PART TWO

ECONOMIC REPORT

CHAPTER 3

WORLD OUTPUT, PRICES AND TRADE

The global economy was projected to have grown by 5.2 per cent in 2007, an increase of 0.8 percentage point above the previous year's level. About half of the global output expansion was accounted for by China, India and Russia. World output growth was however, moderated by the weakening of the United States economy.

3.1 OUTPUT AND GROWTH

The global economy was projected to have grown by 5.2 per cent in 2007, driven by the output expansion in the emerging market economies and the modest growth in the Euro area. Asian output growth was significant, as China and India grew by 11.5 and 9.25 per cent, respectively. The growth in the region which witnessed increased investment and domestic consumption was not affected by the US financial market volatility. Countries in the region recorded an average growth rate of 9.2 per cent, a marginal decrease of 0.1 percentage point from the level in the previous year.

The Euro area economy expanded initially but eased subsequently due to weather-related problems and the contagion effects of the US subprime crisis. The initial growth was driven by broad based acceleration in investment spending, especially in Germany, in response to higher regional and global demands for machinery and equipment. Private consumption also eased as a result of VAT hike in Germany and election uncertainties in France. In the UK and other European countries such as Norway, Sweden and Switzerland expansion was also strong. Growth was projected at 2.5 per cent and 3.1 per cent in the Euro area and the UK, respectively.

Sub-Saharan Africa (SSA) recorded an output growth of 6.1 per cent, mainly from the operation of new production facilities in oil exporting countries such as Nigeria and Angola. Most countries in the region maintained relatively high growth rates and made progress in poverty reduction. The growth in the region was attributed to a combination of favourable external environment, particularly improved terms-of-trade through diversification of exports into non-industrial manufactures, and its extension to new destinations in Asia, as well as sound policy implementation and openness of the economies.

Countries of the western hemisphere recorded an output growth rate of 5.0 per cent, 0.5 percentage point lower than in the previous year. The decline was partly attributable to the slowdown of activities in the US and the end of the construction boom in Mexico, Central America and the Caribbean. In addition, commodity exporting countries in the region such as Argentina, Columbia, Peru, Uruguay and Venezuela experienced significant decline due largely to supply constraints. Other impediments to improved performance included inefficient public sectors, limited financial intermediation, weak infrastructure and high income inequality.

Emerging European countries recorded an output growth rate of 5.8 per cent, 0.5 percentage point lower than the previous year's level. Investment and productive activities in the region were bolstered by cross border inter-bank loans, particularly in southern and southeastern Europe. Exports from these countries, particularly Turkey, benefitted from the boom in Western Europe. Demand was boosted by cross border credits which provoked concern about widening external imbalances and overheating in some countries of the region, especially the Baltic states. Among the countries in the region, Hungary experienced slow growth due to the short-term impact of fiscal consolidation.

The global output expansion was however, dampened by the sluggish growth in the US and Japanese economies. The US economy grew modestly despite a weak start and the mortgage crisis in the fourth quarter. The growth in the economy was undermined by increase in gasoline prices and the decline in residential investment which affected financial markets. The economy was projected to have grown by 1.9 per cent, 1.0 percentage point below the previous year's level. Also, the Japanese economy contracted slightly after initial strong gains with the growth in output projected at 2.0 per cent, compared with 2.2 per cent in 2006.

3.2 WORLD PRICES

Inflation was generally contained in the advanced economies before the financial market turbulence triggered by the US subprime crisis. The mortgage crisis created a credit crunch which forced major central banks to inject liquidity. In the US, core inflation subsided to below 2.0 per cent because of the slowdown in the mortgage sector. The Federal Reserve cut the funds rate twice to 4.25 per cent in order to stem the slowdown in the economy. In Japan, despite the four years of robust growth, deflation subsisted as a result of growth in corporate investments, combined with structural reforms and demographic changes that kept wages down.

In the Euro area, the headline consumer price index (CPI) remained below 2.0 per cent in the early part of the year but inched upwards in the third quarter due to higher energy and food prices. Inflation was curtailed, despite the tight labour market by increased competition (due to an enlargement of the EU) and huge home remittances from new member states in Eastern Europe. In the emerging market economies, the inflationary pressures impacted variously. Among the Asian countries, surging food prices drove the CPI up in China. Declining inflation in such countries as Thailand, Indonesia and the Philippines prompted the central banks to cut interest rates, whereas countries such as China, India and Korea tightened monetary policy to stem excess liquidity and the overheating of the economies.

For SSA countries, inflation was moderate with the exception of Zimbabwe where it was over 1000 per cent. The moderate inflation in most SSA countries reflected the consistent implementation of policy reforms, which strengthened the business environment, and narrowed fiscal deficits, as well as the improved terms-of-trade.

3.3 WORLD TRADE

Global trade expansion was sustained in 2007 as the value grew by 14.2 per cent to US$15,516.0 billion. A disaggregation of global trade revealed that both exports and imports recorded modest growth in advanced economies. Export and import trade were estimated at US$7,313.4 billion and US$8,203.4 billion, representing growth rates of 11.1 per cent and 11.3 per cent, respectively, over the previous year. Developing countries recorded a significant increase in trade due to the high prices of commodities, especially crude oil and solid minerals. The values of non-oil exporting countries' export and import trade were estimated at US$5,350.4 billion and US$5,165.3 billion, representing growth rates of 16.6 and 15.7 per cent, respectively while the values of oil exporting countries' recorded export and import trade were estimated at US$988.5 billion and US$481.8 billion, representing growth rates of 14.7 per cent and 13.4 per cent, respectively.

BOX 1: CHINA'S DEMAND FOR PETROLEUM: IMPLICATIONS FOR GLOBAL OIL PRICES

Strong economic growth in Asia, particularly in China has had a significant impact on the global markets in recent years, including the markets for crude oil and petroleum products. China's economy has been growing at 10 per cent or more per annum since the 1990s, lifting nearly 300 million people out of poverty. Specifically, the real GDP grew from 9.2 per cent in 1991 to 10.0 per cent in 1996, 11.0 per cent in 2006 and 11.5 per cent in 2007. The stock exchange has also, witnessed phenomenal growth as evident from key market indicators. For example, the share price index of the Chinese Stock Exchange rose by 6.2 per cent in 1990 and 129.0 per cent in 2006. Before the 1990s, China was a net oil exporter, but from the early 1990s, nearly 50.0 per cent of its oil consumption was imported (International Financial Statistics).

China's demand for crude oil and refined petroleum products has grown phenomenally over the years, driven principally by strong growth in industrial production and transportation, thus making China the second largest oil consumer in the world after the United States. China's consumption of crude petroleum increased from 2,296.4 million barrels per day in 1990 to 3,363.2 million barrels per day in 1995, an average annual increase of 8.0 per cent. It recorded annual growth rates of 7.4 and 7.5 per cent for the periods 1996 to 2000 and 2001 to 2006, respectively. The major drivers of consumption included higher demand for energy in the transport sector, associated with growth in personal consumption, rising urbanisation, growth in industrial sector output and the high demand for petrochemical feed-stocks, rapid rural electrification which increased the consumption of petroleum for power generation and increase in the consumption of diesel fuel needed to power over 15 million Chinese tractors and 22 million small rural vehicles for the rural agricultural sector.

The rising demand for petroleum and its products in China and Asia as a whole has long run implications for prices. Recent investments in the subsector indicate that China is rising to become the biggest centre for petroleum refining in the world (Annual Energy Outlook 2005).

The growing preference of the Chinese market for light products, such as diesel fuel, gasoline and petrochemical feed-stocks, increases the price for premium grades of crude oil and adds to refiners' costs for processing low quality oil. China, therefore, is competing with the United States for the brands of crude oil that are most easily refined into motor fuels especially in the face of stringent environmental standards. China is also investing in additional refining capacity to process heavy sour oils as a way of providing more light products to the growing domestic market, hence the phenomenal growth in her consumption of crude oil. Thus, the price of the world market benchmark crude, the West Texas Intermediate (WTI) rose by 7.2, 57.4 and 17.1 per cent in 1995, 2000 and 2006, respectively.

The rising crude oil demand in China also implies that available buffer or excess production capacity in the world is becoming very slim. Therefore, any increase in demand must be met from costly incremental sources that propel sharp price increases, especially at a time when this is fraught with supply disruptions due to violence in the oil exporting regions. China is also developing strategic inventory of crude oil like other countries such as the USA. Currently, the United States and other members of the International Energy Agency (IEA) are committed to maintaining a 90 day emergency supply of oil and oil products. China currently is not a member of IEA, but as a major consumer of oil, the additional oil purchase to fill its reserve would further boost demand in the world oil market with its implications for a further hike in oil prices in the future.

3.4 THE INTERNATIONAL FOREIGN EXCHANGE MARKET

Relative to other major currencies, the naira appreciated against the US dollar (2.2 per cent), the Japanese yen (3.7 per cent), and the Saudi Riyal (0.4 per cent), while it depreciated against the pound sterling (5.7 per cent), the euro (6.0 per cent), and the Swiss franc (5.4 per cent).

3.5 THE IMPACT OF INTERNATIONAL ECONOMIC & POLITICAL DEVELOPMENTS ON THE NIGERIAN ECONOMY

Global economic development during 2007 had a positive impact on the Nigerian economy in several areas. First, the sustained high crude oil price throughout the year boosted foreign exchange earnings and the build-up of external reserves, the decline in crude oil output and export notwithstanding. Second, deriving from the increased earnings from crude oil exports, government revenue was enhanced, which facilitated government's decision to invest in infrastructural rehabilitation and development, which ordinarily would not have been undertaken. Third, the increased revenue boosted government deposits in the banking system and helped free up resources for the DMBs to enhance credit flows to the private sector. Fourth, Nigeria's external balance position remained robust and coupled with strong external reserves engendered foreign investors' confidence and facilitated substantial capital inflows, all which contributed to the relative stability in foreign exchange market. Furthermore, investment in the oil and gas sector continued as demand for crude petroleum surged in the world oil market. Finally, the Nigerian financial system was insulated from the adverse effects of the global financial crisis emanating from the US mortgage crisis.

CHAPTER 4

THE FINANCIAL SECTOR

The Nigerian financial sector grew stronger in 2007 in all the segments, as indicated by the various performance measures . The depth of the financial sector increased, as broad money supply to nominal GDP ratio rose to 21.1 per cent from 19.8 per cent at the end of 2006. The banking sector also showed a stronger capacity to finance real sector activities with substantial credit flow to the core private sector as the Cp/GDP ratio increased from 13.0 to 21.7 per cent at end-2007. In addition, the increased use of the various electronic money products reflected the shift away from cash transactions and, thus, an improvement in the efficiency of funds intermediation. Consequently, the ratio of currency outside banks to broad money supply fell further to 15.2 per cent from 18.8 per cent at end-2006. The money market was further deepened with the introduction of the ten-year government bond, while liquidity was enhanced through the trading of the bonds in the secondary market, using the two-way quote system. Thus, the ratio of money market assets outstanding to GDP at end-2007 rose to 9.9 per cent, from 8.8 per cent at end-2006. The performance of the capital market improved substantially as the ratio of market capitalisation to GDP increased to 58.2 per cent from 27.6 per cent in 2006.

The outcome of monetary policy actions by the Bank was modest in 2007 as broad money supply grew by 30.9 per cent compared with 30.6 per cent at end-2006 and the target of 24.1 per cent for the fiscal year. The reserve money target at end-June 2007 exit point of the PSI was met, although the end-year indicative target was missed. The Nigerian Risk-Free Yield curve incorporating treasury bills and bonds at the short and long benchmarks, respectively, was launched in 2007. The yield curve remained normal throughout the year. Also, with the appointment of nineteen (19) primary money market dealers, secondary market activities in FGN bonds commenced.

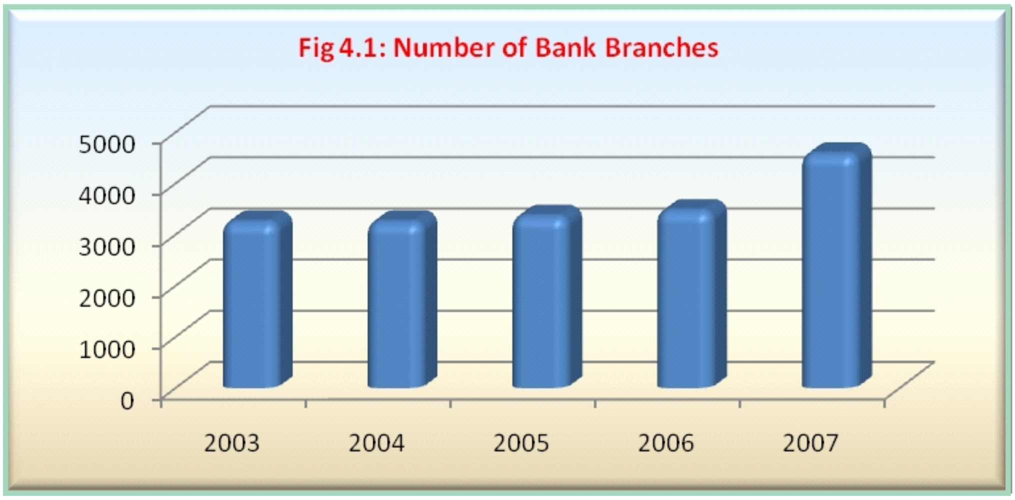
At end-December, 2007, the Nigerian financial system comprised the CBN, the Nigerian Deposit Insurance Corporation (NDIC), the Securities and Exchange Commission (SEC), the National Insurance Commission (NAICOM), the National Pension Commission (PENCOM), 24 deposit money banks (DMBs), 5 discount houses (DHs), 709 microfinance banks (MFBs), 112 finance companies (FCs), 703 bureaux-de-change (BDCs), 1 Stock Exchange, 1 Commodity Exchange, 93 primary mortgage institutions (PMIs), 5 development finance institutions (DFIs), and 77 Insurance companies.

4.1 INSTITUTIONAL DEVELOPMENTS

4.1.1 Growth and Structural Changes

The number of deposit money banks (DMBs) in the industry dropped to twenty-four (24) from twenty-five (25) at end-December 2006, following the merger of Stanbic Bank and IBTC Chartered Bank. Also, there was no new application for banking a licence. The number of banks' branches, however, grew from 3,468 in 2006 to 4,579, representing an increase of 32.0 per cent.

The Nigerian Deposit Insurance Corporation (NDIC) intensified efforts in the resolution of the fourteen (14) failed banks whose operating licences were revoked by the CBN in January 2006. The Corporation obtained final court orders to wind up eleven (11) of the banks and a provisional court order to wind up one (1) more bank. The cases of the remaining two (2) banks were still pending in court. The policy of assets cherry-picking under the Purchase & Assumption (P&A) model of bank liquidation continued, in 2007 as the NDIC invited the healthy banks to assume the private sector deposit liabilities of the banks for



which it had obtained final court orders for their liquidation. At end-December 2007, the total private sector deposits of the 14 banks in liquidation expected to be assumed were N89.99 billion, out of which 80.8 per cent had been assumed, while 53.2 per cent had been paid out.

