

AN ASSESSMENT OF CURRENT DEVELOPMENT IN THE NIGERIAN ECONOMY AND THE CENTRAL BANK OF NIGERIA (CBN) POLICY ACTION

It is with great pleasure that I welcome you all to my maiden briefing on the activities of the CBN in addressing the challenges faced by the financial sector owing to the downturn in the global economy. I, therefore, take this opportunity to appraise the CBN monetary actions in the recent past and indicate the way forward in the immediate future.

As someone just coming from the other side of the aisle of the financial sector (the regulated), you will appreciate that my remarks today as a regulator must be viewed as one that is not bereft of the first-hand knowledge of what regulation means.

As you are well aware, the primary objective of the CBN is to promote sustainable output and employment while maintaining price stability over time. These goals are not unique to this country. Indeed, most central banks pursue the same objectives. The pursuit of these objectives is central to eliminating uncertainties and distortions of high and variable inflation, thereby, providing an economic environment that is conducive to growth.

The Central Bank of Nigeria has in recent times pursued these goals by influencing financial conditions, that is, the cost and availability of credit as well as asset prices.

The growth performance of the Nigerian economy, has until recently, been sustained at a relatively high level due largely to the sustenance of macro-economic stability – a product of effective conduct of monetary policy, financial sector reforms and relative improvement in fiscal prudence. The current global financial melt-down has weakened growth considerably in the first quarter of 2009 to 4.85 per cent from 5.75 per cent estimated for 2008 and projections for the future are not encouraging.

To ameliorate the situation, CBN took measures to encourage the flow of credit for productive investment. The MPR was reduced by 175 basic points in April 2009 while the liquidity and cash ratios declined from 30 per cent and 2 per cent to 25 per cent and 1 per cent respectively. As these actions did not seem to have yielded the desired economic outcomes in time, the Bank resorted to direct control measures involving interest rate caps and the re-introduction of exchange control measures.

The failure of the economy to respond favourably to the monetary easing measures reflected mainly the under-developed character of the financial

market and, concomitantly, the weakness of the transmission mechanism of monetary policy.

The major challenge facing the CBN, therefore, is the critical need to strengthen the implementation of the on-going financial sector reforms to achieve enhanced efficiency of the financial markets on which the effective conduct of monetary policy depends.

In this regard, the CBN policies will continue to support government endeavours to promote strong and sustainable growth without compromising its mandate to ensure the maintenance of price stability. The conduct of monetary policy will be driven by market-based mechanisms, thereby, building on the progress we have made since we abandoned the direct control measures in 1993. Consequently, interest rate policy, which is an essential component of monetary policy will be flexible and, as much as, practicable market-determined in order to ensure allocative efficiency in the financial markets.

We will address some of the failures leading to high lending rates, including operational efficiency in the financial system.

Finally, an efficient and effective transmission mechanism of monetary policy can only be assured in an environment of safe, sound and competitive banking system.

In this regard, the CBN surveillance activities will receive new impetus to ensure efficient management and good corporate governance that will complement the gains made under the banking consolidation.

Please, permit me to elaborate on the four points just outlined.

Deepening the Financial Market

The financial market has not as yet attained the depths that are necessary to have efficient transmittal of policy stance. As a result, the short term interest rates which should ordinarily affect the lending rates to the real sector have not played this role. Bank lending rates remained high and the spread between lending and deposit rates has been unacceptably wide.

The role of the financial system in economic development cannot be overstated. Apart from the critical role financial markets play in mobilizing savings and allocating them to productive investment, an efficient financial market would provide a more stable source of financing for both private and public sector. At present, there is a near total absence of debt

instruments in the capital market. As a result, banks are responsible for almost 100 per cent of the loan taken by the private sector.

The Central Bank will work with the Tax Authorities to have a tax free yield curve and encourage the development of a bond market. The Bank will also collaborate with Securities and Exchange Commission (SEC) and Nigerian Stock Exchange (NSE) to reduce the cost of bond issues so as to diversify funding sources away from banks.

