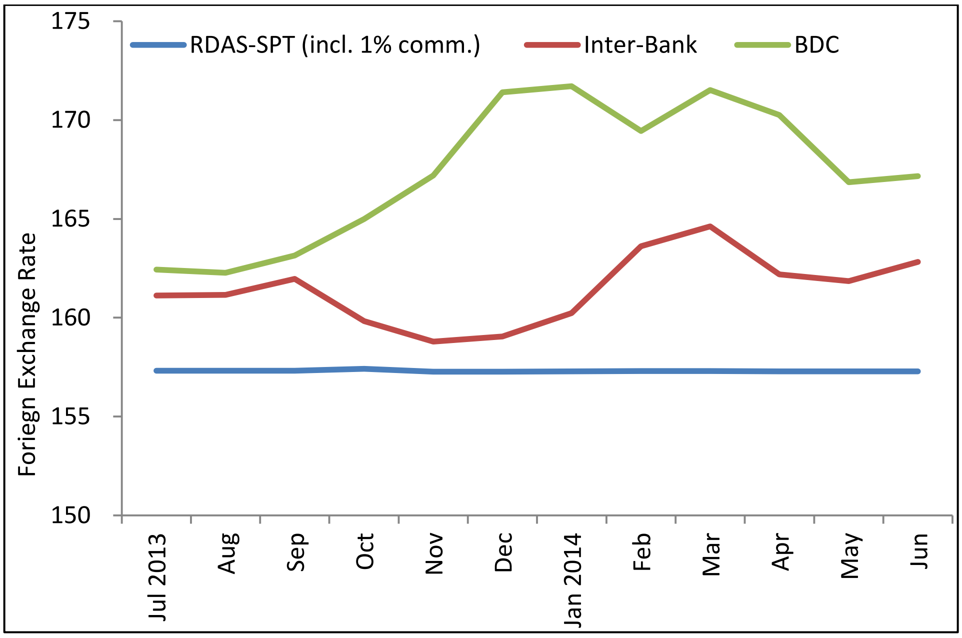
2.6.2 The Foreign Exchange Market

Activities were relatively calm in the first half of 2014, except on February 20, 2014 when market players reacted to changes in the Bank's leadership. This resulted in a sharp but temporary depreciation of the naira at the inter-bank segment, largely because the Bank's intervention at the foreign exchange inter-bank market as well as inflows from autonomous sources contained the effects and kept foreign exchange rates within the target band at the official segment of the market. Some volatility was, however, observed at the BDC segment.

The exchange rate at the RDAS spot was stable as it averaged ₦157.31/US$ during the review period. It opened at ₦157.29/US$ in January and remained at that level, except in February when it rose temporarily to ₦157.31/US$.

The average foreign exchange rate at the RDAS spot and inter-bank segments depreciated by 0.01 and 2.31 per cent to ₦157.29/US$ and ₦162.82/US$, respectively, during the first half of 2014.The average BDC foreign exchange rate appreciated by 2.53 per cent to close at ₦167.17/US$ at end-June 2014.

Figure 2. 9: Monthly Average Exchange Rates of the Naira to the US Dollar



2.6.3 The Capital Market

The All Share Index (ASI) and Market Capitalisation (MC) trended upwards in the first half of 2014. This reflected investors' expectations of favourable returns, based on the financial performances of listed companies. Meanwhile, in their efforts to deepen the market, the regulators embarked on developing a ten-year master plan for the market, entrenching market discipline, facilitating compliance with rules and regulations, enhancing integration within the West African sub-region, and attracting more participants to the market.

2.6.3.1 The Bond Market

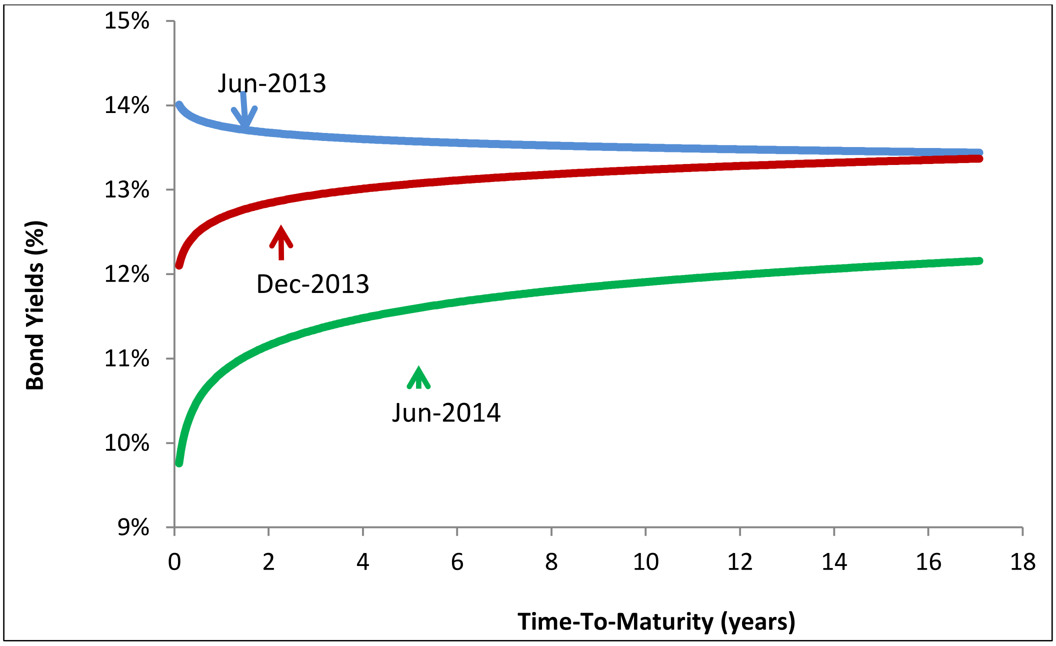
Total bonds outstanding at end-June 2014 were valued ₦6,314.32 billion, compared with ₦6,187.91 billion at end-December 2013, reflecting an increase of 2.04 per cent. FGN, agency, sub-national and corporate bonds constituted 69.21, 18.68, 9.07and 3.04 per cent, respectively, of the outstanding bonds at end-June 2014.

FGN Bonds

New issues and re-openings comprising FGN Bonds series 1 and 3 were auctioned during the review period. Total FGN Bonds offered for sale were valued ₦460.00 billion, while public subscriptions and sales amounted to ₦1,171.52 billion and ₦552.97 billion, respectively. The huge subscriptions were attributed to the high level of liquidity in the banking system and investors' preference for low risk, long-term instruments.

The level of liquidity in the banking system increased the demand for FGN bonds in the secondary market as evidenced by the decline of yields on FGN bonds compared with end-December 2013 (Figure 2.10). However, with headline inflation at 8.20 per cent, which was lower than the average FGN bond yield of 11.53 per cent at end-June 2014, the bonds remained attractive to investors. The yield curve was upward-sloping reflecting investors' demand for higher returns on long-dated assets.

Figure 2. 10: FGN Bonds Yield Curves



Source: FMDQ-OTC Plc

Agency Bonds

There was no bond issuance by FGN agencies, whilst bonds valued ₦13.30 billion were redeemed by AMCON during the review period. Consequently, total outstanding bonds issued by FGN agencies stood at ₦1,179.41 billion, of which AMCON issued ₦853.44 billion, FMBN ₦30.56 billion and Local Contractors Receivables Management (LCRM) Limited[4] ₦295.41 billion.

[4] LCRM is a special purpose vehicle established by the Debt Management Office.

Sub-National Bonds

In the first half of 2014, three state governments issued bonds valued ₦15.00 billion, compared with two state governments that issued bonds valued ₦99.50 billion in the second half of 2013. During the review period, the Lagos State Government redeemed its ₦50.00 billion tranche 1 bond. Thus, the total of outstanding bonds held by 16 state governments stood at ₦572.90 billion at end-June 2014, compared with ₦607.90 billion[5] held by 14 state governments at end-December 2013.

Table 2. 4: Sub-National Bonds Issued in the First Half of 2014

State Government	Bond Features	Value (₦ Billion)	Issue Date
Kogi	14.50% Fixed Rate 7-Year	5.0	Jan-2014
Ekiti	15.00% Fixed Rate 7-Year	5.0	Jan-2014
Nasarawa	15.00% Fixed Rate 7-Year	5.0	Jan-2014
Total		**15.00**	

Source: FMDQ-OTC PLC

Corporate Bonds

One corporate organization issued a bond valued ₦4.50 billion during the review period, compared with three corporate bonds valued ₦10.60 billion issued in the preceding period. The value of total outstanding corporate bonds at end-June 2014 was ₦192.17 billion.

2.6.4 The Equity Market

The NSE ASI closed at 42,482.49 at end-June 2014, reflecting an increase of 2.79 per cent above the 41,329.19 recorded at end-December 2013. Market capitalisation closed at ₦14,031.66 billion, representing an increase of 6.06 per cent above the ₦13,230.25 billion recorded at the end of the preceding period. There were five new issues valued ₦129.63 billion.

Foreign portfolio investments in the market were valued ₦302.52 billion, while total sales amounted to ₦402.63 billion, reflecting a net outflow of ₦100.11 billion at end-June 2014. Foreign investors dominated the market, with a 60.29 per cent share of the total equity trades. This represented an increase of 11.05 percent over the end-December 2013 level.

The performance of the market during the period under review was influenced largely by developments in the global economy, performance of listed companies, the stance of regulators towards market developments and new listings. Although there was a slowdown in the first quarter, increased market activities, and the listing of two companies in the second quarter, resulted in improvements in the major capital market indices.

In furtherance of its objective of addressing low market activities and boosting investor confidence, the SEC introduced the risk-based approach to supervision and the net liquid

[5] Revised

capital rule. In addition, electronic mail filing of quarterly returns by capital market operators commenced in the first quarter of 2014. This development has ensured timely rendition of returns and effective detection of red flags for risk mitigation purposes.

2.7 Real Sector Interventions

2.7.1 Risk Mitigation/Insurance Schemes

2.7.1.1 The Nigerian Incentive-based Risk Sharing System for Agricultural Lending Plc

Nigeria Incentive-based Risk Sharing System for Agricultural Lending**(**NIRSAL) Plc, which was established to de-risk agricultural lending and unlock financial resources for agricultural value chain development in Nigeria, issued four Credit Risk Guarantees (CRGs) valued ₦2.06 billion to four counterparties during the review period, compared with 23 CRGs valued ₦3.051 billion issued in the second half of 2013. It also guaranteed ₦5.66 billion accessed by 24 agro-dealers and paid ₦163.83 million as interest drawback to 116 projects under the Growth Enhancement Scheme of the Federal Ministry of Agriculture and Rural Development.

Table 2.5: CRGs Issued by NIRSAL (Jan – June 2014)

S/N	Focus Area	Number of Projects	Amount (₦)	(%)
1	Agro Processing	2	2,020,059,000	98.18
2	Crop Production	2	37,500,000	1.82
	Total	**4**	**2,057,559,000**	**100**

The company trained 12,830 cocoa and cotton farmers and conducted a train-the-trainer refresher training programme for West African Cotton Company Ltd (WACOT) staff and 44 agricultural extension staff.

2.7.1.2 The Agricultural Credit Guarantee Scheme

A total of 35,413 loans, valued ₦5.93 billion granted by six commercial and 46 microfinance banks were guaranteed during the review period. Compared with the 33,667 loans valued ₦5.84 billion guaranteed in the second half of 2013, the outcome in the first half of 2014 showed an increase of 5.19 and 1.54 per cent respectively, in number and value of loans guaranteed.