In 2007, the NDIC extended deposit insurance cover to the PMIs. Also, Oceanic Bank Plc and Guaranty Trust Bank Plc acquired one (1) PMI each, bringing the number of PMIs with DMB controlling interest to eleven (11). Five (5) PMIs were granted approval to restructure their capital base, while one (1) PMI undertook a rights issue in the capital market.

A total of 603 community banks (CBs) converted to MFBs during the year, bringing to 607 the number of CBs that had met the requirement for conversion before 31st December, 2007. Of the 607 converted CBs, 528 were given provisional approval, while 79 obtained final licences. In addition, seventy-six (76) new applications for fresh MFB licences were received, bringing the total number of applications from new investors since the MFB policy was launched on 15th December, 2005 to 122. Out of the total applications received, 40 final licences and 62 approvals-in-principle (AIPs) were granted, while the remaining 20 applications were still undergoing processing. As a means of ensuring the stability of the MFB subsector, efforts at setting up a certification programme for the training of supervisors, directors and operators in the subsector were intensified.

At end-December 2007, the Nigerian financial system comprised the CBN, the Nigerian Deposit Insurance Corporation (NDIC), the Securities and Exchange Commission (SEC), the National Insurance Commission (NAICOM), the National Pension Commission (PENCOM), 24 Deposit Money Banks (DMBs), 5 Discount Houses (DHs), 709 Microfinance Banks (MFBs), 112 Finance Companies (FCs), 703 Bureaux-de-Change (BDCs), 1 Stock Exchange, 1 Commodity Exchange, 93 Primary Mortgage Institutions (PMIs), 5 Development Finance Institutions (DFIs), and 77 Insurance companies.

4.1.2 Fraud and Forgery

The number of reported cases of attempted or successful fraud and/or forgery in the banking industry rose in 2007. There were a total of 1,553 reported cases of attempted fraud and forgery involving N8.8 billion, US$591,487.8, €35,390.76 and £12,410.00, compared with 1,193 reported cases involving N4.6 billion, US$1.8 million and £14,399.74 in 2006. Out of this number, 825 cases resulted in losses to the banks amounting to N2.7 billion, US$238,621.50, €390 and £12,410.00, compared with 612 cases involving N4.6 billion, US$1,753,024.06 and £14,399.74 in 2006.

4.1.3 Public Complaints Desk

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

4.1.4 Cheque Clearing

The reform of the payments system continued to produce salutary outcomes in 2007. The volume and value of cheques cleared in the system rose substantially by 33.3 and 70.5 per cent to 19.9 million and N28.1 trillion from 14.9 million and N16.4 trillion in 2006. The astronomical increase in the value of cheques cleared reflected a major shift to the use of non-cash transactions by the public. As in the previous years Lagos, as the commercial hub of Nigeria dominated other clearing centres in volume and value of transactions (44.6 and 41.2 per cent respectively). Ibadan accounted for 19.6 and 17.0 per cent in volume and value, displacing Abuja to the third position.

Table 4.1: Volume and Value of Cheques Cleared

	2006		2007	
	Volume	Value (N'billior	Volume	Value (N'billion)
Clearing System	14,927,414	16,492.1	19,895,61	28,111.2
Lagos Clearing House	7,759,599 (520%)	7,332.1 (44.5%)	8,865,35 (44.6)	11,585.3 (41.2)
Ibadan Clearing House	957,449 (6.4)	556.9 (3.4)	3,904,94 (19.6)	4,784.4 (17.0)
Abuja Clearing house	1,130,175 (7.6%)	2,749.0 (16.7%)	1,554,52 (7.8)	3,402.5 (12.1)
Others	5,080,231 (34.0)	5,854.0 (35.5)	5,570,78 (28.0)	8,339.0 (29.7)

Figure 4.2: Volume of Cheques Cleared (2006-2007)

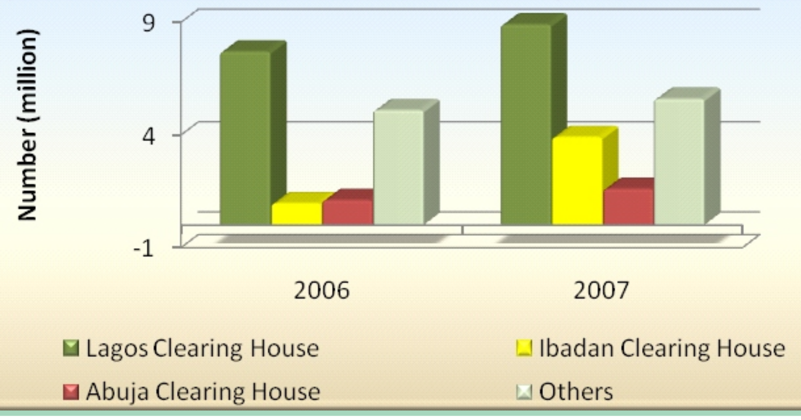
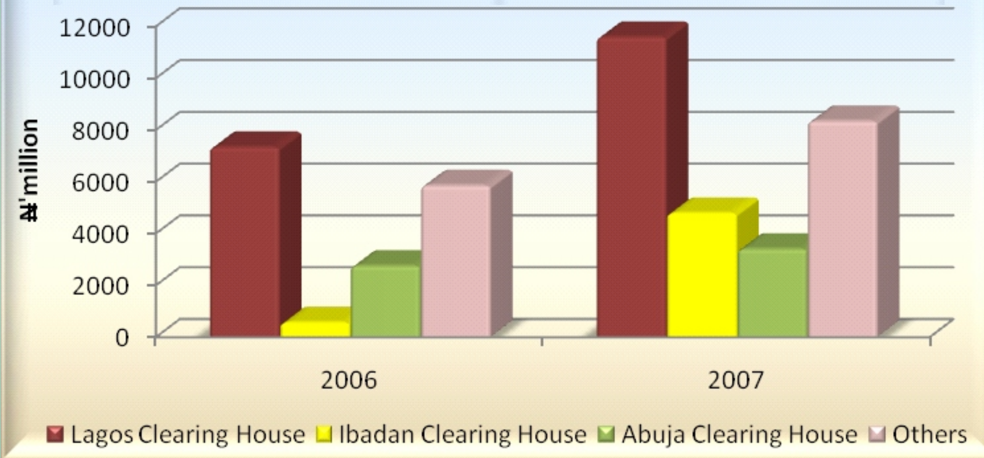


Figure 4.3: Volume of Cheques Cleared (2006-2007)



4.1.5 Inter-bank Funds Transfer (IFT)

Inter-bank transfers through the CBN's Inter-bank Funds Transfer System (CIFTS) recorded substantial growth of 56.0 and 121.9 per cent in the volume and value of transactions to 143,854 and N29.1 trillion, respectively. The development reflected the participants' confidence in the use of CIFTS and Temenos Internet Banking (TIB) as well as the effect of the CBN policy of non-payment of interest on standing deposit facility, which encouraged banks and discount houses to place funds among themselves.
Further analysis of transactions showed that third party transfers accounted for 53.5 per cent while inter-bank market transfers accounted for 41.6 per cent in volume terms. The CBN debit transfer accounted for the balance. In value terms, however, the share of inter-bank market transfers was 65.7 per cent, while the CBN debit and third party transfers accounted for 23.6 and 10.7 per cent, respectively.

4.1.6 Use of e-Money Products

The market frontier for electronic payments in Nigeria continued to expand in 2007 as evident in the growth in all its segments. New products such as naira credit cards and V-pay debit cards, were introduced to the market, while connectivity of point-of-sale (POS) terminals via GPRS increased. In terms of market share, ATM transactions remained dominant, followed by the Internet, POS and mobile segments.

Table 4.2: Market Share in e-Payment Market in 2006 and 2007

e-Payment Segment	Volume (per cent)		Value (per cent)	
	2006	2007	2006	2007
ATM	93.16	88.7	73.35	88.5
Web (Internet)	1.71	5.1	3.51	7.1
POS	4.83	2.4	23.04	4.3
Mobile	0.31	3.8	0.11	0.1

The volume and value of ATM transactions rose by 30.0 and 108.0 per cent to 15.7 million and N131.6 billion, respectively. The performance of the ATM segment was due to the increase in the number of ATMs deployed by the banks as well as the upgrade of the Quickcash brand of ATM machines to accept all cards issued by Nigerian banks irrespective of the switching platform.

The volume and value of foreign currency denominated card transactions stood at 233,175 and US$63.56 million, up by 75.8 and 82.8 per cent, respectively, above the levels in 2006. At 421,946 and N6.44 billion, the POS segment recorded impressive growth in both volume and value terms with increases of 493.4 and 1,151.9 per cent, over the levels in the preceding year. The development was attributable to increased connectivity of sales terminals, wider public acceptance of debit cards, increased number of merchants and the phasing out of Valucard (an off-line card) and the introduction of V-pay which is an on-line card. Also, Internet based transactions increased to 903,067 and N10.6 billion showing an increase of 306.4 and 261.1 per cent in volume and value terms, respectively, over the levels in 2006. The growth was due to the increased number of financial institutions offering Internet based banking and the growing number of merchants accepting payments through the web sites.

Figure 4.4: Volume of Electronic Card-based Transactions in 2007

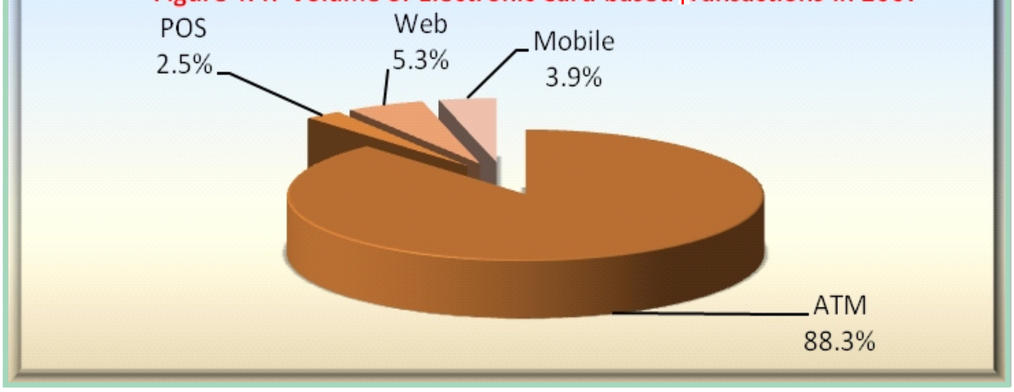
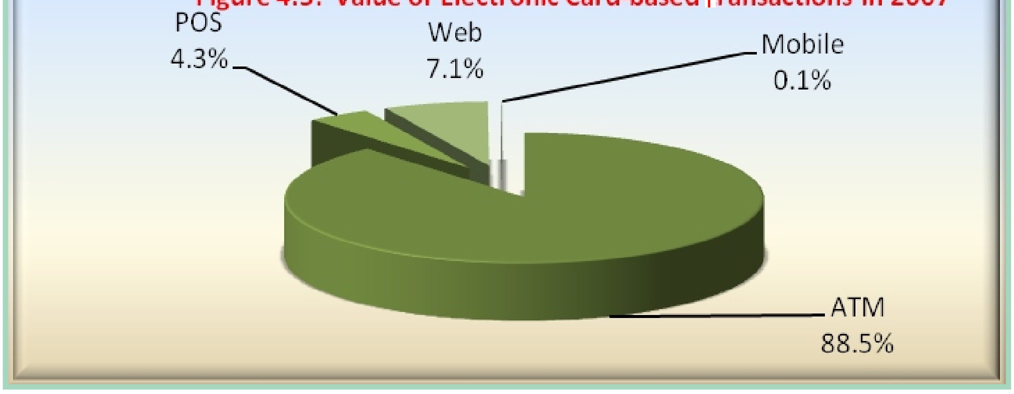


Figure 4.5: Value of Electronic Card-based Transactions in 2007



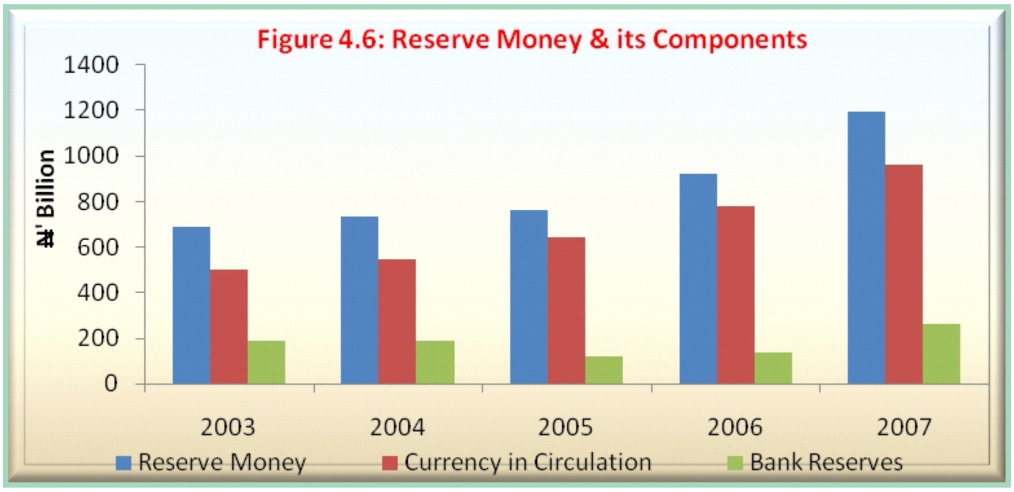
4.1.7 Institutional Savings

Aggregate financial savings rose by N1,082.0 billion or 57.9 per cent to N2,949.8 billion at end-December 2007, compared with N1,867.8 billion at the end of the preceding year. The proportion of income also improved as the ratio of financial savings to GDP stood at 12.9 per cent, compared with 10.1 per cent in 2006. The DMBs maintained their dominance as the major depository institutions within the financial sector, accounting for 76.0 per cent of the total financial savings, compared with 94.0 per cent in the preceding year. Other savings institutions including the PMIs, Life Insurance Funds, the Pension Funds, the Nigerian Social Insurance Trust Fund and Community/Microfinance Banks held the balance of 24.0 per cent.