Interest Rates

A major impediment to the realization of development through the intermediation role of the banking industry is the wide and persistent spread that exists between deposit and lending rates. The interest rate spread, which is the difference between the bank's earnings from loaned funds and its cost of funds is influenced by non-interest expense, prudential and reserve requirements, market structure, inflation, credit risk and profit expectation of banks, among others.

Available studies on interest rate margins and profitability determinants show that high non-financial costs are largely responsible for the wide intermediation spread in Nigeria. These costs often reflect inefficiencies in the operations of the banking system which very often are passed on to

consumers. The data also show a positive relationship between net interest margin and overhead costs.

The Central Bank will work with banks to improve efficiency in the banking system. We will encourage the banks to explore the idea of infrastructure sharing to improve efficiency and reduce cost of operations. Other areas of cost cutting are through innovations that will reduce the cost of delivery of banks products. It is expected that gains from banking efficiency and other financial system reforms will reduce intermediation spreads.

In addition to these measures, it is expected that banks will realize that excessive interest charges increase the risk of huge loan losses and financial instability in the medium term. It is, therefore, necessary for banks to moderate short-term profit expectations and curtail expenditure on compensation and bloated overheads. The CBN will work with the Bankers' Committee and, through moral suasion, encourage a consensus on what constitutes a reasonable margin. It is clear that in the present arrangement, all but the most powerful companies are at the mercy of banks as fund providers, and the regulator must play the role of consumer protection and ensure that banks charges are reasonable and consistent with both the profit motive of the individual banks and in the interest of the system. Real interest rates in double digits are much higher than the growth potential of GDP given structural constraints.

Reform of the Payments System

The payments system plays a crucial role in any economy as a channel of inter-sector, inter-industry and inter-company financial resource flows, thus, promoting economic growth. Understandably, the Central Bank of Nigeria (CBN) accorded the payments system due priority in its reform agenda of the financial system. Thus, the CBN in partnership with other stakeholders embarked on extensive reforms of the payments system to enhance its safety, efficiency and reliability. This effort culminated in the introduction of institutional arrangements, operational mechanisms, interrelated IT infrastructure and instruments that are gaining wide acceptability among service consumers in the banking industry.

The emerging payments landscape in Nigeria has generally been significantly influenced by financial liberalization and integration across the globe and, in particular, developments in payments framework including regulations, infrastructure and information and communications technology. The first major step towards reforming the National Payment Systems (NPS) by the CBN was the articulation of national payments system framework and guidelines for all payments system initiatives with the objectives of generally, ensuring availability without interruption, meeting as much of the users' needs as possible, and operating at minimum risk and reasonable cost.

In retrospect, the CBN's payments system reform agenda has produced salutary outcomes. The major developments so far have been in the areas of deployment of several requisite infrastructures since 2002 and the establishment of the institutional framework to drive the payments system reforms.

Therefore, the NPS would be a major driver of changes in the financial markets, and would serve as a platform for supporting the integration of the Nigerian wholesale and retail payments system with that of the West African Monetary Zone (WAMZ). The Bank will continue to pursue the payments system reforms as outlined in the Financial System Strategy FSS 2020. Specifically, the implementation of the seven key initiatives that will drive the usage of electronic payments will be vigorously pursued. These initiatives include Government supplier payments, person-to-person trade, salary and bill payments, business and individual taxes and securities settlement.

Financial Stability Issues

The Bank has since March 2006 adopted a new code of corporate governance to engender confidence in the industry and, hence, attract foreign investors in the sector. Risk-based supervision and consolidated supervision have also been adopted in the industry to further boost confidence and ensure stability of the system. In addition, common

accounting year end for all banks and international financial reporting standards aimed at improving integrity and comparability of both financial reports and data is to be adopted in the industry by the end of 2009 and 2010, respectively. Also, greater emphasis has been placed on e-FASS as a tool for banks' returns analysis for speedy identification of early warning signals.