The increases in the first half of 2014 were attributed to a number of factors, including the following:

- Increase in the number of participating microfinance banks;
- Prompt processing and payment of interest drawback claims which encouraged more farmers to patronize the scheme; and

- Intensity of farming activities in the northern part of the country that peaked with the rains in the first half of the year.

2.7.1.3 The Small and Medium Enterprises Credit Guarantee Scheme

The Scheme, established to fast-track the development of the Nigerian economy by guaranteeing bank credits to small and medium enterprises (SMEs), continued to play a critical role in facilitating funding for start-ups, although with reduced momentum. In the first half of 2014, the number of facilities guaranteed decreased by 76.47 per cent to 4, valued ₦155.23 million, from 17 facilities valued ₦896.78 million that were guaranteed in the second half of 2013, reflecting an 82.69 per cent decrease in value. The observed low patronage was attributed to the market interest rate charged under the scheme as against other schemes with lower interest rates.

2.7.2 Credit Support Schemes

2.7.2.1 The Commercial Agriculture Credit Scheme

The Bank continued to finance large projects in the agricultural value chain through the Commercial Agriculture Credit Scheme (CACS) established in 2009. During the review period, a total sum of ₦8.18 billion was disbursed to 17 projects through eight banks, compared with ₦9.90 billion disbursed to 16 projects in the second half of 2013, through 13 banks. This reflected an increase of 6.25 per cent in number, and a decrease of 17.40 per cent in value, of the projects financed. An analysis of the total funds disbursed also showed that marketing, production and processing accounted for 19.0, 38.0, and 43.0 per cent, respectively.

The recoveries from the projects for the second half of 2013 stood at ₦6.92 billion, while the figure for the first half of 2014 stood at ₦8.72 billion, representing a 26.0 per cent increase.

2.7.2.2 The Power and Aviation Intervention Fund

The Fund, established to stimulate and sustain investment in the power and aviation sectors of the economy, through the provision of long-term credits suitable for infrastructure projects, contributed to enhancing the quality of credits in the banking industry by refinancing existing facilities and granting new ones.

During the review period, ₦508 million was disbursed to one aviation project, compared with ₦11.628 billion disbursed to five projects in the second half of 2013. In the first half of 2014, ₦19.77 billion was paid back by borrowers under the Scheme**.**

2.7.2.3 The SME Restructuring and Refinancing Fund

The Fund was established to fast-track the development of the manufacturing sector of the Nigerian economy by facilitating access to credit by manufacturers, improving the financial position of banks, generating employment and increasing foreign exchange earnings, among others. The total amount disbursed under the Fund in the first half of 2014 stood at ₦17.8 billion while ₦28.98 billion was disbursed in the second half of 2013.

2.7.2.4 The Micro, Small and Medium Enterprises Development Fund (MSMEDF)

The Revised Microfinance Policy, Regulatory and Supervisory Framework for Nigeria, stipulates that "a Microfinance Development Fund shall be set up, primarily to provide for the wholesale funding requirements of Microfinance banks/institutions (MFBs/MFIs)". Consequently, the CBN launched the Fund with ₦220 Billion in 2013 to address the funding gap in the Micro, Small and Medium Enterprises (MSME) sub-sector in Nigeria. The Fund is aimed at enhancing access to financial services by operators in this sub-sector through the provision of wholesale funds to Participating Financial Institutions (PFIs).

In the first half of the year, the CBN carried out the following activities within the purview of the above Fund:

- Amended the Fund's operating guidelines to include banks as PFIs, while excluding the refinancing facility and interest drawback components; revised SME: Micro Enterprises borrowing ratio to 50:50 from 80:20; and earmarked two per cent of the Fund for persons with disabilities;
- Signed an MoU with the Kano State Government for its participation under the Fund;
- Conducted a capacity building programme for 60 CBN and NDIC staff and 120 Officers of 44 PFIs in March, 2014; and
- Approved the utilization of ₦33.2 billion from the PAIF repayments as take-off fund for the MSMEDF.

2.7.3 Entrepreneurship Development Centres (EDCs)

A total of 3,101 participants were trained by the new Entrepreneurship Development Centres (EDCs) located in Maiduguri, Makurdi and Calabar in the first half of 2014. This number surpassed the target of 3,000 trainees set for that period. This also resulted in the creation of 2,703 jobs. In addition,904 of the beneficiaries accessed credits from banks for start-ups and expansion of existing businesses.

Meanwhile, the process of transferring ownership of the first phase EDCs located in Kano, Lagos and Onitsha to the host states has been completed, in line with the policy establishing the Scheme.

2.8 The External Sector

The level of gross external reserves decreased to US$37.33 billion at end-June 2014, from US$42.85 billion at end-December 2013, reflecting a decline of US$5.52 billion or 12.88 per cent. Notwithstanding the decline, this level of external reserves could finance 8.7 months of imports.

Analysis of the external reserves indicated that the CBN, the FGN and the Federation holdings were US$29.87 billion, US$3.66 billion and US$3.80 billion, respectively, at end-June 2014, compared with US$36.94 billion, US$2.62 billion and US$3.29 billion, respectively at end-December 2013. Analysis of holdings by currency showed that 79.78 per cent of the external reserves were held in US dollars, 6.73 per cent in euro, 4.10 per cent in renminbi, 2.42 per cent in pound sterling, and 6.94 per cent in Special Drawing Rights (SDR) at end-June 2014, while 0.03 per cent of the reserves were held in other currencies.

Total inflow of foreign exchange during the review period amounted to US$22.89 billion, compared with US$21.32 billion recorded in the second half of 2013, showing an increase of US$1.57 billion or 7.36 per cent which was due to the increase in crude oil and gas revenues. Similarly, total outflow rose to US$28.50 billion in the review period, from US$23.46 billion in the second half of 2013, reflecting an increase of US$5.04 billion or 21.48 per cent. Consequently, there was a net outflow of US$5.61 billion compared to US$2.14 billion recorded in the second half of 2013.

3.0 REGULATORY AND SUPERVISORY ACTIVITIES

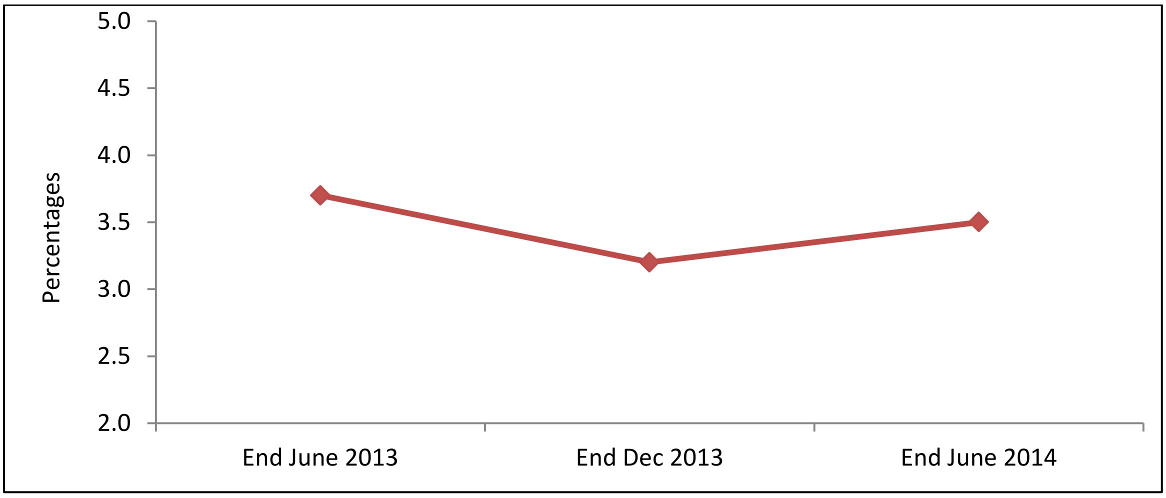
3.1 Macro-Prudential Supervision

3.1.1 Financial Soundness Indicators

3.1.1.1 Asset Based Indicators

The asset quality in the banking sector showed a slight decline in the review period, compared with the position at end-December 2013, as the ratio of NPLs to gross loans increased by 0.3 percentage point to 3.5 per cent at end June 2014 (Figure 3.1 and Appendix 1).

Figure 3.1: Banking Industry NPLs to Gross Loans

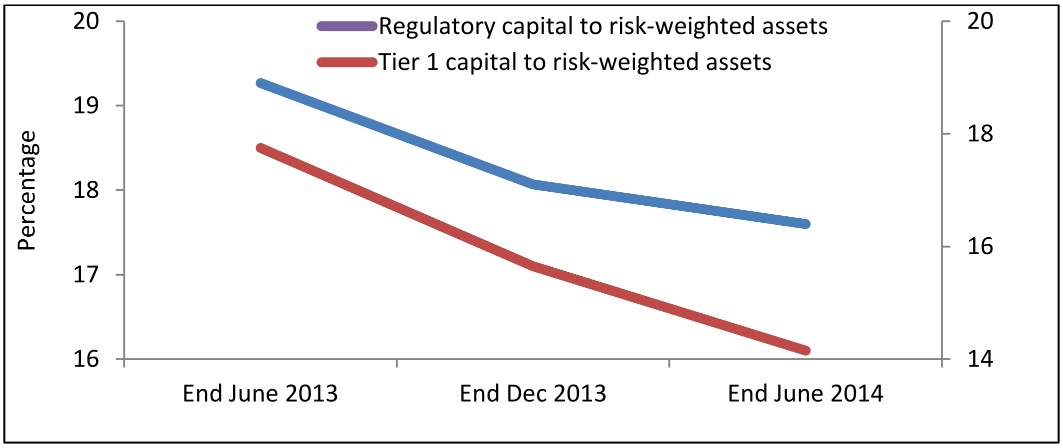


The ratio of core liquid assets to total assets decreased by 5.1 percentage points to 11.4 per cent at end-June 2014, from 16.5 per cent at end-December 2013. Similarly, the ratio of liquid assets to short-term liabilities declined by 5.6 percentage points to 13.1 per cent at end-June 2014 as compared with 18.7 per cent at end December 2013**.**

3.1.1.2 Capital-based Indicators

The ratio of regulatory capital to risk weighted assets stood at 16.4 per cent at end-June 2014, showing a decrease of 0.7 percentage point below the level at end-December 2013. Similarly, the ratio of Tier 1 capital to risk weighted assets, which stood at 16.1 per cent at end-June 2014, was 1.0 percentage point below the level at end-December (Figure 3.2). Also, the industry non-performing loans (net of provisions) to capital declined to 5.6 per cent at end-June 2014 from 5.8 per cent at end-December 2013.

Figure 3. 2: Banking Industry Capital Adequacy Indicators



3.1.1.3 Income and Expense-based Indicators

The ratio of interest margin to gross income declined by 1.6 percentage points to 63.3 per cent during the review period, from 64.9 per cent at end-December 2013. In the same vein, the ratio of non-interest expense to gross income decreased by 3.5 percentage points to 65.4 per cent at end-June 2014, from 68.9 percent at end-December 2013. The decrease in this ratio signifies an improvement in the operations of the sector, particularly the reduction in operational cost. However, the ratio of personnel expenses to non-interest expense rose by 1.7 percentage points to 38.2 per cent, from 36.5 per cent at end-December 2013.