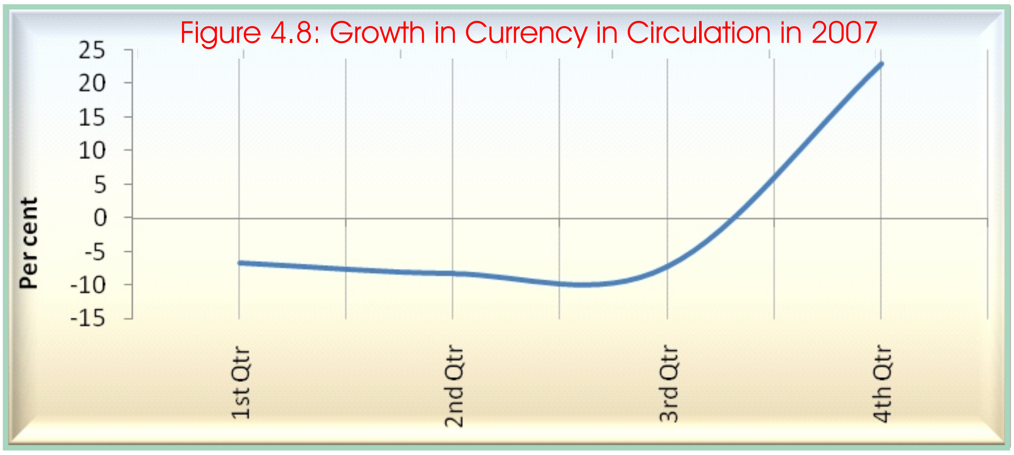
4.2 MONETARY AND CREDIT DEVELOPMENTS

4.2.1 Reserve Money

The CBN sustained its proactive monetary management stance in 2007. Notwithstanding, the operating target of monetary policy, the reserve money (RM) at N1,195.3 billion was 18.7 per cent above the indicative target of N1,007.0 billion at end-December 2007. The development was attributable to the growth in currency in circulation (CIC), driven by the seasonal demand for currency during the last quarter of the year, as well as the increase in bank reserves.



The currency component of RM, relative to the end-December 2006 level, fell by 6.7, 8.3 and 7.3 per cent in the first, second and third quarters of 2007, respectively, but rose sharply by 23.3 per cent at the end of the fourth quarter. Similarly, over the end-2006 level, DMBs' reserve balances at the CBN increased by 19.9 per cent to N234.5 billion in December 2007 reflecting, largely, the non-payment of interest on DMBs' overnight deposits with the CBN, effective October 2007.

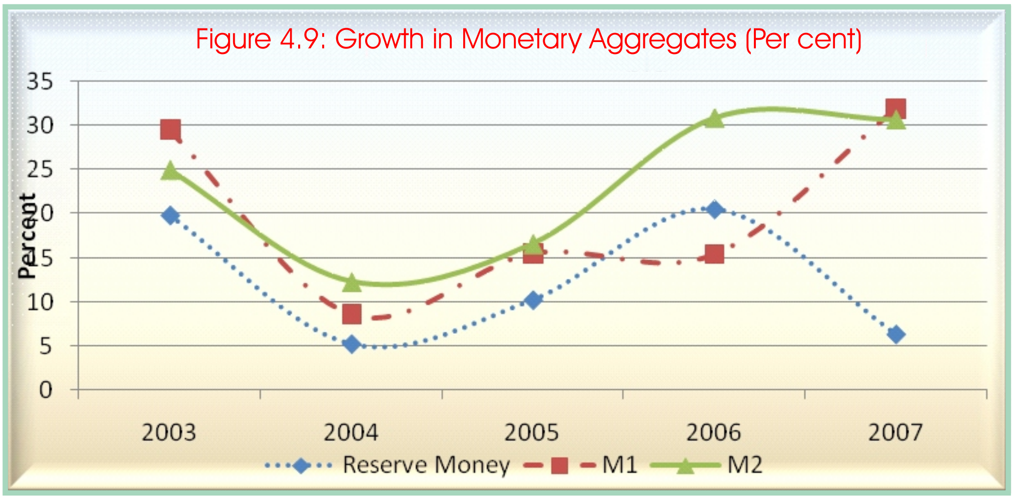


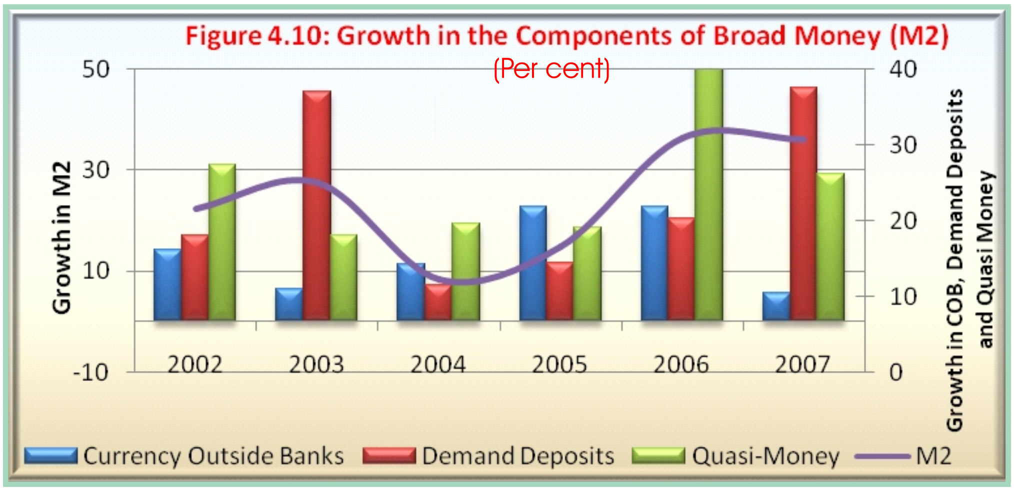
4.2.2 Narrow Money (M1)

Narrow money supply (M1), grew by 32.4 per cent at end-December 2007, compared with 12.2 per cent at end-December 2006. The growth was driven largely by demand deposits, which grew by 47.2 per cent while the currency component rose by 5.8 per cent. As a proportion of M1, currency outside banks (COB) was 28.5 per cent, compared with 35.7 per cent at end-December 2006. The lower ratio in 2007 reflected a shift to other means of payment for transactions, an evidence of improved intermediation. The ratio of COB to nominal GDP fell marginally to 3.2 per cent at end-December 2007 from 3.7 per cent at end-December 2006.

4.2.3 Broad Money (M2)

The growth in broad money supply (M2) remained high when compared with the outcome at the end of the previous year. At N4, 811,961.9 billion, M2 grew by 30.9 per cent at end-2007, compared with 30.6 per cent at the end of the preceding year. The growth in M2 at the end of the year was higher than the indicative target growth of 24.1 per cent for the fiscal year. The growth in M2 was driven by the substantial growth in both M1 (32.4 per cent) and quasi-money (29.3 per cent).





The analysis of the composition of total monetary liabilities (M2) showed that it was fairly distributed between the highly liquid M1 and semi-liquid quasi-money, but skewed towards the former. The skewness reflected the need for liquidity to finance increased economic activities. However, the shift away from physical currency holding to demand deposit continued in 2007 as COB was 15.2 per cent of M2, down from 18.8 per cent in 2006. Also, foreign currency deposit remained an important component of M2 at 9.7 per cent although down by 1.0 percentage point relative to 2006.

Table 4.3: Composition of Total Monetary Liabilities (M_2) (Per cent)

	2006	2007
Money Supply (M_1)	52.7	53.2
Currency outside banks	18.8	15.2
Demand Deposit	33.9	38.1
Qausi Money	47.3	46.8
Time & Savings Deposit	36.5	37.0
Foreign Currency Deposit (FCD)	10.8	9.7
Total Monetary Liabilities (M_2)	100.0	100.0

Factors Influencing Broad Money Growth

4.2.3.1 Net Foreign Assets (NFAs)

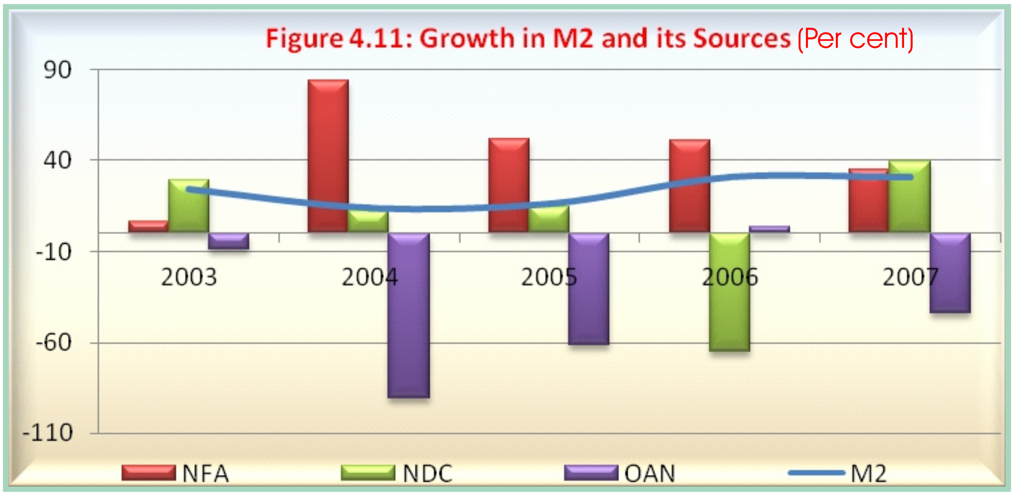
The growth in total monetary assets in 2007 was partly accounted for by the significant increase in the net foreign assets (NFAs) of the banking system. The NFAs rose by 18.5 per cent over its level at end-December 2006, owing to favourable crude oil prices in the international market. NFAs contributed 31.2 per cent to the growth in M2 in 2007.

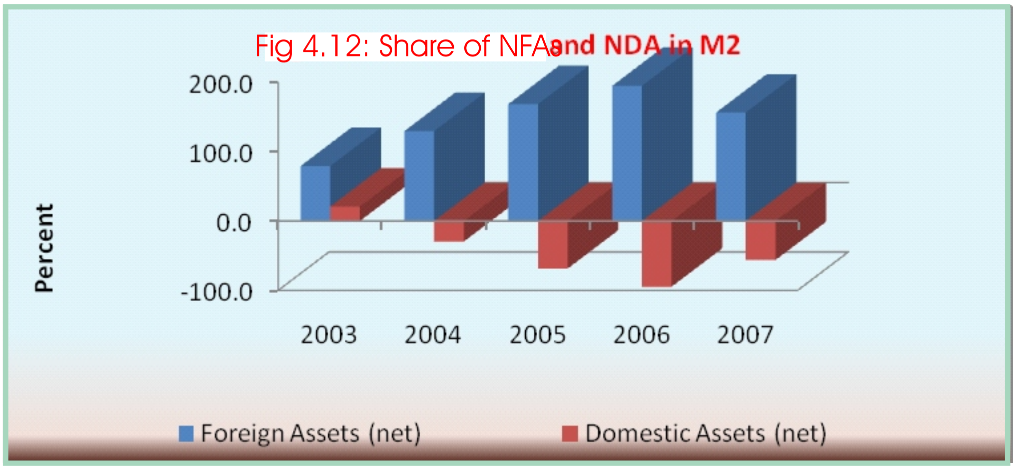
4.2.3.2 Net Domestic Credit (NDC)

Net credit to the domestic economy grew by 193.5 per cent in contrast to the decline of 67.4 per cent at end-December 2006. The development reflected the significant increase in credit to the private sector. However, net credit to government declined following substantial improvements in earnings from crude oil exports, which boosted government deposits. NDC contributed 37.8 per cent to the growth in M2 in 2007.

4.2.3.3 Credit to the Government (CG)

Net credit to the Federal Government fell by 60.5 per cent, compared with the target of negative 54.9 per cent for fiscal 2007 and the decline of 692.1 per cent recorded at end-December, 2006. The development was as a result of increased Federal Government deposit with the banking system which make the Federal Government a net creditor to the banking system in 2007.

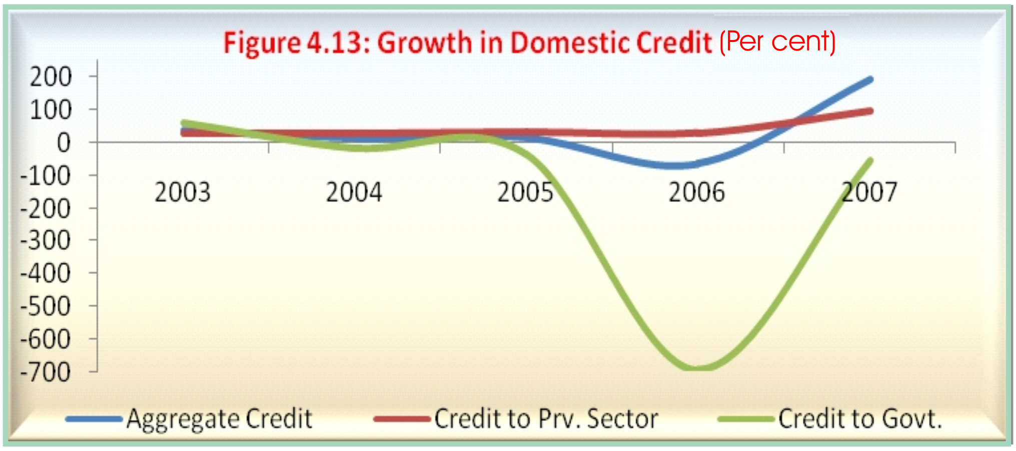




4.2.3.4 Credit to the Private Sector (CP)

Banking system credit to the private sector (including state and local governments and non-financial public enterprises) grew by 96.8 per cent, overshooting the target of 30.0 per cent for the fiscal year by a wide margin. The increase in CP more than offset the decline in net credit to government and resulted in the overall increase in NDC. Credit to the core private sector[1] grew by 98.7 per cent in 2007.

[1]Credit to the private sector less credit to state and local governments and non-financial public enterprises



4.2.3.5 Other Assets (Net) (OAN)

Other assets (net) of the banking system fell by 49.2 per cent as against an increase of 8.6 per cent at end-2006. The fall in OAN moderated the growth in M2. The contribution of OAN to the growth in M2 was -38.1 per cent.

Table 4.4: Contribution to the Growth in M2 (2005-2007) (Per cent)

	2005	2006	2007
Net Foreign Assets (NFA)	61.8	74.9	31.2
Net Domestic Credit (NDC)	13.0	-55.4	37.8
Other Assets (net) (OAN)	-50.4	11.1	- 38.1
M2	24.4	30.6	30.9

4.2.4 Sectoral Distribution of Credit

Credit to the core private sector by the DMBs grew by 98.7 per cent. Of the outstanding credit to the core private sector, the priority sector accounted for 24.8 per cent while the "other" (non-priority) sector accounted for the balance of 75.2 per cent. Specifically, outstanding credit to agriculture, solid minerals, exports and manufacturing stood at 3.1, 10.2, 1.4 and 10.1 per cent, respectively. Credit flows to the core private sector in 2007 amounted to N2,289.2 billion. Of this amount 17.3 per cent went to the priority sector while 82.7 per cent went to the non-priority sector. Further analysis showed that credit flows to specific sectors in 2007 were as follows; agriculture (4.4%), solid minerals (10.5%), exports (0.6%) and manufacturing (1.8%). The development reflected the preference of DMBs for the non-priority sector.