The Bank has also reviewed the Contingency Planning Framework for Systemic Distress in banks. Others include the introduction of Credit Bureau, deployment of resident examiners to banks since January 2009 as well as standby teams of target examiners being deployed to any bank at any given time to ensure timely regulatory action when necessary.

Despite the measures taken by the CBN, there have been concerns in recent times about the health of the Nigerian banking system occasioned largely by the system's exposure to the capital market and the effect of the global financial crisis as well as exposure to oil marketers and Ministries, Departments and Agencies (MDA). While there is no doubt that the banks were challenged in the face of these developments, there is no evidence, thus far, that our banking system is facing a crisis as has been reported in some newspapers recently. All reports purporting to suggest that some named banks are not sound or shaken are unfounded and we urge journalists to exercise caution and show more responsibilities in reporting

and quoting unofficial sources. Our view is that there are stress points in banks' balance sheets (margin loans, proprietary positions, oil marketing names, unsecured large exposures) and these are being dimensioned. An appropriate resolution framework will be developed in consultation with reputable independent advisers, and the market will have information on steps being taken at appropriate junctions in the process. We reiterate that, based on the totality of information available to the regulator, there is no basis for suggesting that the system is at risk. We also re-affirm our commitment to stand behind every financial institution and work with its board and management to ensure a smooth resolution of any issues that may arise as an outcome of the diagnostic process. No bank will be allowed to fail.

Going forward, the CBN will strengthen the regulatory and supervisory framework and enhance monitoring of the operations of the DMBs to ensure that they remain safe, sound and healthy to support the macroeconomic objectives of the government, in general, and monetary policy, in particular.

To this end, the CBN will continue to ensure the maintenance of public confidence through appropriate disclosure and would reinvigorate the policy of zero tolerance on all unprofessional and unethical conduct. Banks would also be required to further strengthen their risk management

process, while the present supervisory methodology of risk-based and consolidated supervision with special emphasis on macro-prudential regulation and sound stress testing practices would be pursued more vigorously.

More and rigorous emphasis would be placed on the implementation of the Code of Corporate Governance for banks in Nigeria. Banks that have not fully complied with the requirements of the code would be encouraged to do so. For the avoidance of doubts, enforcement of the code of conducts on the board and top management of banks, especially in the areas of display of professionalism and high ethical standard shall not be compromised. In addition, we will put in place a code of conduct for regulators to ensure that our own staff live up to the high expectation of the nation.

Meanwhile, the on-going assets' quality audit by the CBN and NDIC would ensure that appropriate policies are put in place to address identified lapses.

It should be emphasized that the determination of the health of banks is a continuous exercise. The CBN on its part will continue to monitor developments in the sector and proffer appropriate policies to ensure that the Nigerian banking system remains sound and stable. The decision of

the MPC this morning to guarantee inter-bank exposures and Pension Funds Administrators (PFA) placements in the banks is aimed at re-assuring the market and stabilizing the system while the reform process continues over the next 6-9 months. This should stop the current overheating in the system and exert a downward pressure on interest rates.

Conclusion

To conclude, let me reiterate that the conduct and implementation of monetary policy will continue to be dictated by the prevailing domestic economic conditions. Thus, the monetary policy framework will continue to be transparent and market-driven using standard monetary policy instruments, like cash reserve requirements, appropriate interest rate policy, open market operations, discount window operations, foreign exchange market intervention, amongst other market-related tools.

Furthermore, while achieving a low interest rate regime remains the principal target of monetary policy, the determination of interest rate will continue to be flexible and driven by market forces - demand and supply conditions, amongst other factors. Similarly, our exchange rate policy will be transparent and dictated by our economic fundamentals while remaining market-driven at all times, but with due cognizance of ensuring

that instability does not creep into the various segments of the foreign exchange market.

Overall, our ultimate goal is to establish a credible monetary policy regime that will facilitate the attainment of our two key mandates of ensuring price and monetary stability and promoting financial soundness and stability, to support government's macroeconomic objectives of high and sustainable economic growth and low unemployment, in the medium- to long-term.