3.2 Banking Industry Stress Tests

3.2.1 The Liquidity Stress Test

Liquidity stress tests were conducted at end-June 2014 using the Implied Cash Flow Analysis (ICFA) and Maturity Mismatch/ Rollover Risk approaches to assess the resilience of individual banks and the banking industry to liquidity and funding shocks.

3.2.1.1 Implied Cash Flow Analysis (ICFA)

The ICFA assessed the ability of the banking system to withstand unanticipated substantial withdrawals of deposits, short-term wholesale and long-term funding over 5 days and cumulative 30 days, with specific assumptions on fire sale of assets. The test assumed gradual average outflows of 3.8, 5.0 and 1.5 per cent of total deposits, short-term funding and long-term funding, respectively, over a 5-day period (Test 1.1) and a cumulative average outflow of 22.0, 11.0 and 1.5 per cent of total deposits, short-term funding and long-term funding, respectively, on a 30-day balance (Test 1.2). It also assumed that the assets in Table 3.1 would remain unencumbered after a fire sale.

Table 3. 1: Percentage of Assets Unencumbered after Fire Sales

Item No	Assets	% Unencumbered
1	Cash and cash equivalent	100
2	Current account with CBN	100
3	Government bonds, treasury bills and other assets with 0% risk-weighting	66.5
4	Certificates of deposit held	66.5
5	Other short-term investments	49
6	Collateralized placement and money at call	49
7.	CRR	30

The ICFA revealed that the industry liquidity ratio (LR) declined to 10.80 and 6.20 per cent from 49.76 per cent after the 5-day and cumulative 30-day shocks, respectively. Under each of the two shock scenarios, the LRs of 17 banks were below the 30.0 per cent minimum threshold. Seven banks also recorded negative LR following a cumulative 30-day shock. Of these banks, six were among those categorised as "large banks".[6]

Table 3. 2: Implied Cash Flow Analysis

Total Number of Banks tested	Number of Banks with < 30% liquidity ratio				June 2014	
23	June 2014	Mar 2014	Dec 2013	Sept. 2013	System LR (%)	Liquidity Shortfall to make 30% LR (₦' billion)
Test 1.1: Implied Cash Flow Test (5-Day shock)						
Day 1	10	10	7	12	30.96	
Day 2	13	15	10	13	26.40	427.74
Day 3	14	15	14	17	21.45	954.43
Day 4	17	16	16	17	16.80	1,458.66
Day 5	17	16	17	17	10.80	1,940.57
Test 1.2: Implied Cash Flow Test (30-Day shock)						
	17	17	17	18	6.20	2,312.61

[6] Banks with assets over ₦1 trillion

Figure 3. 3: Individual Banks and Industry Pre-shock Liquidity Ratio Positions[7]

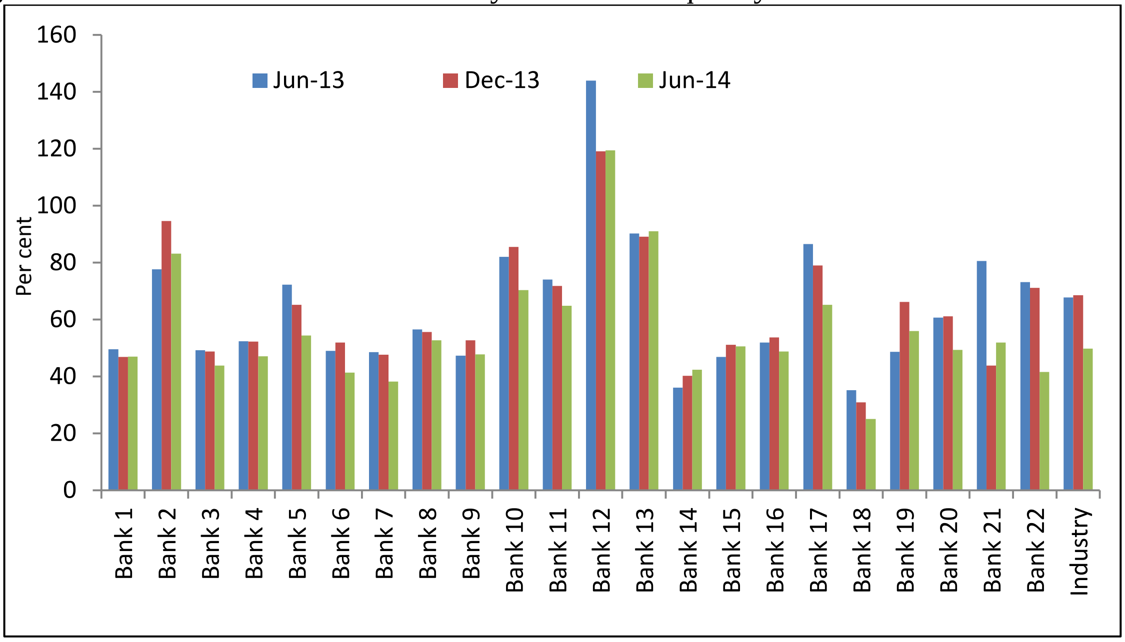


Figure 3. 4: Industry Position after 5-day and Cumulative 30-day Shocks

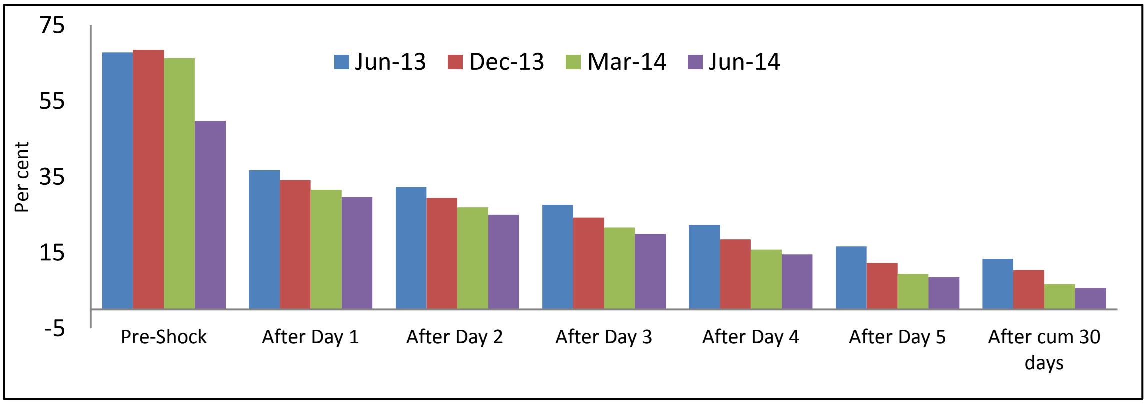
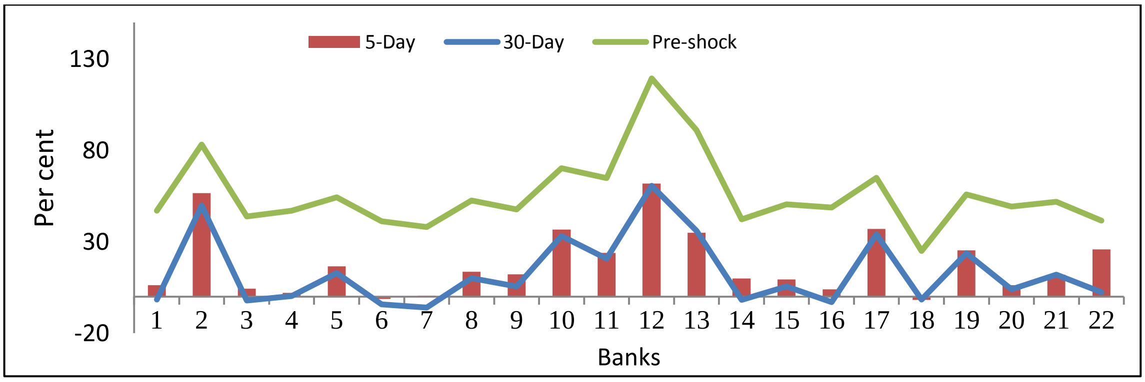


Figure 3. 5: Individual Bank Position after 5-day and Cumulative 30-day Shocks



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[7]Bank 23 was excluded from Figures 3.4, 3.5 and 3.6 because it was an outlier.

3.2.1.2 Maturity Mismatch/Rollover Risk

The Maturity Mismatch/Rollover Risk approach assessed funding maturity mismatch and rollover risk for assets and liabilities in the 0-30 and 31-90 day buckets, with assumptions on the availability of funding from CBN and intra-group as described below:

i. Test 2a: *Descriptive Maturity Mismatch* assumed that the baseline mismatch remained but that 5 per cent of total deposits would be made available from the CBN and the intra-group;

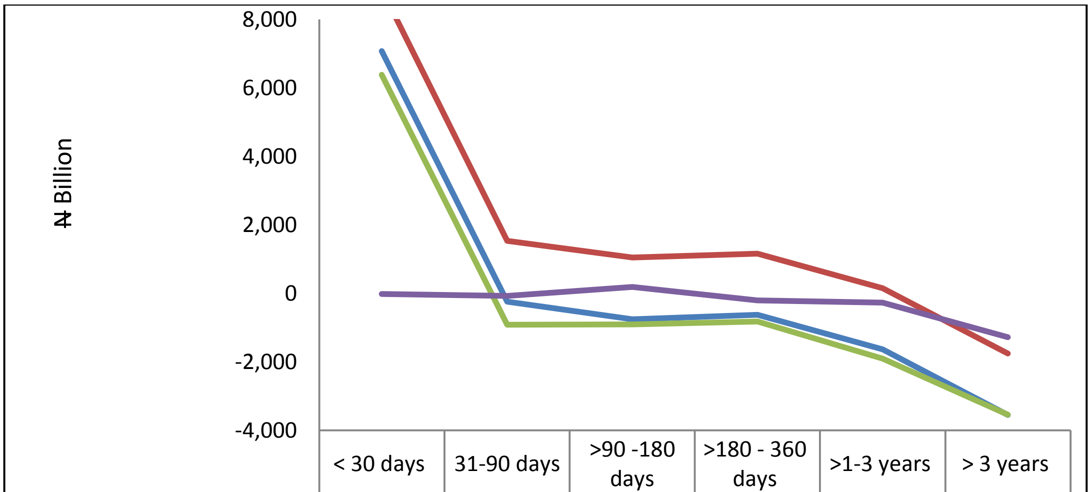
ii. Test 2b: *Static Rollover Risk* assumed that 80.0 and 72.0 per cent of the funding in the 0-30and 31-90 day buckets would be rolled over, with no possibility to close the funding gap from other buckets. However, 5 per cent of the total deposits would still be available from the CBN and the intra-group; and

iii. Test 2c: *Dynamic Rollover Risk* made the same assumption as in 2b above, but with the option of closing the liquidity gap from other buckets.

Under this test, assets in the 0-30 day bucket were adequately funded in two of the three scenarios used (2a and 2b).There was deterioration in the 31-90 day bucket under the Static Rollover Analysis Test (Test 2b) and the Dynamic Rollover Risk Test (Test 2c) (See Figure 3.6).

The test results revealed that although the banking system was resilient as at June 2014, it was less so compared with the position in the second half of 2013.