Table 4.5: Credit to the Core Private Sector in 2007

	Share in Outstanding (%)	Share in flows (%)
Priority Sector	24.8	17.3
Agriculture	3.1	4.4
Solid Minerals	10.2	10.5
Exports	1.4	0.6
Manufacturing	10.1	1.8
Unclassified	75.2	82.7
Total	100.0	100.0

Figure 4.14: Share in Outstanding Credit to the Core Private Sector in 2007

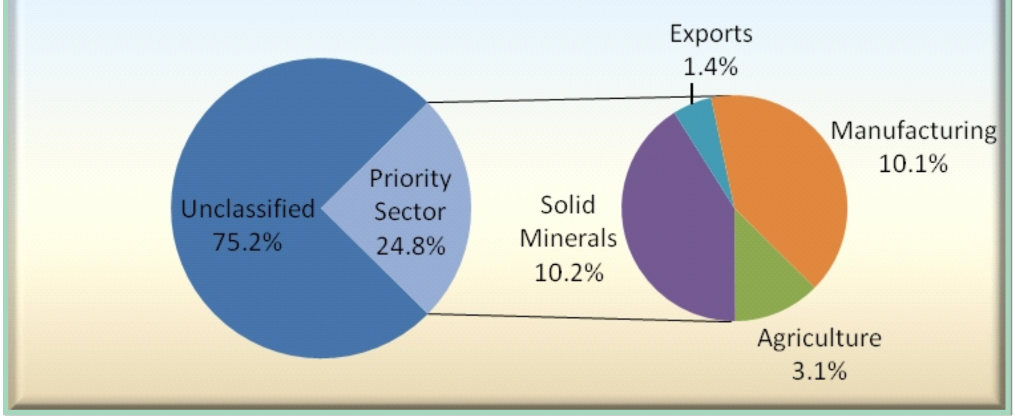
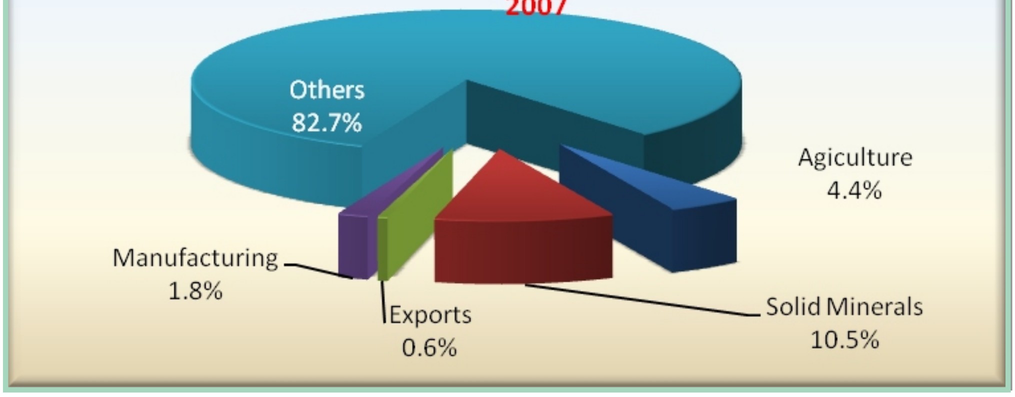
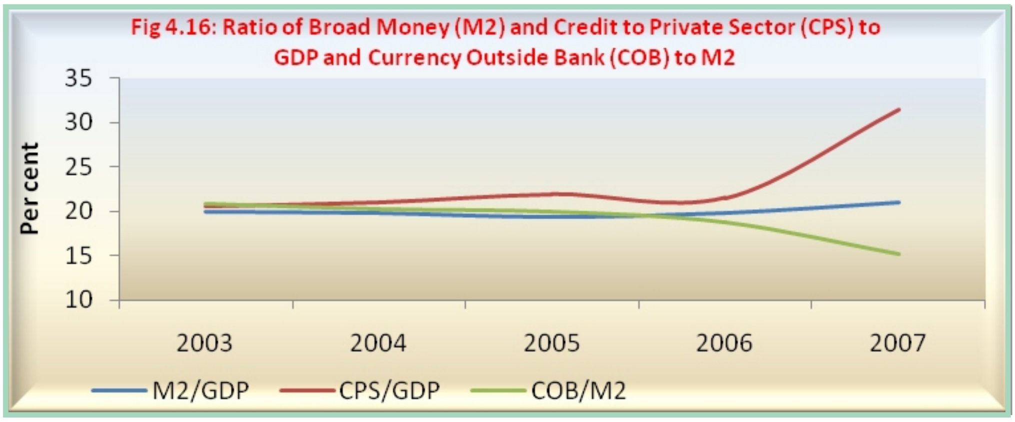


Figure 4.15: Share in Credit Flows to the Core Private Sector in 2007

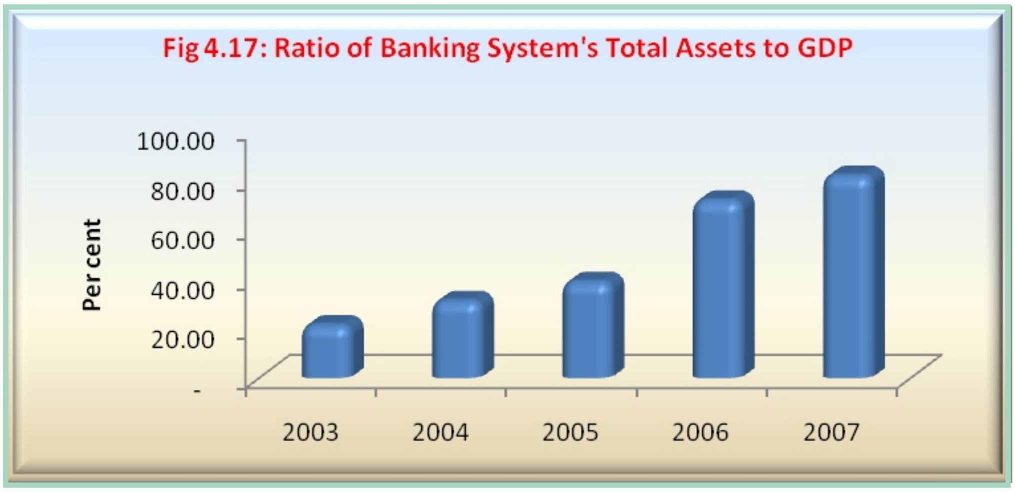


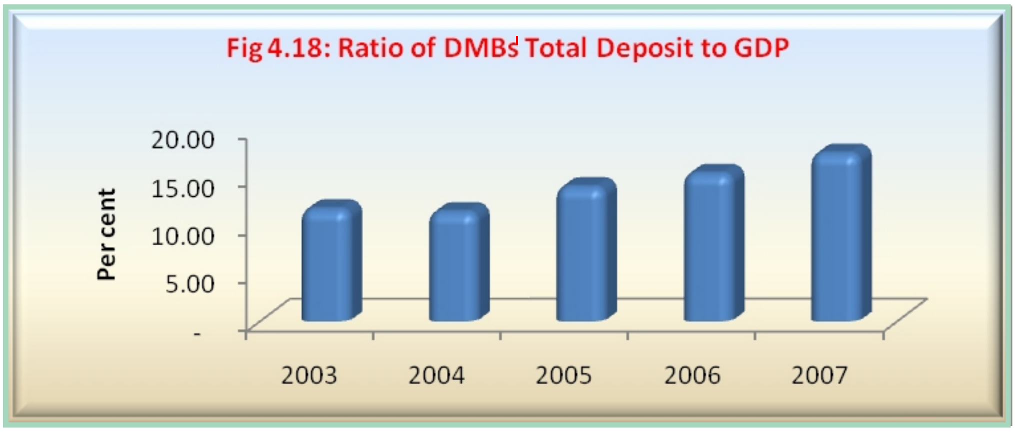
4.2.5 Financial/Banking System Ratios

Nigeria's financial sector continued to improve in both depth and breath in 2007. The depth of the financial sector, as measured by the ratio of M2 to GDP stood at 21.1 per cent at end-December, 2007, indicating a slight improvement when compared with the 19.8 per cent at end-December, 2006. Thus, the banking system's capacity to provide liquidity for the exchange of goods and services increased relative to the preceding year. Bank financing of the economy, measured by the ratio of banking system credit to the core private sector (CP) to GDP increased significantly to 21.7 per cent at end-December 2007, from 13.5 per cent at end-December, 2006. In addition, financial institutions have become more efficient as the intermediation ratio (currency outside banks to broad money supply) declined further at end-December 2007 to 15.2 per cent from 18.8 per cent at end-December, 2006. The development reflected partly the impact of the increased use of electronic and other forms of payments, particularly ATM and other card products.



The banking system grew more robust in 2007 as its size in relation to the economy increased. The ratio of the total assets of the banking system to the GDP at end-2007 was 82.3 per cent compared with 71.7 per cent at end-2006. Of this, the ratio of CBN assets to GDP increased slightly from 33.5 per cent in 2006 to 38.0 per cent in 2007. Also, the ratio of DMBs' assets to nominal GDP increased significantly from 34.5 per cent at end-December, 2006 to 44.2 per cent at end-December, 2007. The total deposit liabilities of DMBs as a ratio of nominal GDP also rose to 17.6 per cent in 2007, up from 15.4 per cent in 2006, evidence of an enhanced financial sector development.





4.2.6 Money Multiplier

The broad money multiplier at end-December, 2007 rose to 4.4, compared with the 3.8 at end-December, 2006. The development was attributable to the fall in both the currency and reserve ratios. The currency-deposit ratio fell to 18.2 per cent at end-December, 2007 from 24.2 per cent at end-December, 2006, owing to the significant increase in total deposit liabilities of the DMBs, arising partly from the increased use of electronic money which sucked in currency outside banks. Also, reserve-to-deposit ratio declined from 3.1 per cent at end-December, 2006 to 2.3 per cent at end-December, 2007 owing largely to the impact of the new monetary policy implementation framework on banks' excess reserve balances.

Table 4.6: Money Multiplier and Velocity of M_2

	2003	2004	2005	2006	2007
Currency Ratio	30.8	27.6	27.6	24.2	18.2
Reserve Ratio	12.0	10.3	5.6	3.1	2.3
M_2 Multiplier	2.7	2.9	3.2	3.8	4.4
Income Velocity of M_2	5.3	5.5	6.0	5.1	4.7

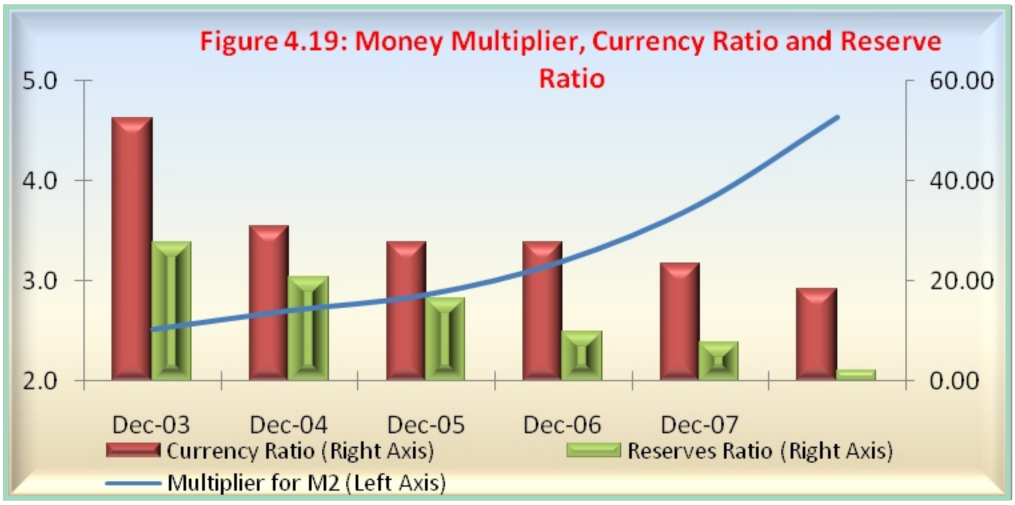


Figure 4.19: Money Multiplier, Currency Ratio and Reserve Ratio

The income velocity of broad money declined further in 2007. The M2 income velocity, which stood at 5.1 at end-2006, fell to 4.7 at end-December, 2007. This development reflected the effects of financial deepening in the economy.

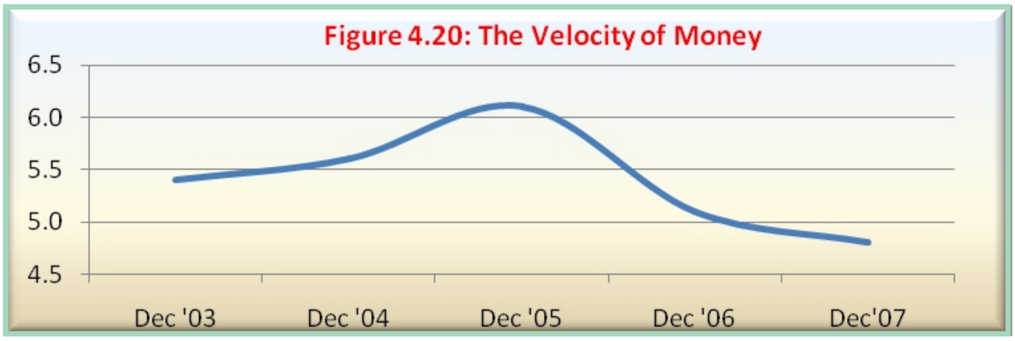


Figure 4.20: The Velocity of Money

4.3 OTHER FINANCIAL INSTITUTIONS

4.3.1 Development Finance Institutions (DFIs)

Four out of the five DFIs, namely, the Bank of Industry (BOI), the Federal Mortgage Bank of Nigeria (FMBN), the Nigerian Export Import Bank (NEXIM), and the Nigerian Agricultural, Cooperative and Rural Development Bank (NACRDB) rendered returns to the Bank during the year. Aggregate assets of the four DFIs indicated an increase of 17.0 per cent over the level in the preceding year. Further analysis of the assets base of the four institutions indicated that NACRDB accounted for the highest share of 31.9 per cent followed by FMBN, NEXIM and BOI with shares of 29.9, 24.4 and 13.8 per cent of the total, respectively.

Cumulative loan disbursements by the four DFIs increased by 38.0 per cent to N57.5 billion. The composition of the loan disbursements indicated that NACRDB, FMBN, BOI and NEXIM accounted for N20.4 billion (35.0 per cent), N15.3 billion (27.0 per cent), N13.9 billion (24.0 per cent) and N8.0 billion (14.0 per cent), respectively.

The analysis of the portfolio assets of the four DFIs indicated a general deterioration in quality with the exception of BOI. The total capitalisation of the four DFIs was N21.8 billion, the same as in 2006, owing to the loss of one of the DFI's headquarters buildings. The combined paid-up share capital of BOI and NEXIM, however, increased by N8.8 billion to N15.5 billion in 2007, through additional capital injection by both the Federal Ministry of Finance and the CBN.

4.3.2 Microfinance Banks (MFBs)

The total assets/liabilities of all CBs (80 per cent of which converted to MFBs) rose by 37.0 per cent to N75.6 billion. The paid-up capital increased by 35.0 per cent to N11.2 billion, while the shareholders' funds increased by 70.0 per cent to N21.8 billion. Investible funds available to the subsector totalled N20.8 billion in 2007. The funds were sourced mainly from an increase in paid-up capital of N2.9 billion, reserves N2.1 billion, deposits N7.2 billion and other liabilities N4.1 billion, among others, and were used mainly in increasing other assets (N4.5 billion), loans and advances (N6.4 billion), placements with other banks N5.0 billion, among others.

4.3.3 Discount Houses

The analysis of the activities of the five discount houses indicated improved performance in 2007. Their total assets/liabilities rose by 59.9 per cent to N298.3 billion, while total funds sourced amounted to N68.6 billion, compared with N91.9 billion in 2006. The funds were sourced mainly from a reduction in claims on Federal Government (N29.1 billion) and money-at-call (N18.3 billion), among others. The funds were utilised primarily for the extension of credit to non-bank customers (N44.9 billion) and placements with banks (N21.9 billion). Discount houses' investments in Federal Government securities of less than 91 days maturity amounted to N115.4 billion as at end-December, 2007, representing 44.6 per cent of their total deposit liabilities. This was 15.4 percentage points below the prescribed minimum of 60.0 per cent for fiscal 2007.

4.3.4 Finance Companies (FCs)

The existence check carried out on the subsector by the CBN showed that out of the 112 licensed FCs, only 76 were active as at end-December, 2007. The total assets/liabilities of the FCs increased to N65.8 billion, representing a growth rate of 21.2 per cent. Loans and advances increased by 12.0 per cent to N26.7 billion. Placements with other FCs increased by 23.1 per cent to N11.5 billion. Total borrowings increased by 15.3 per cent to N39.9 billion, while shareholders' funds rose by 30.3 per cent to N14.9 billion. Investible funds that accrued to the subsector stood at N12.6 billion in 2007. The funds were sourced mainly from increase in borrowings (N5.3 billion), other liabilities (N2.7 billion) and reserves (N3.1 billion), among others. The funds were used essentially to increase investments (N4.0 billion), loans and advances (N2.9 billion) and placements with other FCs (N2.2 billion).

4.3.5 Primary Mortgage Institutions (PMIs)

The total number of licensed PMIs stood at 93 as at end-December, 2007. Out of this number, only 80 PMIs were confirmed to be active in terms of timely rendition of returns to the CBN. The total assets of the PMIs, which stood at N114.4 billion at end-December 2006, rose by 164.3 per cent to N302.3 billion. The increase was attributable largely to the growth in the balance sheet size of the PMIs that were acquired by DMBs arising from capital injection. Investible funds available to the PMIs totalled N188.5 billion. The funds were sourced mainly from increases in paid-up capital (N15.4 billion), reserves (N9.0 billion), deposits (N81.7 billion) and other liabilities (N60.8 billion). The funds were utilised in the acquisition of other assets (N63.8 billion) and placements/bank balances (N113.8 billion), among others.

4.3.6 Bureaux-de-Change (BDC)

Following the liberalisation of the operations of the BDC subsector in 2006, two hundred and seventy-nine (279) fresh applications for licences were received in 2007, compared with one hundred and ninety six (196) in 2006, thus bringing the total number of applications to 475 as at end-December 2007. Out of this number, 135 final licences and 80 Approvals-in-Principle (AIPs) were granted, while 64 others were at various stages of processing. Also, 72 previously inactive BDCs were resuscitated during the year through restructuring and recapitalisation, bringing the number of BDCs in operation to 703 at end-December 2007, compared with 352 in 2006.

4.4 MONEY MARKET DEVELOPMENTS

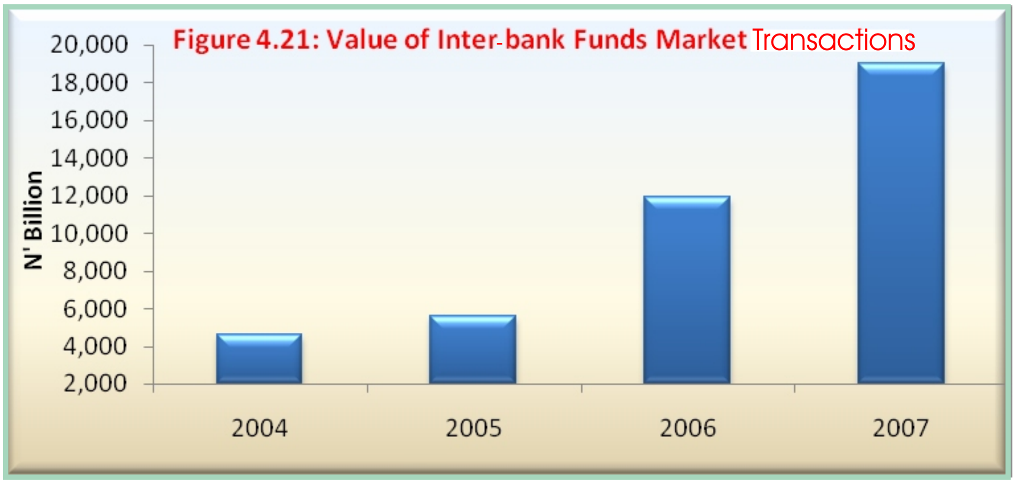
The money market further deepened in 2007 with the introduction of the ten-year FGN bond (which is now traded in the secondary market). The vigorous implementation of monetary policy also boosted the performance of the market. Government remained the dominant player in the Nigerian money market, as treasury securities constituted 78.3 per cent of money market assets outstanding as at end-December, 2007. Private sector securities (certificates of deposits, commercial papers and bankers' acceptances) accounted for 21.7 per cent. FGN bonds dominated the money market instruments both in terms of share in total assets outstanding and share in treasury securities. The depth of the money market as measured by the ratio of value of money market assets outstanding to GDP increased by 1.0 percentage point to 9.8 per cent at end 2007, reflecting the effect of the issuance of the 4th FGN Bonds. However, the size of this ratio compared with the ratio of credit to core private sector to GDP 21.6 per cent, showed that short-term credit remained a prominent feature of financial markets in Nigeria. The size of private sector securities to GDP at 3.9 per cent was relatively small.

4.4.1 Inter-bank Funds Market

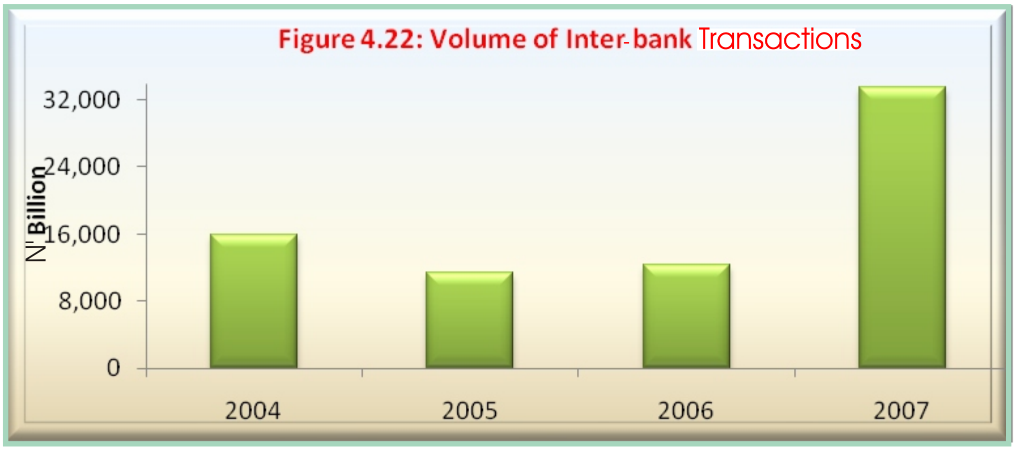
The performance of the inter-bank funds market (inter-bank placements and securities trading) improved remarkably in 2007. The value of transactions increased by 59.3 per cent to N19,020.5 billion. The development reflected increased transactions at the open-buy-back segment, influenced by the occasional liquidity squeeze and the periodic call up of NNPC funds prior to Federation Account Allocation Committee (FAAC) meetings for statutory allocations to the three tiers of government.

Table 4.7: Composition of Money Market Assets Outstanding in 2007

Asset	Share in Total (%) in 2006	Share in Total (%) in 2007
Treasury Bills	43.1	25.6
Treasury Certificates	0.0	0.0
Development Stocks	0.0	0.0
Certificate of Deposit	0.0	0.0
Commercial Papers	12.6	17.8
Bankers' Accepbances	4.8	3.9
FGN Bonds	39.5	52.7
Total	100	100



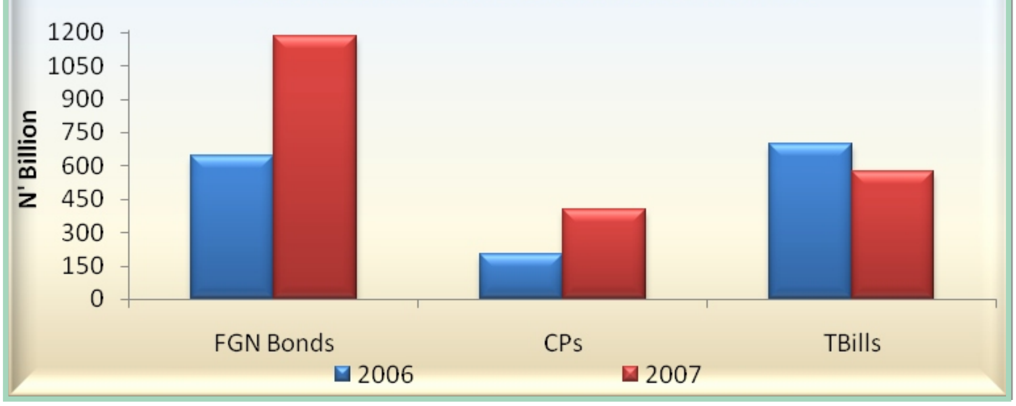
In volume terms, transactions at the inter-bank funds market rose by 8.9 per cent to 33,475 deals in 2007, reflecting the huge volume of transactions at the open-buy-back segment. The open-buy-back segment accounted for 68.3 per cent of the total value of transactions, while call placements accounted for the balance. At the inter-bank call placement segment, the value of transactions rose substantially by 83.9 per cent to N6,967.8 billion. At the open-buy-back segment, investments also shot up to N12,052.8 billion, from N8,151.2 billion in 2006.



4.4.2 Money Market Assets Outstanding

The value of the total money market assets outstanding as at end-December 2007, increased by 38.1 per cent to N2,250.1 billion. The development was traceable to the increase in the value of commercial papers (CPs) and FGN bonds outstanding.

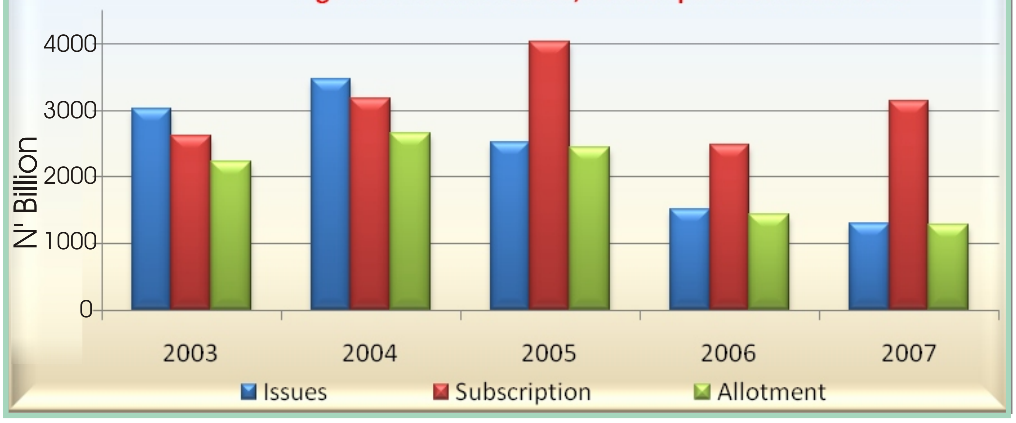
Figure 4.23: Money Market Assets Outstanding



4.4.2.1 Nigerian Treasury Bills (NTBs)

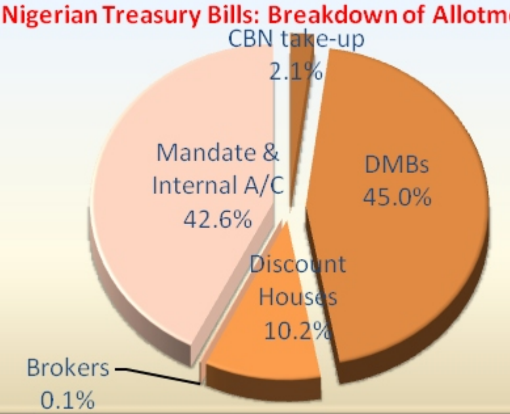
A total of N1,304.0 billion NTBs was issued in 2007, compared with N1,509.1 billion in 2006, showing a decline of 13.6 per cent. The decline reflected the restructuring of NTBs into FGN bonds with a view to lengthening the maturity structure of the domestic debt. Public subscription and allotment of the securities stood at N3,141.0 billion and N1,281.4 billion, respectively, compared with the N2,485.0 billion and N1,445.3 billion, in 2006. The increase in subscription was attributed to investors' preference for long tenored bills that attracted higher yields, as well as patronage by foreign investors.

Figure 4.24: NTB Issues, Subscription & Allotment



A breakdown of the allotment showed that the banks had a total of N587.3 billion, mandate and internal fund customers, N556.3 billion; Discount Houses, N133.8 billion; and Brokers, N1.772 billion; compared with N771.6 billion, N643.2 billion, N24.5 billion and N6.0 billion, respectively, in the previous year.

Figure 4.25: Nigerian Treasury Bills: Breakdown of Allotment in 2007



Patronage remained appreciable owing to the combined effects of the varying levels of repayments and roll-overs and the smoothening of issue amounts. Mature NTBs worth N1,438.0 billion were repaid, bringing the total outstanding treasury securities to N574.9 billion at end-December 2007, compared with N701.4 billion as at end-December 2006.