Figure 3. 6: Rollover Risk, Baseline and Post-shock Funding Gap



	< 30 days	31-90 days	>90 -180 days	>180 - 360 days	>1-3 years	> 3 years
Baseline (N'billion)	7,077	-243.91	-758.54	-627.82	-1,639	-3,553
Test 2a (N'billion)	8,879.90	1,535.15	1,043.27	1,161.55	148.74	-1,759.89
Test 2b (N'billion)	6,377.70	-914.44	-908.6	-821.73	-1,907.35	-3,547.26
Test 2c (N'billion)	-18.89	-79.95	188.12	-210.07	-270.35	-1279.35

3.2.2 The Solvency Stress Test

The test captures the characteristic nature of individual banks' balance sheets and macro-prudential concerns, using the bottom-up and top-down approaches, specified in the modified IMF solvency stress test model. Assessment of the resilience or otherwise of the Nigerian banking system was done by applying a series of exceptional but plausible shocks and scenarios, which effectively translated the single factor and multifactor shocks into bank balance sheets.

The exercise covered the 23 banks, using the following risk channels: credit, liquidity, interest, foreign exchange rates, and foreign exchange trading risks. The resilience of the banking system was assessed against defined benchmarks with reference to 10.0 per cent CAR, 30.0 per cent liquidity ratio, 5.0 per cent NPLs, as well as significant declines in return on assets (ROA) and return on equity (ROE).

For systemic and peer assessment, the banks were classified into three broad groups, based on their asset size. Large banks were those with assets equal to or greater than ₦1 trillion (≥₦1 trillion); medium banks are those with assets equal to or greater than ₦500 billion, but less than ₦1 trillion; and small banks were those with assets less than ₦500 billion, respectively.

A. Baseline (Pre-shock) Position

The baseline (pre-shock) CAR for the banking industry, large, medium, and small banks stood at 16.43, 16.90, 14.43 and 16.06 per cent, respectively, which reflected 0.77, 3.62, and 2.27 percentage points decrease for the banking industry, medium, and small banks below their December 2013 positions. Large banks showed 0.66 percentage point increase over the December 2013 position of 16.24 per cent (Table 3.3).

Table 3. 3: Baseline CAR

		Banks		
	Banking Industry	**Large**	**Medium**	**Small**
June 2014**(%)**	16.43	16.90	14.43	16.06
December 2013**(%)**	17.20	16.24	18.05	18.33
Percentage Point Change	-0.77	0.66	-3.62	-2.27

Similarly, the pre-shock liquidity ratios for the industry, large, medium, and small banks were 49.91, 47.17, 59.03and 54.82 per cent, respectively, reflecting 1.11, 3.58, 3.27, and 13.65 percentage points decrease below their respective December 2013 ratios of 51.02, 50.75, 62.30 and 68.47 per cent (Table 3.4).

Table 3. 4: Baseline Liquidity Ratio

		Banks		
	Banking Industry	Large	Medium	Small
June 2014 (%)	49.91	47.17	59.03	54.82
December 2013 (%)	51.02	50.75	62.30	68.47
Percentage Point Change	-1.11	-3.58	-3.27	-13.65

Figure 3. 7: Number of Banks in CAR Buckets

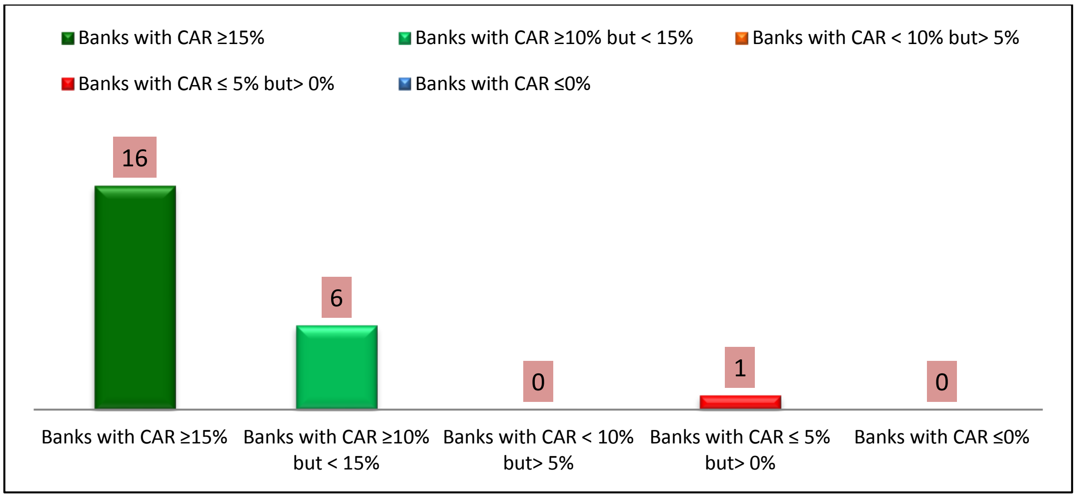


Figure 3. 8: Number of Banks in LR Buckets

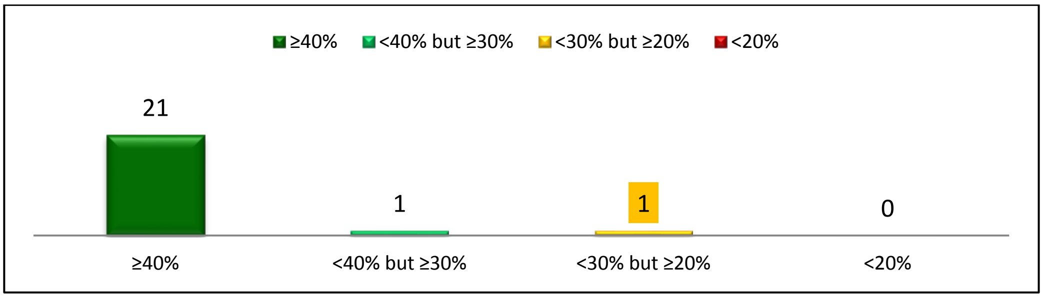
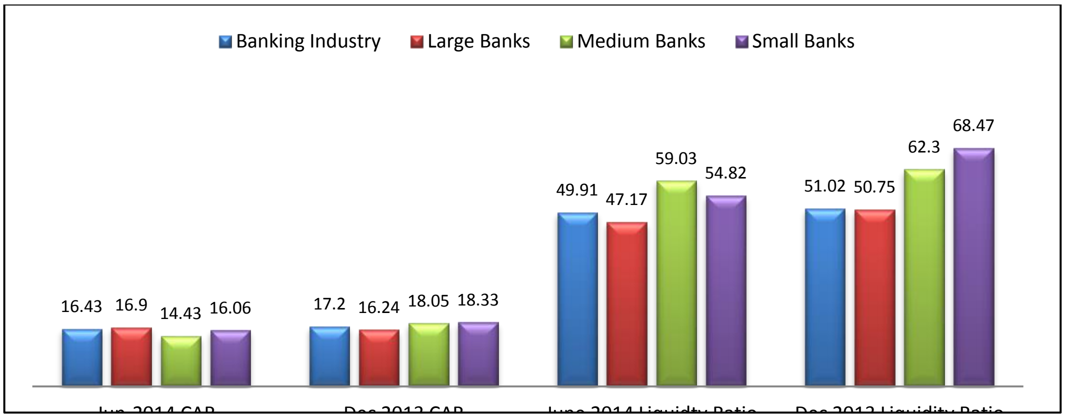


Figure 3. 9: Baseline (Pre-shock) CARs and LR (%)



The pre-shock ROA of the banking industry, large, medium, and small banks were 1.41, 1.53, 1.34 and 0.78 per cent, respectively. These reflected respective decreases of 0.90, 1.51, 1.08 and 1.24 percentage points over December 2013 positions. On the other hand, the ROE for these broad groups of banks declined to 9.50, 10.56, 9.63 and 4.29 per cent, respectively, in June 2014 from 19.83, 22.14, 20.40 and 17.56 per cent in December 2013. These reflected decreases of 10.33,11.58,10.77 and 13.27 percentage points, respectively (Tables 3.5 and 3.6).

Table 3. 5: Baseline ROA

		Banks		
	Banking Industry	**Large**	**Medium**	**Small**
June 2014 **(%)**	1.41	1.53	1.34	0.78
March 2014 (%)	0.87	0.92	0.92	0.74
December 2013 **(%)**	2.31	3.04	2.42	2.02
Percentage Point Change Btw June and December	-0.9	-1.51	-1.08	-1.24

Table 3. 6: Baseline ROE

		Banks		
	Banking Industry	**Large**	**Medium**	**Small**
June 2014 **(%)**	9.50	10.56	9.63	4.29
March 2014 (%)	5.18	5.24	6.14	4.07
December 2013 **(%)**	19.83	22.14	20.40	17.56
Percentage Point Change btw June and Dec 2013	-10.33	-11.58	-10.77	-13.27

A. Analysis of the Results

At end-June 2014, nine (9) banks were classified as large, four (4) as medium and 10 as small, based on their asset size.

1. Credit Risk

Except for banks in the small group, all other groups remained resilient to credit risk as their CARs were above the 10 per cent threshold, even after the shock of a 200 per cent rise in NPLs. Under this scenario, 17 banks maintained CARs above the 10 per cent threshold, while no bank, and 3 other banks had <5 but ≥0 per cent, ≤10 but ≥5 per cent, and <0 per cent CARs, respectively.

Table 3. 7: General Credit Risk Shocks

	Banks' CAR After Shocks			
Single Factor Shocks	All	Large	Medium	Small
Baseline CAR	16.43	16.90	14.43	16.06
Shock 1av-50% NPLs increase	15.24	16.14	13.49	12.53
Shock 1avi-100% NPLs increase	13.99	15.36	12.52	8.65
Shock 1avii-200% NPLs increase	11.44	13.79	10.56	-0.10

The banking industry, large, medium, and small groups of banks, showed significant resilience to credit concentration risk, as their CARs remained above 10.0 per cent under the shocks and scenarios presented in Table 3.7. However, this was not without its challenges as the banking industry's exposure to the top five corporate borrowers remained significant.

2. Interest Rate Risk

The results of the stress tests on the net positions of interest sensitive instruments relative to ROAs and ROEs, revealed that the banking industry and the broad groups of banks were resilient to interest rate risk. This is because their pre-shock positions (in terms of capital impairment, ROAs and ROEs) decreased only marginally. However, small banks' indices improved as they were net-takers of funds after the most strained shocks of 1,000bps downward parallel shift in the yield curve were applied (Figures 3.10 and 3.11).

Figure 3. 10: Impact of Interest Rate Risk on CAR

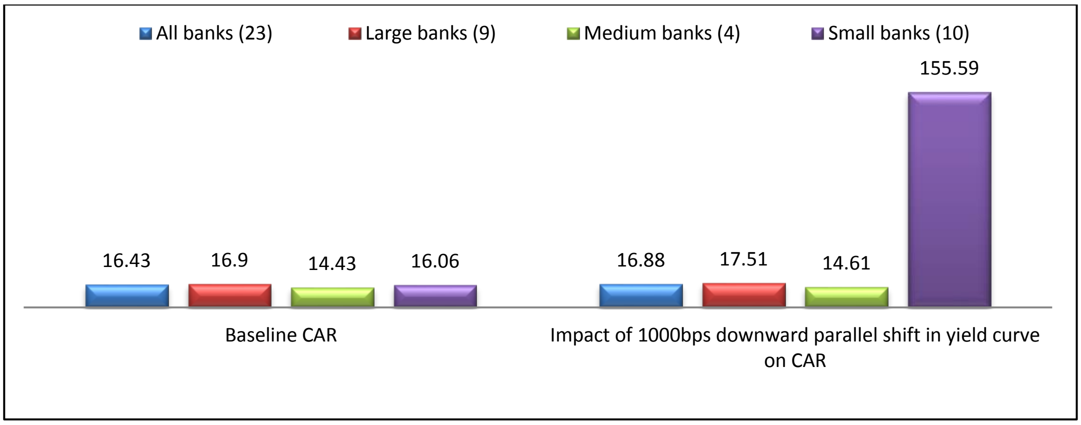


Figure 3. 11: Impact of Interest Rate Risk on ROA and ROE

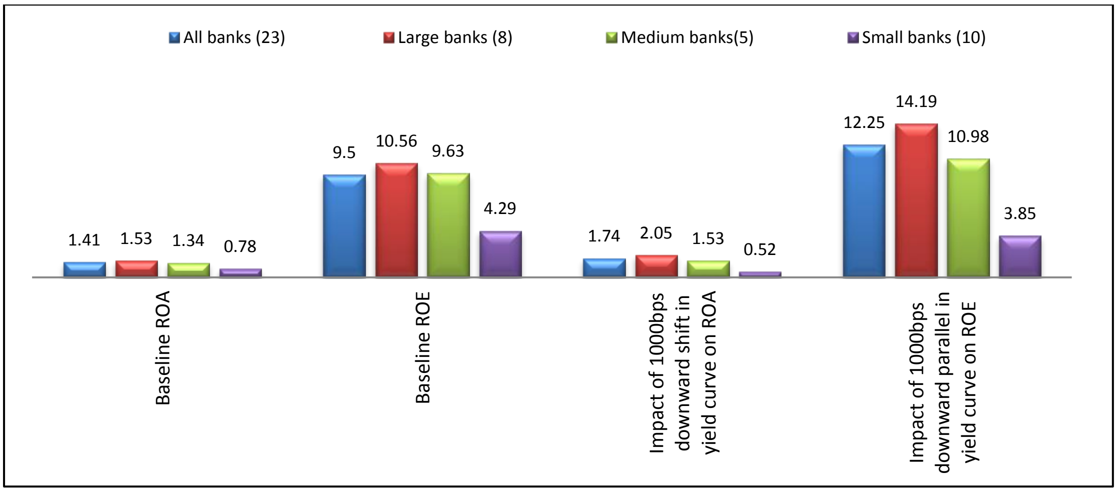


Table 3. 8 : Impact of Selected Shocks on CAR, ROA and ROE

	Banks			
Most Severe Shocks (500to 1000bps)	**Banking Industry**	**Large**	**Medium**	**Small**
Baseline ROA (%)	**1.41**	**1.53**	**1.34**	**0.78**
Baseline ROE (%)	**9.50**	**10.56**	**9.63**	**4.29**
Baseline CAR (%)	**16.43**	**16.90**	**14.43**	**16.06**
Interest Rate Volatility (Impact on CAR)				
Shock 5b iii (500bps downward parallel shift in yield curve)	16.65	17.20	14.52	16.02
Shock 5b iv (1000bps downward parallel shift in yield curve)	16.88	17.51	14.61	15.99
Impact of Parallel Shift in Yield Curve Shocks on ROA				
Interest Rate Volatility				
Shock 5biii (500bps downward parallel shift in yield curve)	1.55	1.79	1.43	0.55
Shock 5biv (1000bps downward parallel shift in yield curve)	1.74	2.05	1.53	0.52
Impact of Parallel Shift in Yield Curve Shocks on ROE				
Interest Rate Volatility				
Shock 5biii (500bps downward parallel shift in yield curve)	10.87	12.37	10.30	4.07
Shock 5biv (1000bps downward parallel shift in yield curve)	12.25	14.19	10.98	3.85

3. Exchange Rate Risk

The banks showed significant resilience to foreign exchange rate risk as their capital deteriorated (falling below the regulatory minimum) only after a shock of 50 per cent exchange rate appreciation was induced on their net foreign assets. At this point, nine banks which had baseline CAR above 10.0 per cent, slipped below the 10 per cent minimum regulatory benchmark (Table 3.9).

Table 3. 9: Number of Banks with CAR under Restricted Scenarios

	<0%	≥0 &<5	≥5 &<10	≥10 &<15	≥15
Baseline	0	1	0	6	16
Shock 4bi (10% appreciation of the Naira)	0	1	0	10	12
Shock 4bii (20% appreciation of the Naira)	0	1	1	9	12
Shock 4biii (50% appreciation of the Naira)	1	2	6	4	10
Shock 4biv (100% appreciation of the Naira)	6	3	4	3	7

4. FX Trading Risk

The results of the tests showed that the banking industry was resilient to FX trading risk relative to the baseline position. The banks' pre-shock positions, in terms of impact on both ROAs and ROEs, changed only marginally, even after an induced 100 per cent decline in FX trading income. This was due mainly to the low proportion of FX trading income relative to other income sources.

Table 3. 10: Impact of FX Trading Shocks on ROA -Number of Banks with ROA in Respective Buckets

	<0%	≥0&<1%	≥1<2%	≥2≤5%	>5%
Impact of FX Trading Shocks on ROA					
Baseline ROA	2	9	6	5	1
FX Trading Income Volatility					
Shock 7ai (10% decline in FX trading Income)	3	10	4	6	0
Shock 7aii (20% decline in FX trading Income)	2	12	3	6	0
Shock 7aiii (50% decline in FX trading Income)	2	12	6	3	0
Shock 7aiv (100% decline in FX trading Income)	6	11	5	1	0

Table 3. 11: Impact of FX Trading Shocks on ROE - Number of Banks with ROE in Respective Buckets

	<0%	<5%	<10%	<15%	>15%
Baseline ROE	2	0	1	6	14
FX Trading Income Volatility					
Shock 7ai (10% decline in FX trading Income)	2	0	1	7	13
Shock 7aii (20% decline in FX trading Income)	2	0	1	7	13
Shock 7aiii (50% decline in FX trading Income)	3	2	2	5	11
Shock 7aiv (100% decline in FX trading Income)	5	3	3	2	10

In summary, banks were adjudged to be more sensitive to credit concentration and exchange rate risks than to other risks. Liquidity and interest rate risks had tolerable effects, except in a few cases where volatility in interest rates produced a large impact on account of duration mismatches in the tenored buckets. Overall, the banking industry stress tests suggested that the industry was considerably resilient.

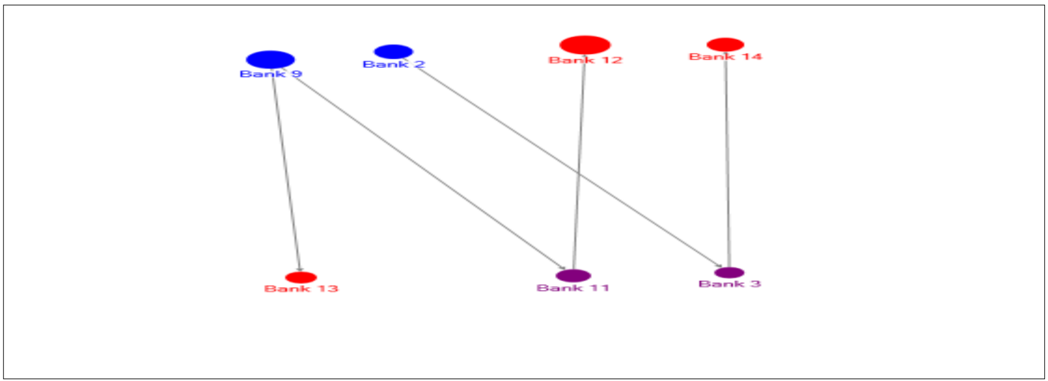
3.2.3 Contagion Risk Analysis

The contagion risk analysis assessed interbank exposures and their impact on the interconnectedness of financial institutions that could lead to the transmission of shocks to the whole banking system. A network analysis tool, which relied on exposures in respect of interbank placements, takings, and money-at-call (with emphasis on unsecured transactions) was used to test the degree of interconnectedness among the institutions. The analysis revealed that nine (9) institutions were central in the network as they had three (3) or more bilateral exposures. Also, the contagion risk through interbank exposure was limited as the CARs of all the net placers and that of the industry were within the prudential requirements (Table 3.12).

Table 3. 12: Results of Contagion Risk Analysis on Net Interbank Unsecured Exposures

Description	Placing Banks			
	Bank 2	Bank 9	Bank 11	Industry
Baseline CAR (%)	24.29	20.83	17.63	16.64
Post-Test CAR (%)	19.68	19.36	12.63	16.20
Net Placement (₦' Billion)	8.15	17.45	4.94	Nil

Figure 3. 12: Tiered Structure of Unsecured Placements



Note: Node colour representation (Blue= Lenders and Red= Borrowers; Purple= Borrower and Lender)

3.3 Supervision of Banks and Other Financial Institutions

3.3.1 Banks

A joint CBN and NDIC risk assets assessment examination of all the banks was conducted to ascertain the quality of their assets and adequacy of loan loss provisioning for the purpose of considering their 2013 annual accounts. Also, the CBN commenced the computation of consolidated prudential ratios for banking groups. Consequently, banks are now required to calculate all prudential ratios on a consolidated basis.

The key challenges in the banking industry remained weak corporate governance and inadequate risk management practices. The rating of the control functions generally trended towards 'needs improvement', owing to non-implementation of some previous examiners' recommendations. Improvements were, however, noted in the internal audit and financial analysis functions of most banks. In order to ensure effective compliance by banks, the CBN created a Monitoring and Compliance Division.

3.3.1.1 Foreign Exchange Examinations

The CBN examined the foreign exchange activities of banks during the review period to ascertain the extent of compliance with extant foreign exchange laws and regulations. The major infractions by banks included: delay in issuing certificates of capital importation; rendition of inaccurate and incomplete returns; non-compliance with approved Net Open Positions, and inadequate documentation for imports. Appropriate sanctions were applied on the erring banks. A special investigation was also conducted on the foreign exchange operations of banks to determine the aggregate foreign exchange sold to BDCs. The investigation revealed that the BDCs sourced most of their foreign exchange from banks that obtained a significant proportion of their foreign exchange from official sources. Corrective measures were taken to address this development.

In order to address the inadequate information technology skills faced by on-site examiners, the CBN conducted a special in-house training on ACL, SQL and advanced Excel. The training greatly improved the ability of examiners to conduct effective analysis of spooled banks' operational back-up data in foreign exchange examinations.

Spot checks were conducted on AML/CFT compliance and utilization by banks of the proceeds of Eurobonds/other foreign loans for on-lending. The aim of the latter was to confirm the creation or existence of assets that would serve as a repayment source for foreign obligations at maturity and how the banks were managing the foreign exchange risk associated with such transactions.

3.3.2 Other Financial Institutions

3.3.2.1 Microfinance Banks (MFBs)

A total of 367 MFBs were examined at end-June 2014, which represented 40 per cent of the existing 925MFBs. The examination revealed improvements in the operations of microfinance banks and a higher level of risk management practices.

During the review period, the CBN analysed the reports on the post-examination monitoring exercise earlier conducted to evaluate the level of compliance of MFBs with examiners' recommendations. The exercise revealed that 115 or 20 per cent of the 567 evaluated MFBs implemented not less than 60 per cent of examiners' recommendations, 153 or 27 percent implemented between 40 and 59 per cent of the recommendations, while the remaining 299 or 53 per cent implemented not more than 39 per cent of the recommendations. Accordingly, supervisory letters were issued to all erring institutions and penalties applied as appropriate. The low level of compliance with examiners' recommendations was being addressed through periodic monitoring.