Figure 4.26: Treasury Bills Outstanding

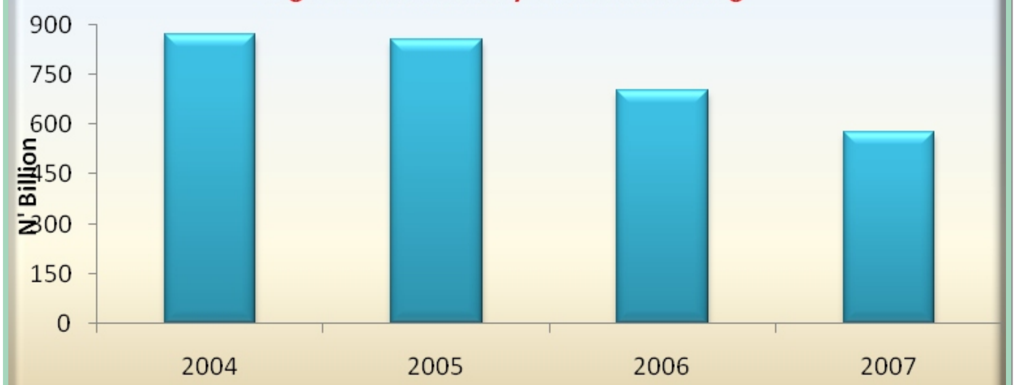
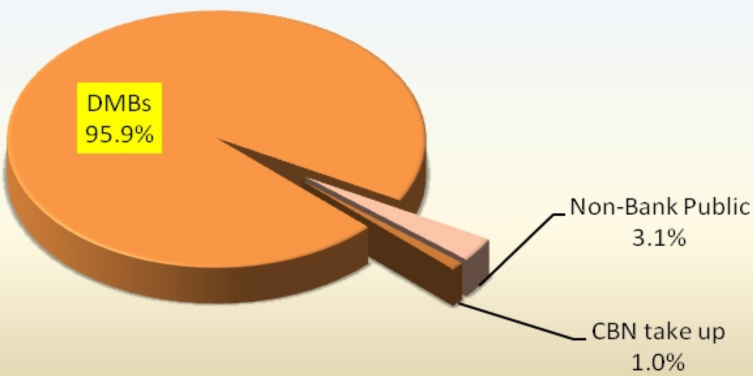


Figure 4.27: Nigerian Treasury Bills: Classes of Holders in 2007



The efforts to deepen the money market and lower government's exposure to short-term interest rate risks led to the sustained issuance of the one-year tenored NTBs. This development engendered an improved yield curve of the NTBs and provided the opportunity for financial institutions to effectively manage their liquidity and market-related risks. Moreover, it resulted in increased foreign investment in the 364-day NTBs.

4.4.2.2 Commercial Papers (CPs)

As a supplement to bank credit to the private sector investments, CPs recorded an upward trend as holdings by DMBs rose by N196.2 billion to N400.8 billion at end-December 2007, compared with an increase of N10.0 billion at end-December, 2006. Thus, CPs constituted 17.8 per cent of the total value of money market assets outstanding as at end-December 2007, compared with 12.6 per cent at the end of the preceding year.

4.4.2.3 Bankers' Acceptances (BAs)

Deposit money banks and discount houses investments in BAs rose by 11.6 per cent to N87.6 billion at end-December 2007. The rise reflected increased investments by DMBs and discount houses. However, the share of BAs in the total money market assets outstanding fell by 0.9 percentage point to 3.9 per cent at end-2007.

4.4.2.4 Development Stocks (DS)

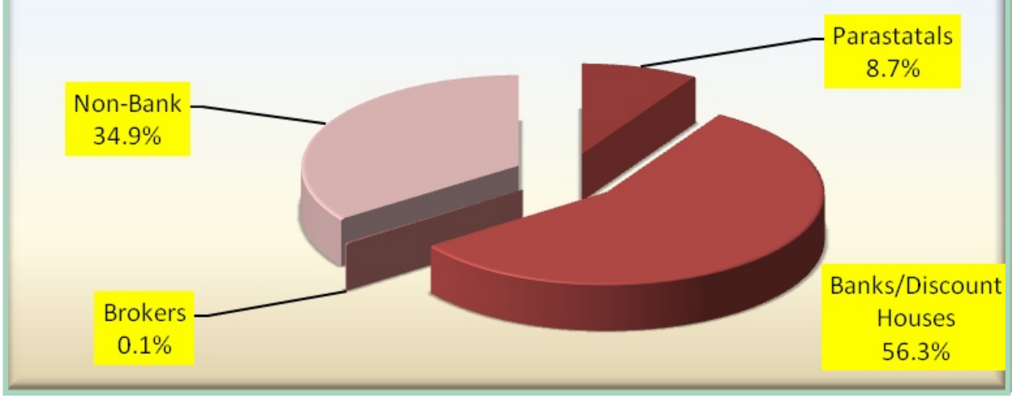
Development stocks outstanding at end-December 2007 fell by 83.9 per cent to N0.6 billion. The decrease was accounted for by the redemption of the 10.75 per cent FRN 21 DS that matured during the year. Of the amount outstanding at end-December 2007, the CBN held a total of N0.14 billion, compared with N0.10 billion in the preceding year. Holdings on the account of sinking funds stood at N0.38 billion, down from N0.46 billion in the preceding year. Holdings by other institutions were down to N0.06 billion from N0.15 billion in the preceding year.

Figure 4.28: Development Stock: Classes of Holders in 2007

4.4.2.5 FGN Bonds

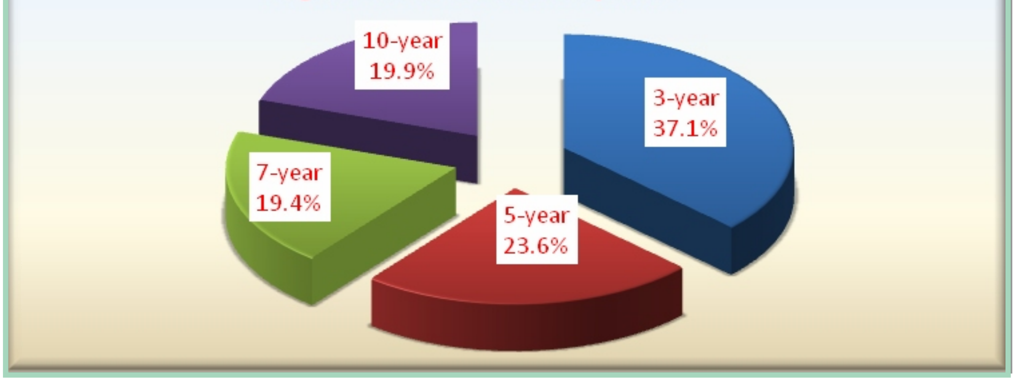
The Federal Government's efforts to restructure its domestic debt profile and to develop a virile bonds market, continued in 2007 as the Debt Management Office (DMO) in collaboration with the CBN issued the 4th Federal Government of Nigeria (FGN) Bonds series, with tenors of three (3), five (5), seven (7) and ten (10) years. The issues attracted impressive subscription and patronage from foreign investors, indicating improved confidence in the Nigerian economy. The CBN acted as the issuing house and registrar to all the series. The total issue of all the series was N603.7 billion, indicating an increase of N304.2 billion over the N280.6 billion issued in 2006. The higher issue frequency (twice monthly since July 2007 by the DMO) as well as the increase in Contractors' Bonds accounted for the substantial increase. Public subscription for the bonds was N1,083.5 billion, representing an over-subscription of N498.7 billion or 85.3 per cent.

Figure 4.29: FGN Bonds by Holder



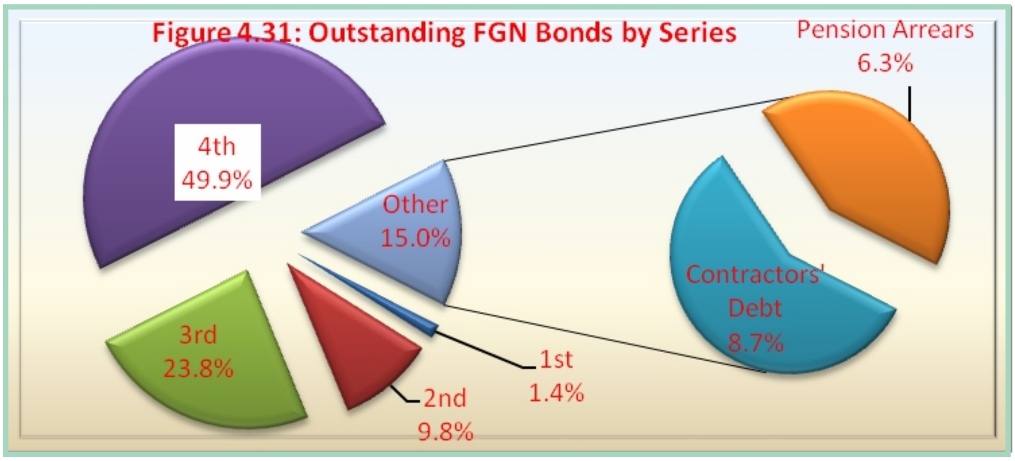
Out of the total sale of N592.0 billion, 37.8 per cent was for the three-year tenor, 22.1 per cent was for the five-year tenor, 19.8 per cent was for the seven-year tenor while the balance of 20.3 per cent was for the ten-year tenor. Special bonds of five-year tenor worth N11.6 billion were also issued during the year to settle outstanding local contractors' debt. The coupon rates for all the issues in 2007 ranged from 7.0 to 13.5 per cent, compared with 10.98 to 16.00 per cent in 2006. The downward trend in the coupon rate reflected the effect of the adjustment in the MPR.

Figure 4.30: FGN Bonds by Tenor



The total outstanding FGN Bonds rose from N643.9 billion as at end-December 2006 to N1,186.2 billion at end-December, 2007. Of this amount, 1.42 per cent was for the 1st FGN Bond series, 9.86 per cent was for the 2nd FGN bond series, 23.82 per cent for the 3rd FGN bond series, 49.99 per cent for the 4th FGN bond, while the balance of 14.9 per cent was for the special FGN bond issued to settle outstanding local contractors' debt and pension arrears.

During the year, total foreign investment in the instrument amounted to N34.76 billion, compared with N51.91 billion in 2006. The bonds were actively traded at the Nigerian Stock Exchange (NSE) and banks' holdings were admitted in the computation of their liquidity ratios. To further deepen the bonds

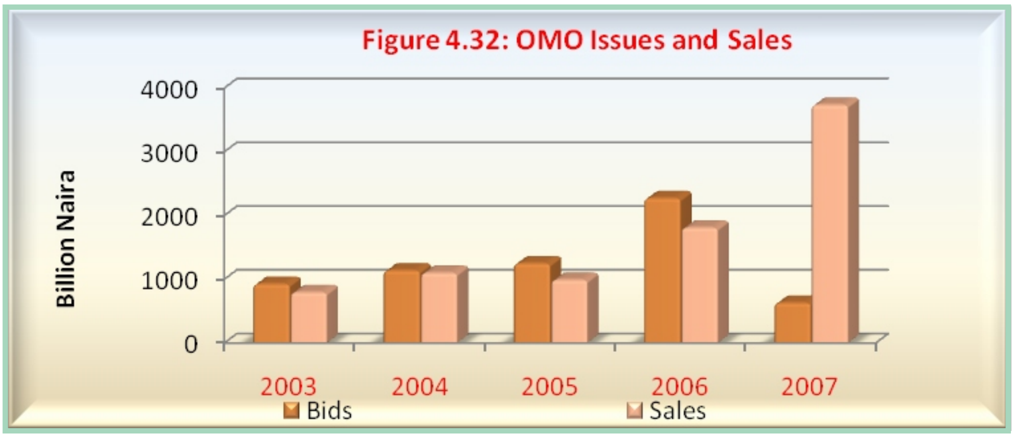


market, the DMO appointed additional five (5) primary market dealers bringing the total number to 19 at end-December 2007, comprising the five (5) discount houses and fourteen (14) DMBs.

4.4.3 Open Market Operations (OMO)

Open market operations (OMO) remained the major tool for liquidity management in 2007. In order to enhance the efficiency of the money market, OMO was conducted on a two-way quote platform among the Money Market Dealers (MMDs) on the Reuters trading system; while the normal auctions and tenored reverse repo continued on the Temenos Internet Banking (TIB). The pilot run of trading among MMDs commenced in June 2007. At the two-way quote trading, the Bank bought and sold NTBs in the market in a bid to moderate rates at the auctions. Similarly, the multiple tenors offered, ranged from 7 to 157 days and were structured to synchronise maturity with that in the primary market, in order to enhance the tradability of the instruments.

Total subscription and sales of the intervention securities were N627.4 billion and N3,736.3 billion, respectively, compared with N2,270.20 billion and N1,808.4 billion in 2006. The breakdown of sales in 2007 showed that regular auctions accounted for N1,600.2 billion, the two-way quote trading system accounted for N1,383.1 billion, while the reverse repurchases accounted for N753.1 billion. The substantial increase in sales at the open market was attributable to the underwriting of the unsubscribed portion of the bills by the MMDs in line with the operational guidelines for money market dealership in Nigeria; the introduction of over the counter (OTC) two-way quote trading system in government securities; and the aggressive liquidity mop-up exercise during the year in order to meet the reserve money target under the



PSI. Other factors were the market driven rates that prevailed at the two-way quote trading platform and the additional securities issued at the 182-day primary auction specifically for liquidity management.

4.4.4 Discount Window Operations

4.4.4.1 Repurchase Agreements

Repurchase agreements complemented other liquidity management instruments employed during the year. However, with the introduction of the standing lending and deposit facilities in December, 2006, repurchase agreements were scarcely patronized due to similarities in the features of both in providing overnight funds. Tenored reverse repo resumed in June 2007 in order to combat the persisting excess liquidity in the system. Total reverse repurchase transactions amounted to N753.1 billion, compared with N10,301.8 billion in 2006. NTBs of 7- and 14-day tenors were used for the transactions. The tenors and rates, which initially ranged from 7- to 14-days and 6.00 to 6.30 per cent, respectively, were reviewed to between 4- and 28-days and 5.7558 to 5.7675 per cent, in September, 2007 in order to broaden the available tenors and harmonize the rates with the prevailing deposit facility rate. With the upward review of the MPR in December, 2007, the reverse repo rates were also adjusted by twenty basis points to range from 5.9558 to 5.9675 per cent.

4.4.4.2 Bills Rediscounting

Bills rediscounted in 2007 amounted to N81.4 billion, down by 68.8 per cent from the value in 2006. The development reflected the widespread between the treasury bills and the rediscount rates which was considered unattractive by market players.

4.4.4.3 Open Buy-Back (OBB)

Transactions in the OBB segment increased in 2007. The value of on-line transactions in OBB rose to N19,527.1 billion, 76.1 per cent above the level in the preceding year. The development reflected market players' confidence in the on-line trading system.

4.4.4.4 CBN Standing Facilities

The CBN standing facilities which became operational in December 2006 were retained. Thus, as monetary policy was reviewed regularly during the year, the changes in MPR and the allowable interest rate corridor had direct impact on the standing lending and deposit facilities. All participants (deposit money banks and discount houses) in the CBN Inter-bank Funds Transfer System (CIFTS), otherwise known as the Real Time Gross Settlement (RTGS) System, had access to the facilities.

4.4.4.4.1 Deposit Facility

The cumulative deposits made as at end-December 2007 amounted to N16,836.8 billion on which the CBN paid interest of N4.49 billion compared with N82.4 billion in 2006, given that it operated for a short period at its inception. One discount house did not access the facility in the review period.

4.4.4.4.2 Lending Facility

The cumulative amount lent during the year was N3,430.7 billion and the interest charged stood at N1,615.2 million, compared with N1,350.5 billion and interest charges of N804.3 million, in 2006.

4.4.4.4.3 Overnight Sweep

This involved the investment of DMBs balances at the CBN on an overnight basis. A total sum of

N4,598.4 billion was invested as at 14th May, 2007 when the facility was suspended. The interest paid by the Bank while the remuneration lasted was N17.2 million on N4,355.6 billion at 0.01 per cent, while the balance of N0.24 billion was not remunerated.

4.4.4.5 Over-the-Counter Transactions (OTCs) in NTBs

In order to deepen the treasury bills market, over-the-counter transactions in the instrument were introduced in June 2007. The operations were consummated at the Nigerian Stock Exchange with final settlement at the CBN. The total value of transactions settled under the 2-way quote was N1,256.1 billion.

4.5 CAPITAL MARKET DEVELOPMENTS

4.5.1 The Nigerian Stock Exchange

Activities on the floor of the Nigerian Stock Exchange (NSE) in 2007 indicated substantial improvement. The aggregate volume and value, as well as the total number of deals in the primary and secondary segments of the market rose significantly. Aggregate market capitalization of the 310 listed securities increased by 159.6 per cent to close at N13.3 trillion, compared with N5.1 trillion recorded in the preceding year. The bulk of the transactions were in equities, which accounted for N2.1 trillion or 99.9 per cent of the turnover value, compared with 99.6 per cent recorded in 2006. Transactions in the industrial loans subsector amounted to N2.9 billion, representing 0.1 per cent of the total. Also, the market capitalisation of the 212 listed equities accounted for N10.3 trillion or 77.5 per cent of the total market capitalization. The development was attributable to the price appreciations of equities consequent upon macroeconomic stability and improved corporate results, as well as the recapitalisation programme of the insurance subsector.

There were many supplementary issues in the banking subsector, while the insurance sub-sector listed some scheme shares arising from the mergers and acquisitions elicited by industry consolidation. The banking subsector accounted for 48.4 per cent of the market capitalisation as at the end of the year. The major capital market development indicators showed significant improvement. Market capitalisation as a percentage of GDP rose from 27.6 per cent to 58.2 per cent in 2007. The ratio of the value of stocks traded to GDP stood at 9.2 per cent in 2007, compared with 2.5 per cent in 2006, while the turnover value as a percentage of market capitalisation was 15.8 per cent, compared with 9.2 per cent in 2006. The annual turnover value (measured as the ratio of the total value of stocks traded to the total value of stocks listed on the domestic market) rose by 343.7 per cent, compared with 78.9 per cent in 2006. Seventeen (17) additional stocks were listed on the exchange during the period under review, compared with twelve (12) in 2006.

Figure 4.33: Trends in Market Capitalization and NSE Value Index

Table 4.8: Indicators of Capital Market Developments (NSE)

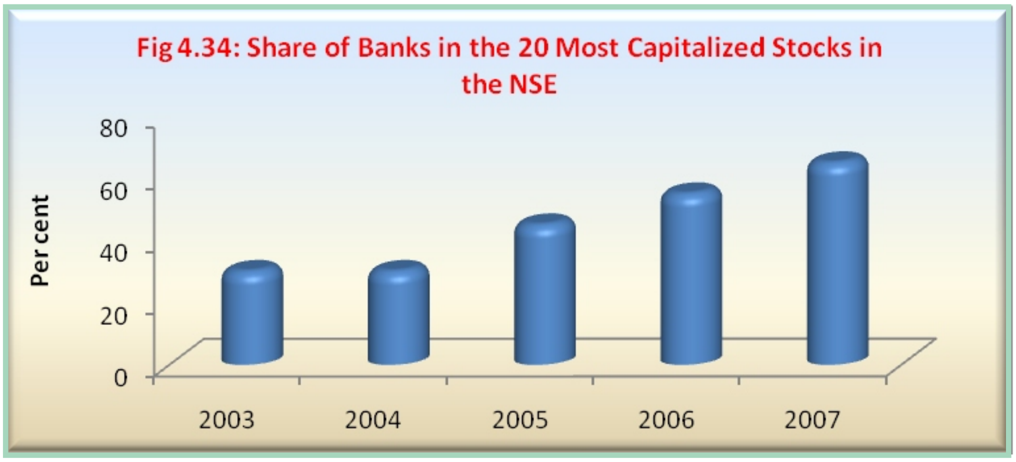
	2003	2004	2005	2006	2007
Number of Listed Securities	265	277	288	288	310
Volume of Stocks Traded (Turnover Volume) (Billion)	13.3	19.2	26.7	36.5	138.1
Value of Stocks Traded (Turnover Val) (Billion Naira)	120.4	225.8	262.9	470.3	2100.0
Value of Stocks/GDP (%)	1.2	1.9	1.8	2.5	9.2
Market Capitalisation (Billion Naira)	1324.9	1925.9	2900.1	5120.9	13294.6
Of which: Banking Sector (Billion Naira)	***354.1***	***662.7***	***1212.1***	***2142.7***	***6432.2***
Market Capitalisation/GDP (%)	13.1	16.5	19.5	27.6	58.2
Of which: Banking Sector/GDP (%)	***3.5***	***5.7***	***8.1***	***11.5***	***28.2***
Insurance Sector/GDP (%)	-	-	-	-	-
Banking Sector Cap./Market Cap. (%)	26.7	34.4	41.8	41.8	41.8
Insurance Sector Cap./Market Cap. (%)	-	-	-	-	-
Annual Turnover Volume/Value of Stock (%)	11.0	8.5	10.1	7.8	6.6
Annual Turnover Value/Market Capitalisation (%)	9.1	11.7	9.1	9.2	15.8
NSE Value Index (1984=100)	20,128.9	23,844.5	24,085.8	33,358.[illegible]	57,990.22
Growth (In per cent)					
Number of Listed Securities	2.7	4.5	4.0	0.0	5.8
Volume of Stocks	101.2	44.4	38.8	36.8	276.3
Value of Stocks	102.7	87.6	16.4	78.9	343.7
Market Capitalisation	77.2	45.4	50.6	76.6	159.6
Of which: Banking Sector	***51.7***	***87.1***	***82.9***	***76.8***	***200.2***
Insurance Sector	-	2.0	1.4	1.2	3.7
Annual Turnover Value	102.7	87.6	16.4	78.9	343.7
NSE Value Index	65.8	18.5	1.0	38.5	74.7
Share of Banks in the 20 Most Capitalised Stock in the NSE (%)	30.0	30.0	45.0	55.0	65.0

Source: Nigerian Stock Exchange (NSE).

4.5.1.1 The Secondary Market

The secondary market segment of the Nigerian Stock Exchange (NSE) recorded a significant increase in activity. The performance of the market was enhanced by improved awareness of opportunities in the stock market, the operating results of some quoted companies, available large float, particularly in the banking and insurance sectors, following the conclusion of the recapitalisation exercise in both sectors, sustained inflow of pension funds as well as the low rates of return on deposits in the money market. Improvements in the macroeconomic environment in the country also attracted foreign investors into the market and, thus, increased the level of activity.

Total turnover was 138.1 billion shares, an increase of 276.3 per cent over the 36.5 billion shares recorded in 2006. The year closed with a market turnover of N2.1 trillion or an increase of 346.6 per cent over the preceding year's level. The banking subsector accounted for 65.0 per cent of the 20 most capitalised stock on the Exchange. Following sustained confidence in the Nigerian economy, foreign portfolio investment worth N200.0 billion, representing 9.6 per cent of the aggregate market turnover was recorded in 2007, compared with N35 billion in 2006.

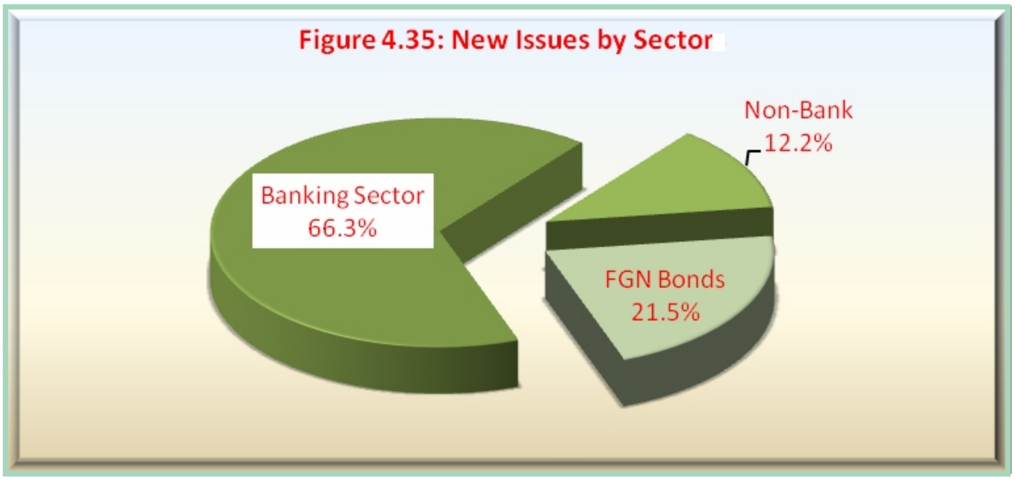


4.5.1.2 NSE Value Index

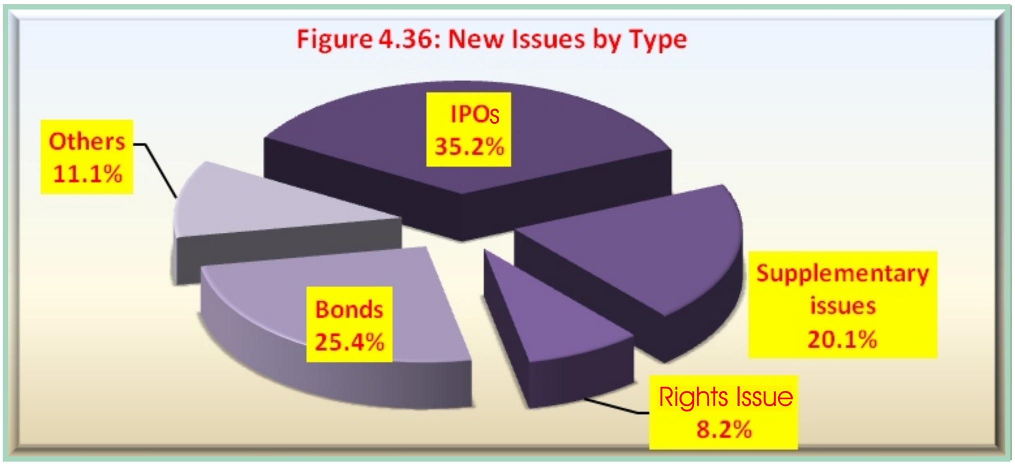
The NSE All-Share Index rose significantly by 74.7 per cent to close at 57,990.22, compared with 33,358.30 at the end of the preceding year, reflecting the improvement in share prices of the highly capitalised stocks on the Exchange.

4.5.2 New Issues Market

There was improved activity in the primary market, reflecting the increased recourse to the stock market by companies and governments. Also, some mergers and acquisitions were concluded through the facility of the Exchange. The Exchange approved 65 applications for both new issues and mergers/acquisitions valued at N2.4 trillion, compared with 69 applications valued at N1.7 trillion in 2006. The banking sector accounted for 66.3 per cent of the new issues approved in 2007, with 19 applications valued at N1.6 trillion, while non-bank corporate issues accounted for 12.2 per cent with 39 applications valued at N294.1 billion. The FGN Bonds issue amounted to N520.0 billion and accounted for 21.5 per cent of the total.



Further analysis of new issues showed that the sum of N719.9 billion was raised through initial public offers (IPOs) and supplementary issues; N168.1 billion through rights issues; and N520.0 billion through bonds issue, including the FGN bonds issue. Other issues accounted for the balance. Approvals in the banking sector to raise fresh funds through public offer stood at N697.9 billion, while rights offer amounted to N152.8 billion in 2007.



The number of securities listed on the exchange increased to 310 from 293 in 2006 as 32 new securities were listed, while 16 others were de-listed during the year. Also, one new subsector (Airline Services) was created on the daily official list, thus raising the number of subsectors in the equity sector to 32.

BOX 2: CAPITAL MARKET DEVELOPMENTS IN 2007

In an effort to strengthen and reposition the Nigerian Capital Market to cope with global competition, the Securities and Exchange Commission (SEC) approved a new minimum capital base for all capital market operators in the country. Specifically, the policy was aimed at ensuring that only well capitalised and properly structured organisations would operate in the capital market. In that regard, the minimum paid-up capital for issuing houses was increased from N150.0 million to N2.0 billion; brokers/dealers, N70.0 million to N1.0 billion; clearing and settlement agencies, N500.0 million to N1.0 billion; and Registrars, N50.0 million to N500.0 million. Underwriters were required to raise their minimum capital base from N100.0 million to N2.0 billion; Fund/Portfolio Managers, N20.0 million to N500.0 million, while corporate sub-brokers were required to have a minimum capital base of N50.0 million.

Operators not affected by the upward review included stock/commodities exchanges, capital trade points, commodities' brokers, venture capital managers and individual investment advisers. Others were consultants (individual and corporate), rating agencies, corporate investment advisers and trustees. The exemption was aimed at encouraging a smooth take off of these relatively new areas of capital market operations in Nigeria. Existing operators were given up to 31st December, 2008 by the Securities and Exchange Commission (SEC) to comply with the new capital requirements either through capital increases or mergers/acquisitions.