3.3.2.2 Finance Companies (FCs)

Supervisory letters were issued to the 61 FCs earlier examined in the last quarter of 2013. The highlights of the examination reports are as follows:

- Three FCs categorized as marginal were required to take necessary corrective actions to restore their prudential ratios to the prescribed minima;
- Thirty FCs categorized as unsound and/or insolvent were directed to recapitalize to restore their adjusted capital to a minimum of ₦20 million stipulated in the previous guidelines within 90 days and take necessary actions to restore other prudential ratios to the prescribed minima; and

- Two FCs undergoing restructuring were granted 180 days to complete the restructuring exercise, failing which their licences would be revoked.

3.3.2.3 Bureaux-de-Change (BDCs)

The CBN constituted a task force for the regular monitoring of foreign exchange utilization by BDCs. During the review period, spot-checks were conducted on 68 BDCs by the task force. The exercise revealed serious regulatory issues in the operations of BDCs. It indicated that BDCs had weak and ineffective operational structures, with adverse consequences for the conduct of monetary policy.

Consequently, the CBN revised the guidelines for the operation of BDCs by increasing the:

- Minimum paid-up capital to ₦35 million;
- Application, licensing and annual renewal fees to ₦100,000, ₦1 million and ₦250,000, respectively; and
- Mandatory cautionary deposit to ₦35 million.

Furthermore, membership of the Association of Bureaux De Change Operators of Nigeria (ABCON) would no longer be mandatory, while multiple-ownership of BDCs by promoters/directors was prohibited. All BDCs were required to comply with the new guidelines, latest by July 31, 2014.

3.3.3 Framework for Crisis Resolution

Following the approval of the *Systemic Policy Partnership/Oliver Wyman (SPP/OW) Report* by the Financial Services Regulation Co-ordinating Committee (FSRCC) at its 50th Meeting on December 17, 2013, the implementation of the *Report* had commenced with the establishment of the Project Management Office (PMO).

The PMO identified potential implementation challenges, formed work streams and proffered strategies for addressing them to guide the work streams and the PMO towards effective and efficient performance.

3.4 Compliance with International Standards

3.4.1 Anti-Money Laundering/Combating the Financing of Terrorism (AML/CFT)

In its effort to address the challenges of money laundering and terrorist financing, the CBN has increased its level of co-operation and collaboration with domestic and international stakeholders through exchange of information, conducting joint examinations, and organizing joint training programmes. Such stakeholders include:

(i) Office of the National Security Adviser (ONSA);
(ii) NFIU, EFCC, Special Control Unit against Money Laundering (SCUML);
(iii) US Department of State and US Embassy;
(iv) US Department of Treasury, International Narcotics & Law Enforcement (INLE);
(v) US Internal Revenue Service (IRS);

(vi) Inter-Governmental Action Group Against Money Laundering in West Africa (GIABA); and
(vii) Other central banks, including the Bank of Ghana, and the South African Reserve Bank (SARB), etc.

Meanwhile, the CBN sustained its function of issuing regulations intended to safeguard the Nigerian financial system against the abuses of financial crime, including money laundering, terrorist financing and other illicit financial transactions.

3.4.2 Implementation of Basel II/III

Following the issuance of six *Guidance Notes* on the implementation of Basel II to banks and discount houses in December 2013, Basel II implementation gained momentum during the period under review with the commencement of a parallel run of Basel II with Basel I. Although the parallel run was originally planned to last for six months, the Bank had to extend the period to nine months. Thus, the parallel run was expected to end on September 30, 2014, with full implementation of Pillar 1 of Basel II, effective October 1, 2014. Banks and discount houses had commenced submission of their Internal Capital Adequacy Assessment Process (ICAAP) Reports, in line with regulatory requirements. The CBN, in collaboration with the NDIC, carried out a sensitization exercise for bank examiners on the review of ICAAP Reports towards enhancing capacity for effective implementation of Basel II and III.

As part of the implementation process, the CBN adopted the Basic Indicator Approach for calculating capital requirements for operational risk and the Standardised Approach for credit and market risks in the first two years. It was expected that an effective rating system would have been developed in the country by the end of the period. Banks were also required to use the period to build adequate, reliable data and gain necessary experience for the migration to the more advanced approaches.

Towards the full adoption of Basel II and III in October 2014, a review of the impact of the initial implementation on the banks' capital, as measured by their capital adequacy ratios and other relevant indicators, was undertaken. It showed that despite the additional capital charge for operational and market risk, the banks largely met the minimum capital requirements.

3.4.3 International Financial Reporting Standards (IFRS)

Banks, discount houses, credit bureaux and some other financial institutions issued IFRS - compliant financial statements for the year ended December 31, 2013.The CBN and the banks continued to build capacity on IFRS to enhance supervision and the quality of reporting. Furthermore, the CBN completed the test-run and deployment of a new IFRS-compliant regulatory reporting system, the Financial Analysis (FinA).

Banks have so far published two IFRS-compliant annual financial statements. At end-June 2014, banks were reporting on both the old NGAAP-based electronic Financial Analysis Surveillance System (e-FASS) and the IFRS-compliant FinA.

During the review period, a joint CBN/NDIC IFRS Implementation Technical Committee issued a Report on the review of *optional exemptions* elected and *accounting policies* adopted; implementation of information technology systems to support IFRS-based financial reporting and review of *impairment methodology*; and the first IFRS financial statements. Lapses observed in respect of the first IFRS financial statements and the accounting policies were rectified during the review of banks' 2013 financial statements.

Following the implementation of IFRS by significant public interest entities, the *ad-hoc* committee on IFRS implementation of the FSRCC was dissolved and its residual activities transferred to the FSRCC's Harmonisation and Coordination Sub-Committee. As reporting entities, some member agencies of the FSRCC, including NDIC, NAICOM, CAC, and NSE, commenced the implementation of IFRS.

3.4.4 Competency Framework for the Nigerian Banking Industry

The Competency Framework (CF), which prescribes the minimum requirements for directors and officers engaged to perform control functions seeks to ensure that they possess the qualifications, skills and experience relevant to their jobs. The CBN conducted an industry Baseline Assessment which indicated that of the 5,258 directors and officers who perform control functions, about 35 per cent were considered to have met the minimum requirements of the Framework.

Lack of relevant professional certifications was the major reason why most directors and officers failed to meet the minimum requirements. The institutions were requested to submit proposed remedial action plans for their directors and officers who were found deficient. The CBN will continue to monitor effective compliance with the Framework by banks and discount houses.

3.4.5 Regulation of Financial Holding Companies

In furtherance of the implementation of the banking model introduced in 2010, the CBN issued guidelines to facilitate the regulation, supervision and operation of financial holding companies in Nigeria.

3.4.6 Nigerian Sustainable Banking Principles

The CBN issued the reporting template for the Nigerian Sustainable Banking Principles on March 6, 2014, and banks have since commenced implementation of the principles. Templates for quarterly returns were designed to enable the CBN to monitor the progress of implementation at individual bank and industry levels, and banks had started rendering the returns.

3.5 The Asset Management Corporation of Nigeria (AMCON)

Total outstanding bond liabilities of AMCON stood at ₦4.67 trillion at end-June 2014, of which ₦866.73 billion would be due for redemption in October 2014. The Corporation continued to meet payments due on its maturing bonds from the sinking fund set up for that purpose and from recoveries. It also repurchased bonds worth ₦13.295 billion during the period, bringing the net amount due for redemption in October 2014 to ₦853.44 billion. This amount represents the balance of AMCON bonds held by the private sector, banks and other entities. The Corporation had, in December 2013, redeemed its Series 1 bonds totalling ₦1.699 trillion. The CBN continued to hold AMCON bonds with a total face value of ₦3.80 trillion, earlier restructured into a 10-year Note at 6 per cent coupon.

During the period under review, AMCON made total recoveries of ₦130.60 billion (comprising - cash of ₦20.99 billion; property settlement of ₦26.78 billion and securities settlement of ₦82.83 billion).

The balance of Eligible Bank Assets (EBAs) purchased by the Corporation stood at ₦1.613 trillion at end-June 2014, compared with ₦2.37 trillion at end-December 2013 and ₦2.72 trillion at end-June 2013. Restructured loans amounted to ₦428.654 billion at end-June2014, indicating an increase of ₦54.30billion or 14.5 per cent, over the level of ₦374.35 billion at end-December 2013. The development indicated that borrowers were finding it difficult to meet their credit obligations to the Corporation, thus increasing its credit risk.

Twenty one banks paid their contributions to the Sinking Fund for year 2013. AMCON's funding model showed that it would be able to redeem fully its outstanding bond exposure to the CBN within the next ten years from the sale of acquired banks, loan recoveries, asset sales and the contributions to the Banking Sector Resolution Cost Fund.

3.6 Key Risks in the Financial System

3.6.1 Credit Risk

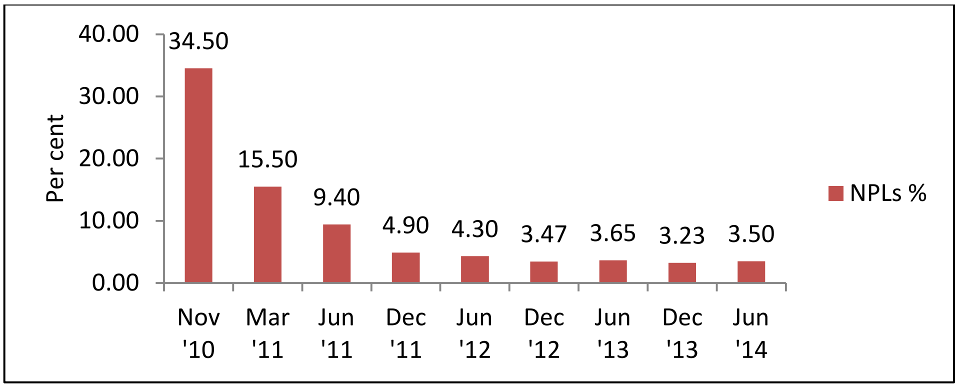
The industry NPL ratio increased to 3.50 per cent at end-June 2014, from 3.23 per cent recorded at end-December 2013, indicating a deterioration in the quality of bank assets. Although the industry ratio was within the regulatory limit of 5 per cent, six banks failed to operate within the prescribed threshold. Total NPLs also grew by 16.93 per cent to ₦379.01 billion at end-June 2014, from ₦324.13 billion at end-December 2013.

The average prime and maximum lending rates of 16.73 and 25.76 per cent respectively were high. This significantly limited access to credits and contributed to NPLs as well as the high cost of doing business in the country.

The high level of credit concentration persisted, as the top 50 and 100 borrowers accounted for 31.52 and 40.77 per cent of gross credit, respectively, at end-June 2014, compared with 31.88 and 40.51 per cent, respectively, at end-December 2013.

With inflation at 8.2 per cent, Nigerian Treasury Bills rate, ranging from 9.98 to 11.93 per cent for 91 days tenor, continued to yield a positive real rate of return; hence, crowding out investments from the real sector of the economy.

Figure 3. 13: Trend of Banking Industry NPLs



3.6.2 Liquidity Risk

All banks exceeded the minimum liquidity ratio of 30 percent with the industry average of 42.66 per cent. Liquidity risk was moderated, attributable to the effects of monthly statutory allocations to the various tiers of government by the Federation Accounts Allocation Committee (FAAC). Thus, the Bank continued to incur high costs in managing excess liquidity in the system in order to achieve its monetary policy objectives.

3.6.3 Market Risk

Most interest rates increased during the period under review, reflecting the sustained tight monetary policy stance of the Bank towards containing the excess liquidity in the system.

The exchange rates were generally stable in the RDAS, interbank and BDC segments, but were characterized by a wide spread (₦10+) between the RDAS and BDC segments. The wide margin created arbitrage opportunities, with negative implications for exchange rate stability and the external reserves. The Bank's interventions in the FX market to preserve the value of the naira resulted in the depletion of the external reserves by US$5.52 billion to US$37.33 billion by end-June 2014. Market risk was accentuated by the high level of volatility in oil receipts and potential reversal of foreign portfolio investments (FPIs) owing to developments in the domestic and advanced economies.

3.6.4 Operational Risk

The key operational risks faced by the banking industry included insecurity, frauds and forgeries. Reported incidents of fraud and forgeries continued to rise, increasing from 3,917 in the second half of 2013 to 5,197 in the first half of 2014. However, the value involved declined from ₦31.49 billion in the second half of 2013 to ₦16.82 billion in the first half of 2014. Similarly, consequent losses declined from ₦2.08 billion in the second half of 2013 to ₦1.72 billion in the first half of 2014.

A recent international development that has serious operational risk implications for Nigerian banks is the *US Foreign Account Tax Compliance Act (FATCA) of 2010*. *FATCA* is aimed at boosting revenue generation by the US Internal Revenue Service (US-IRS) through the targeting of the income of US citizens with substantial interests in foreign financial institutions (FFIs). These entities are required to report the income of US citizens directly to the US-IRS or through the FIRS. Countries are expected to comply with this legislation with effect from July 2014.

In the event of non-compliance by Nigeria, 30 per cent of funds transferred to US-based FFIs by Nigerian FIs will be withheld until the US Government is satisfied that such funds are not taxable benefits of US citizens. Given this scenario, *FATCA* has exposed Nigeria to operational and reputational risks that may undermine the stability of financial institutions. In order to address this issue, an inter-agency committee is working out modalities for compliance with the *FATCA*.

Improved AML/CFT risk-based supervision/examination processes and the earlier delisting of Nigeria from the FATF grey list helped to boost public confidence in the banking system.

3.6.5 Emerging Key Risks

In addition to the traditional sources of risk to the banking system, highlighted above, some of the emerging risks to financial system stability include:

- Impact of declining oil prices on government revenue;
- Geopolitical risk arising from the insurgency in the North-East;
- Political risk due to 2015 elections;
- Inflation risk, arising from the higher election-year spending;
- Asset prices stagnation that could result from sudden capital flow reversals;
- Risks surrounding the current high interest rates environment;
- Depletion of the external reserves; etc.

3.7 The Financial Services Regulation Co-ordinating Committee

The Financial Services Regulation Co-ordinating Committee (FSRCC) continued to provide a useful forum for interaction and coordination by the regulatory authorities in the Nigerian financial system.

As part of efforts to build capacity among the financial system regulators, the FSRCC in collaboration with the Toronto Leadership Centre, Canada, organized a workshop on Macro-prudential Surveillance for staff drawn from member agencies.

In pursuance of its expanded mandate on issues relating to the activities of illegal fund management firms, the Committee sought the assistance of the Nigeria Police to obtain a court order to close the operations of one of them which operated in different locations in Nigeria, freeze its bank accounts and prosecute the directors. The Federal High Court had also appointed liquidators for 18 illegal fund management firms which had earlier been closed.

3. 8 Customers' Complaints

The Bank received 438 new complaints from customers against financial institutions in the first half of the year. The figure showed an increase of 43.61 per cent over the 305complaints received in the second half of 2013. The total refunds to customers amounted to ₦4.03 billion and US$226,476, compared with ₦1.48 billion and US$194,000 recorded in the second half of 2013 (Table 3.13).

Table 3. 13: Complaints Received and Resolved, January - June 2014

Months	No. of new complaints received against FIs	Refunds (₦)	Refunds (US$)	No. of cases resolved
January	71	159,194,123.67	50,116.78	32
February	81	1,663,067,538.79	126,358.77	123
March	86	155,666,901.13	50,000.00	125
April	71	269,133,079.16	-	55
May	58	1,645,778,813.78	-	129
June	71	132,793,602.70	-	33
Total	**438**	**4,025,634,059.23**	**226,475.55**	**497**

The number of complaints resolved included some of the outstanding complaints from the previous period.

The complaints received from customers were related to ATM issues, excess charges, dishonoured cheques and guarantees, fraud, non-crediting of accounts, cheque conversion, and unauthorized deductions, among others.

3.8.1 The Consumer Complaints Management System

The Consumer Complaints Management System (CCMS) is an application developed by the Bank for the management of consumer complaints in the financial services sector. Meanwhile, the Bank conducted training sessions for internal and external stakeholders on the use of the CCMS.

3.8.2 Market Conduct

As part of its efforts to resolve consumer complaints and promote public confidence in the financial system, the CBN conducted spot checks to ensure banks' compliance with the provisions of the *Revised Guide to Bank Charges* during the review period. This resulted in a refund of ₦291.76 million to customers by four banks, being shortfalls in the interest paid to them. One bank refunded ₦143 million to customers, being excess commission on turnover (COT) over the maximum prescribed by the *Revised Guide to Bank Charges*.

The Bank extended the timeline for the resolution of customers' complaints on excess charges and loans from 14 to 30 days to allow for more effective resolution of cases.

4.0 THE PAYMENTS SYSTEM

4.1 Developments in the Payments System

The Nigerian payments system witnessed the following significant developments during the review period:

4.1.1 Introduction of the Bank Verification Number Scheme

In conjunction with the Bankers' Committee, the CBN introduced the above Scheme in February 2014 as part of its efforts to address the challenges of a unique identifier in the Nigerian banking industry. The implementation of the Scheme is expected to increase the effectiveness of the "Know Your Customer" (KYC) requirement and reduce operational and credit risks, among others (Box 2).

4.1.2 E-Reference Portal

An industry e-reference portal was developed and implemented for efficient processing of customers' account references. The portal is intended to digitise manual requests for confirmation of customers' account references so that requests received from other banks could be verified online and promptly.

4.1.3 Cashless Policy

The Bank abolished fees on cash deposits above the thresholds stipulated in the cash-less policy. It also conducted a sensitization exercise in preparation for the take-off of the policy in the remaining 30 states of the Federation. This was expected to broaden the adoption of electronic means of payment.

4.1.4 International Money Transfer and Card Services

The Bank revised the *Guidelines for Card Issuance and Usage in Nigeria* with a view to providing minimum standards and requirements for the operations of payment cards. This would require issuing banks, processors and operators of card schemes to ensure optimum security and efficiency. In addition, the Bank issued *Guidelines on International Money Transfer* services in Nigeria which specify minimum standards and requirements for offering inbound and outbound international money transfer services.

4.2 Payments System Vision 2020

In continuation of its implementation of the Payments System Vision 2020 (PSV 2020), the Bank, in conjunction with the Nigeria Export Processing Zones Authority, drafted guidelines for the operations of banks in the free trade zones (FTZ). The objective of the Guidelines was to prescribe detailed regulatory and supervisory requirements necessary to promote efficient and sustainable banking services in Nigeria's FTZs.

4.3 Large Value Payments

Inter-bank transfers through the new Real-Time Gross Settlement (RTGS) System increased to 323,414 transactions, valued ₦78,011.68 billion at end-June 2014 from 200,918 transactions valued ₦56,610.69 billion at end-December 2013.This reflected an increase of 60.97 and 37.80 per cent in volume and value, respectively, and increased confidence in the usage of this mode of payment.

4.4 Retail Payments

4.4.1 Cheques Clearing

Cheques cleared decreased to 7,144,340 valued ₦3,710.67 billion, respectively in the first half of 2014, compared with the level of 8,257,330 and ₦4,073.15 billion in the second half of 2013. The decrease was attributed to customer preference for electronic and other payment channels.

4.4.2 NIBSS Instant Payment

The volume and value of NIBSS Instant Payment (NIP)rose to 16,839,648 and ₦9,137.76 billion in the first half of 2014, from 11,186,930 and ₦6,666.17 billion in the second half of 2013, indicating increases of 50.53 and 37.08 per cent, respectively. The increase in the use of the channel was attributed to the growing awareness of the scheme, as well as users' preference for its quicker settlement cycle.

4.4.3 NIBSS Electronic Fund Transfer Transactions

The volume and value of NIBSS Electronic Fund Transfer (NEFT) transactions decreased by 14,260,732 and ₦7,356.90 billion in the first half of 2014, compared with 16,115,171 and ₦7,569.17 billion in the second half of 2013, indicating declines of 11.51 and 2.80 per cent, respectively. The declines were due to preference for NIP, being an instant payment platform.

4.4.4 Electronic Card Payments

The volume and value of electronic card (e-card) transactions rose to 199,284,309 and ₦1, 944.56 billion in the first half of 2014, from 176,448,606 and ₦1,763.98 billion in the second half of 2013, reflecting increases of 12.94 and 10.24 per cent, respectively (Table 4.1). This development indicated increased public confidence in the use of e-cards.

Data on various e-payment channels for the period under review indicated that Automated Teller Machines (ATMs) remained the most patronised payment mode, accounting for 89.67 per cent of the total volume, followed by mobile payments, 4.61 per cent, and POS terminal with 4.58 per cent. The internet was the least patronised, accounting for only 1.14 per cent of the total. Similarly, in value terms, ATMs accounted for 85.26 per cent; POS, 7.18 per cent; mobile payments, 5.96 per cent; while the web (Internet) accounted for 1.60 per cent (Table 4.1).

Table 4. 1: Electronic Card Transactions

Payment Channel	Number of Terminals		Number of Transactions		% Change (Volume)	Value of Transactions		% Change (Value)
	Dec 2013	June 2014	Dec 2013	June 2014		Dec 2013 (₦ Billion)	June 2014 (₦ Billion)	
ATMs	12,755	14,764	158,629,927	175,506,932	10.64	1,542.59	1,636.41	6.08
POS	120,191	121,886	6,194,467	8,971,501	44.83	103.79	137.72	32.69
Mobile	-	-	9,832,224	12,575,523	27.90	91.01	139.69	53.49
Internet (Web)	-	-	1,791,988	2,230,353	24.46	26.59	30.74	15.61
Total	**132,946**	**136,650**	**176,448,606**	**199,284,309**	**12.94**	**1,763.98**	**1,944.56**	**10.24**

5.0 OUTLOOK

According to the *IMF World Economic Outlook (WEO) update of April 2014*, global activity has broadly strengthened and is expected to improve further in 2014–15. The recovery will be stronger in advanced economies, with prospects for improved performance. This recovery would be driven largely by fiscal coordination and consolidation as well as expected increase in inventory demand. Output growth in the emerging market economies is expected to improve as a result of stronger exports to advanced economies. However, the combined effect of capital flow reversal and currency depreciation could lower net investments in the emerging market economies.

Global inflation is expected to remain contained, particularly in advanced economies, in an environment of moderate commodity prices and economic recovery. In most advanced economies, although headline inflation rates are now below their central banks' target levels, inflation expectations, as reported in survey data and financial market indicators over the medium to long term, would remain anchored. The outlook for global inflation is strongly influenced by developments in commodity prices and, more importantly, in energy prices.

Nigeria's output growth for the second half of 2014 is expected to remain resilient in spite of disruptions in agricultural activity on account of insurgency in some parts of the country. Domestic demand would continue to drive the services and manufacturing sectors, while the strengthening of growth in advanced economies would bolster external demand. Although there are signs of domestic inflationary pressures, the pass-through effect of foreign prices on domestic inflation is expected to be dampened as global inflation expectations have remained well anchored. In addition, proactive monetary policy measures would stem the liquidity surfeit, arising from the accommodative fiscal policy anticipated in the second half of the year. Consequently, domestic inflation would remain reasonably contained within its recent historical average.

Money market rates in Nigeria are expected to remain stable in the second half of 2014, albeit at a lower level than was recorded in the first half of 2014, owing to increased electioneering expenditure. Expectations of increased liquidity surfeit in the system would be counter-balanced by tight monetary policy in order to maintain price stability.

However, with the tapering of the quantitative easing programme by the Federal Reserve Bank, foreign investors might gradually exit the capital market, with adverse implications for domestic financial stability.

With respect to the payments system, the full implementation of the Bank Verification Number scheme by the deadline of December 31, 2014 is expected to significantly minimise the incidence of fraud and forgeries, thereby, reducing operational risk and enhancing the stability of the financial system. Meanwhile, the National Payments System Strategic Board, comprising 19 members from both the public and private sectors, and chaired by the Governor of the CBN, will be inaugurated which should provide strategic direction to the national payments system.

With the renewed support for the real sector interventions of the CBN in the areas of agriculture, gas-to-power, and micro, small and medium enterprises, it is expected that total bank credit to agriculture, forestry and fishing, as well as power and energy, will continue to improve significantly above their first half-year levels of 3.84 and 3.95 per cent respectively. That outcome will, no doubt, have the overall impact of substantially reducing Nigeria's food import bill on rice, sugar, wheat and fish, and complement government's efforts at ensuring the delivery of additional power for economic development. The gas-to-power intervention programme, which is expected to come on stream in the second half of 2014, will ensure an increase in the number of power projects beyond the existing 36 under PAIF, enhance the potential generating capacities of these projects above the current level of 847.4 MW and add more than the present 440.1 MW of electricity to the national grid by end-December 2014.

In conclusion, the relative stability attained in the financial system in the first half of 2014 is expected to be enhanced during the rest of the year, with the pursuit of more reform measures to address emerging challenges.

Box 1: New Nigerian Interbank Offered Rate Determination

The mechanics for the determination of the Nigerian Interbank Offered Rate (NIBOR) were reviewed, in keeping with the financial benchmarks established by the International Organisation of Securities Commissions (IOSCO).

Interbank Offered Rate (IBOR) is a daily reference rate that is generated, based on the interest rates at which banks offer to lend unsecured funds to counter-parties in the interbank market. It is a wholesale rate adopted by different countries around the globe as the benchmark for pricing financial transactions.

The basis and process for fixing the rate are similar across countries, although named differently in various jurisdictions. Thus, it is called the Nigerian Interbank Offered Rate (NIBOR) in Nigeria, Mumbai Interbank Offered Rate (MIBOR) in India, Shanghai Interbank Offered Rate (SHIBOR) in China, Singapore Interbank Offered Rate (SIBOR) in Singapore, Euro Interbank Offered Rate (EURIBOR) in Europe, Emirates Interbank Offered Rate (EIBOR) in The United Arabs Emirates, Norwegian Interbank Offered Rate (NIBOR) in Norway, Tokyo Interbank Offered Rate (TIBOR) in Japan, Hong Kong Interbank Offered Rate (HIBOR), and London Interbank Offered Rate (LIBOR), among others.

The LIBOR Scandal of 2012 informed the re-examination of the mechanics for the determination of interbank offered rates generally. The basic principles recommended by IOSCO for the computation and presentation of benchmarks used in financial markets further underscored the need for doing so. The nineteen principles are categorized broadly under governance, quality of the benchmarks, quality of the methodology, and accountability.

In Nigeria, the paucity of trades in some segments of the NIBOR benchmarks necessitated the recent reform. Consequently, the Financial Markets Dealers Quotation Over-the-Counter PLC (FMDQ-OTC) undertook a review of the NIBOR determination process, focusing on: the benchmark definition, underlying philosophy, calculation methodology; tenors, and the basis for the selection of participating or contributing institutions. The outcome was the reduction in the number of benchmark tenors for reference to four, namely, overnight, one-, two- and three-month tenors, to reflect the realities in the domestic money market.

Box 2: The Bank Verification Number (BVN) Scheme

The absence of a unique identifier in the Nigerian banking industry has been a major challenge inhibiting the effectiveness of the Know Your Customer (KYC) principle, with negative consequences on the growth of credit cards and other credit-related products. To complement the existing means of identification of customers, which include: the driver's licence; the International Passport; the National Identity Card; and the Permanent Voter's Card; the CBN, in collaboration with the Bankers' Committee, recently introduced the requirement of the Bank Verification Number (BVN) with biometric solution, as a unique identifier for all bank customers.

The BVN initiative is expected to revolutionise the payment system in the country. In addition to providing a unique identifier, the BVN scheme is targeted at addressing cybercrime, ATM and other types of financial crimes as well as avoiding loss of customers' funds through compromising Personal Identification Numbers (PIN) and identity theft.

At the point of enrolment for BVN, a bank customer is required to walk into any of the bank's branches with a valid means of identification, fill and submit the BVN Enrolment Form, and present self for data capturing (such as fingerprint, facial Image, etc.) Thereafter, an acknowledgment slip with the transaction ID will be issued to the customer. Within 24hours the system confirms the enrolment and a unique BVN is generated. The customer will immediately receive an SMS notification with the BVN.

This enrolment process is done only once and BVN will be linked to all the customer's bank accounts across Nigeria.

Meanwhile, a deadline of end-June 2015 has been set for customers to comply with the BVN requirement.

Box 3: Reforms in the BDC Sub-sector

As part of the on-going banking sector reforms to strengthen and reposition the financial system to effectively perform its role of promoting economic development, the CBN, in the first half of 2014 reviewed the operations of the BDC Sub-sector. BDCs were introduced by the Bank in the early 1990s to, among other objectives:

Provide access to foreign exchange for small-scale end users;
Serve as a tool for effective management of the naira exchange rate;
Assist in combating illegal financial activities;
Facilitate economic activities; and
Provide economic data for policy decisions.

In recent times, the CBN observed that BDC operations had negated the objectives for which they were established, thereby, exposing the financial system to systemic risk. In order to correct the observed deficiencies, the CBN reviewed the modalities for their operations. The following are the highlights of the review:

The minimum capital requirement for the operation of BDCs in Nigeria was reviewed to ₦35 million;
The mandatory cautionary deposit was reviewed to ₦35 million, which would be deposited in a non-interest yielding account in the CBN upon a grant of Approval-in-Principle;
Application fee increased to ₦100,000;
Licensing fee raised to ₦1 million;
Annual renewal fee increased to ₦250,000; and
Ownership of multiple BDCs is no longer permissible.

	Old	**New**
Capital Requirement	₦10 million	₦35 million
Mandatory Cautionary Deposit	US$20,000	₦35 million
Application Fee	₦10,000	₦100,000
Licensing Fee	₦100,000	₦1 million
Annual Renewal Fee	₦10,000	₦250,000
Multiple Ownership	Not prohibited	Prohibited

All existing BDCs, including those operating with a final approval letter, were expected to comply with the mandatory cautionary deposit, latest by July 31, 2014. Furthermore, membership of the Association of BDC Operators of Nigeria is no longer mandatory. BDCs that comply with the revised guidelines are expected to be well-capitalized and properly structured to contribute to economic growth and development of Nigeria.

Following the measures above, the CBN was in the process of issuing guidelines for international money transfer operators to carry out inward and outward money transfer services in Nigeria. The compliant BDCs are expected to serve as agents, on a fee basis, to the international money transfer operators. At end-June 2014, BDCs were making encouraging efforts towards compliance.

Box 4: Highlights of the Governor's Strategic Vision for the CBN

- A gradual reduction in key interest rates, and inclusion of the unemployment rate in monetary policy decisions.
- Maintain exchange rate stability and aggressively shore up foreign exchange reserves.
- Strengthen risk-based supervision mechanism of Nigerian banks to ensure overall health and banking system stability.
- Build sector-specific expertise in banking supervision to reflect loan concentration of the banking industry.
- In view of inadequate trigger thresholds from a macro-prudential perspective, consider and announce measures to effectively address this anomaly.
- Abolish fees associated with limits on deposits and reconsider ongoing practice in which all fees associated with limits on withdrawals accrue to banks alone.
- Introduce a broad spectrum of financial instruments to boost specific enterprise areas in agriculture, manufacturing, health, and oil and gas.
- Establish a Secured Transaction and National Collateral Registry, as well as establish a National Credit Scoring System that will improve access to information on borrowers and assist lenders to make good credit decisions.
- Build a resilient financial infrastructure that serves the needs of the lower end of the market, especially those without collateral.
- Renew vigorous advocacy for the creation of commercial courts for quick adjudication on loans and related offences.

Appendix 1: Selected Financial Soundness Indicators of the Nigerian Banking Industry

Indicators	2009		2010		2011		2012		2013		2014
	(1) End June	(2) End Dec	(3) End June	(4) End Dec	(5) End June	(6) End Dec	(7) End June	(8) End Dec	(9) End June	(10)** End Dec	(11)** End June
1. Asset-based Indicators											
NPL to gross loans	8.5	27.6	28.8	15.7	10.8	5.3	4.3	3.5	3.7	3.2	3.5
Liquid assets (core) to total assets	15.6	16.5	17.2	17.2	22.6	25.7	23.5	24.7	21.2	16.5	11.4
Liquid assets (core) to short-term liabilities	21.5	22.3	19.4	19.8	25.7	31.3	28.1	28.9	25.0	18.7	13.1
Return on assets (ROA)	1.7	-8.9	1.0	3.9	0.9	0.1	1.5	1.2	1.4	0.8	1.2
2. Capital-based Indicators											
Regulatory capital to risk-weighted assets	22.4	4.1	1.5	1.8	4.2	17.9	17.7	18.3	18.9	17.1	16.4
Tier 1 capital to risk-weighted assets	21.9	4.9	2.4	2.2	4.5	18.1	17.8	18.0	18.5	17.1	16.1
NPLs net of provisions to capital	12.5	106.8	289.8	192.7	74.3	10.1	6.8	6.1	7.4	5.8	5.6
Return on equity	8.9	-222.8	50.2	265.0	29.4	0.5	13.1	11.2	11.9	7.1	10.1
3. Income and Expense-based Indicators											
Interest margin to gross income	60.1	57.8	54.0	53.7	50.8	45.2	64.6	64.3	61.6	64.9	63.3
Non-interest expenses to gross income	64.5	81.2	80.5	66.9	72.9	75.4	64.8	64.9	65.7	68.9	65.4
Personnel expenses to non-interest expenses	46.7	47.6	45.5	42.8	44.6	36.1	43.6	43.9	38.7	36.5	38.2

* (All figures are in percentages)

*Note:*FSIs are computed, based on IMF guidelines. ** Provisional*