The reduction in all capital market fees for both primary and secondary market transactions by 40.0 per cent was approved. The reduction in cost was the culmination of industry-wide efforts at ensuring that the domestic capital market was made more competitive to attract both local and foreign investments into the country. Consequently, the average equities transaction cost in the primary market was reduced from 6.92 per cent to 4.32 per cent, while the transaction cost on bonds was reduced from 7.03 per cent to 4.79 per cent. For the secondary market, the equities transaction cost on the buy side was reduced from 4.07 per cent to 2.36 per cent, while the sell side was 2.65 per cent, down from 4.12 per cent. The new fee regime came into effect on 24th April, 2007.

Other approvals during the period included an 80.0 per cent mandatory underwriting for public offers; and a code of conduct for shareholders' associations in Nigeria. This was to engender professionalism among underwriters as well as ensure that only viable products would be brought to the market.

In another development, Afprint Nigeria Plc was reclassified from the Textiles subsector to the Agriculture/Agro-Allied subsector due to changes that occurred in the company, while the Managed Funds subsector was renamed “Other Financial Institutions” to permit the listing of more companies providing ancillary financial services within the group. In keeping with the trend in the global securities market, the NSE in 2007 commenced the process of demutualisation with the setting up of a Committee of Council to design a blueprint for its implementation. Similarly, the Exchange embarked on the automation of most of its trading floors. On cross-border listing, the Exchange facilitated a landmark transaction that led to the successful issuance of a Global Depository Receipt (GDR) by Guaranty Trust Bank Plc on the London Stock Exchange, thereby expanding the financing options for listed companies. The modalities for the proposed integration of the markets in West Africa were worked out with a view to enabling the participating countries to exploit the economy of scale inherent in an integrated West African Stock Market. The Exchange introduced the Third-Tier Market with the objective of assisting indigenous small and medium enterprises to access the stock market for financing. In the same vein, to give more Nigerians access to the market, a new automated trading floor of the Exchange was commissioned in Uyo, Akwa-Ibom State in 2007.

4.6 OUTLOOK OF THE FINANCIAL SYSTEM IN 2008

With the launching of the two-way quote in the money market, the appointment of money-market dealers (MMD) in 2007 and the subsequent introduction of the intra-day facility in the money market, it is expected that trading among market operators would be enhanced and, thereby, make the money market rate move around the Bank's policy rate as well as reduce the margin. Also, the commencement of the two-way quote in the inter-bank funds market would provide a proper benchmark for interest rate in the inter-bank funds trading.

Sustained macroeconomic stability in 2008 would enhance the level of economic activity, thus making most of the firms to increase their levels of operations and, thereby, raise more funds from the capital market. Furthermore, the launching of the Investors Protection Fund by the NSE, the migration of bonds trading from OTC to the Exchange as well as the stepping up of the privatisation programme of government, which could make most of the parastatals to raise funds from the capital market, would further boost the system.

Overall, the future of the financial system in 2008 looks bright, especially as the full-fledged risk-based supervision will come into effect to safeguard the banking industry and, thereby, enhance the effectiveness of monetary policy conduct. However, the post-consolidation challenges of the sector remained daunting and would require a continuing pragmatic approach on the part of the Bank in 2008.

CHAPTER 5

FISCAL OPERATIONS

The outcome of the fiscal operations of government was mixed in 2007. At N5,715.6 billion or 25.0 per cent of GDP, the Federation Account revenue declined by 5.7 per cent from the level in 2006. This development was attributed to the decline in oil revenue as a result of youth restiveness in the Niger Delta, which disrupted oil production and export activities. In contrast, non-oil revenue increased by 62.0 per cent above the level in the preceding year to N1,252.6 billion, representing 5.5 per cent of GDP. The sum of N3,878.5 billion was transferred to the Federation Account in 2007, reflecting an increase of 17.0 per cent over the level in 2006.

However, prudent fiscal management during the year resulted in accumulated savings of US$22,183.9 million by the three tiers of government in 2006 and 2007. The savings comprised US$9,783.3 million brought forward from 2006 and US$12,400.6 million accumulated in 2007, which were transferred to the excess crude account.

Meanwhile, the Federal Government retained revenue and aggregate expenditure increased by 20.5 and 20.3 per cent, respectively over the levels in 2006. Fiscal operations of the Federal Government resulted in a notional deficit of N117.2 billion, or 0.5 per cent of GDP in 2007. Provisional data on state governments' finances indicated a modest improvement with an overall deficit of N50.7 billion or 0.2 per cent of GDP, representing an increase of 17.9 per cent when compared with N43.0 billion or 2.0 per cent of GDP in 2006. Conversely, provisional statistics on local governments' finances showed that the fiscal operations resulted in an overall surplus of N5.8 billion, compared with N8.4 billion in 2006. The surplus was driven by increased revenue allocation to local governments in 2007. Fiscal surplus as a percentage of GDP however, dropped from 0.1 per cent in 2006 to 0.03 per cent.

The stock of consolidated public debt at end-December, 2007 was N2,597.7 billion or 11.4 per cent of GDP compared with N2,204.7 billion or 11.9 per cent of GDP in 2006. The stock of Nigerian external debt rose marginally from US$3.5 billion in 2006 to US$3.6 billion, following the contracting of new concessional loans. Domestic debt at N2,169.6 billion continued to increase owing to the issuance of new FGN Bonds for the settlement of outstanding pension arrears and payments due to local contractors.

5.1 FISCAL POLICY THRUST

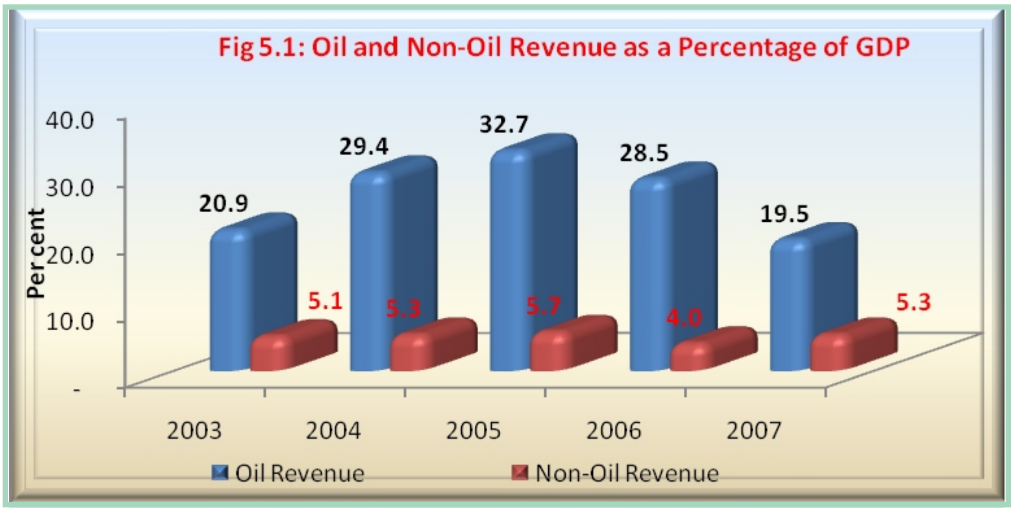
The fiscal policy stance in 2007 continued to focus on strengthening fiscal consolidation and promoting growth-induced development strategy. As outlined under the National Economic Empowerment and Development Strategy (NEEDS) and formulated within the context of the Medium-Term Expenditure Framework (MTEF), the fiscal strategy was directed towards eliminating infrastructural deficiencies inimical to business efficiency, improving the quality of life of the citizenry, and accelerating investments in basic physical infrastructure and human capital . It was also targetted at addressing weaknesses in the planning and budgeting processes in the country to support the development programmes of the government. The Seven-Point Agenda of the new administration reinforced the need for infrastructural (water, power and roads) and social (health and education) developments with ultimate aim of creating wealth, generating employment and achieving the Millennium Development Goals (MDGs).

Pursuant to this broad fiscal policy objective, government specifically strengthened its policies to consolidate the gains of recent reforms and lay solid foundation for economic progress. The following measures were therefore initiated:

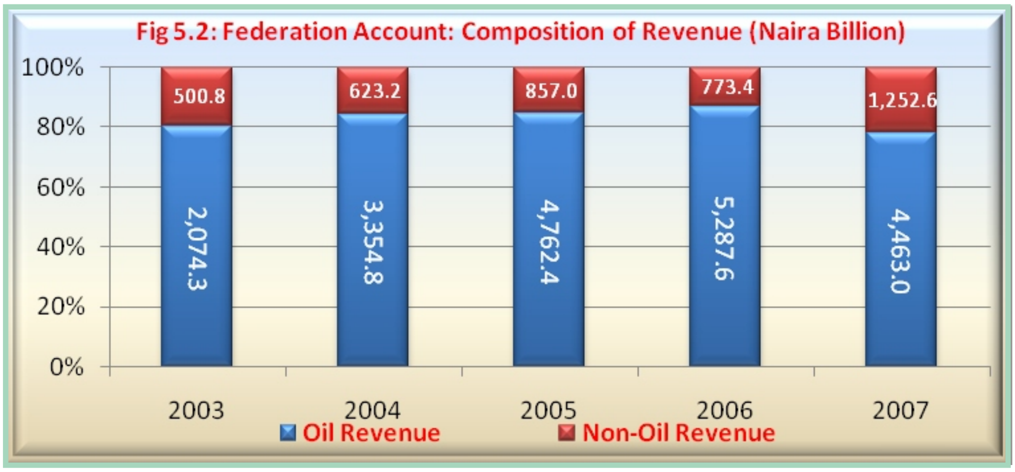
- Liquidation of the outstanding debt owed to the London Club of Creditors, supported with a resolve to support only concessional loans for the investment programmes of government in order to foreclose the agony of debt overhang in the future;
- Massive investment in the energy sector to meet the energy need of the country and attain the objective of employment generation and wealth creation;
- Adherence to the due process mechanism, in addition to promoting the twin principles of accountability and transparency to boost the ongoing fight against corruption;
- Improvement in the agricultural sector to reduce food insecurity;
- Suspension of import duty waivers, tax holidays and rebates, etc., hitherto conceded to industrialists in order to stem abuses of the incentives and shore-up revenue to government for developmental purposes; and
- Completion of the restructuring of Federal Government Ministries, Agencies and Ministerial Departments to cut wastages and ensure efficiency in the operations of government business.

5.2 FEDERATION ACCOUNT OPERATIONS

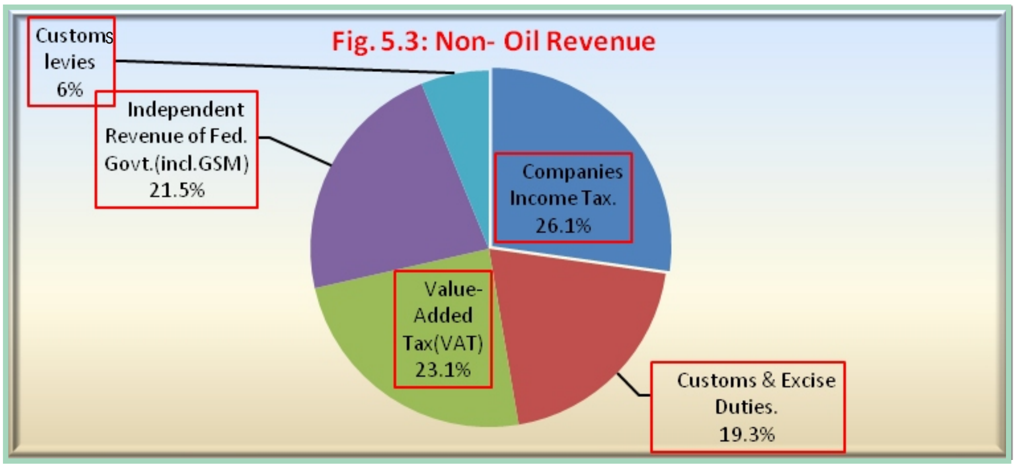
Total federally-collected revenue decreased by 5.7 per cent to N5,715.6 billion in 2007, representing 25.0 per cent of GDP, compared with 32.6 per cent in 2006. At that level, the total federally-collected revenue was 22.0 per cent higher than the budget estimate of N4,685.7 billion. This development was attributable largely to the sustained rise in crude oil prices in the international market.



Revenue from crude oil and gas exports amounted to N1,851.0 billion, representing a decrease of 10.8 per cent from the level in the preceding year. Similarly, revenue from the Petroleum Profit Tax (PPT) and Royalties decreased by 26.4 per cent to N1,500.6 billion, while revenue from domestic crude oil sales fell by 6.6 per cent to N1,094.6 billion. This development resulted from continued restiveness in the Niger Delta Area which led to the disruption of oil production and export activities. The sum of N550.0 billion was deducted from the gross oil receipts for the Joint Venture Cash (JVC) Calls, N1,257.0 billion was deducted in respect of excess crude/PPT/royalty proceeds, while the balance was set aside for distribution to the three tiers of government and other beneficiaries.



Revenue from non-oil sources rose by 62.0 per cent to N1,252.6 billion in 2007. The analysis of the revenue profile indicated that the Value Added Tax (VAT) increased by 30.7 per cent to N289.6 billion, while the Independent Revenue of the Federal Government increased by 706.9 per cent to N268.7 billion. In addition, collections from companies income tax and customs and excise duties rose by 33.5 and 35.8 per cent to N327.0 billion and N241.4 billion, respectively.



The rise in non-oil revenue was due to the enhanced revenue collection machanisms of the Nigeria Customs Service (NCS) and the Federal Inland Revenue Service (FIRS) and the suspension of tax concessions and waivers granted to importers. In addition, the receipts of substantial operating surpluses from some government agencies boosted the FG's independent revenue. At 5.5 per cent, the ratio of non-oil revenue to GDP rose by 1.3 percentage points, indicating the effectiveness of the Federal Governments efforts at improving earnings from non-oil sources.

5.2.1 Federation Account Allocation

The sum of N3,878.5 billion accrued to the Federation Account in 2007, indicating an increase of 17.0 per cent over the level in 2006. Of the total, N3,194.3 billion was distributed among the three tiers of government and the Derivation Fund. The sum of N289.6 billion was deducted for the VAT Pool Account, while the sum of N268.7 billion accrued to the Federal Government as Independent Revenue. Similarly, the sum of N125.9 billion was transferred to the Education Tax Fund and Customs Special Levies Account. A breakdown of the distribution among the three tiers of government showed that the Federal Government received N1,500.9 billion including deductions from natural resources, State Governments N761.2 billion, Local Governments N586.9 billion, while the sum of N345.3 billion as Derivation Fund was shared among the oil producing States.

5.2.2 VAT Pool Account

The sum of N289.6 billion accrued to the VAT Pool Account in 2007, representing an increase of 30.7 per cent over the level in 2006. A breakdown of the distribution among the three tiers of government showed that the Federal Government received N43.4 billion, State Governments N144.8 billion, while the 774 Local Governments shared N101.4 billion.

5.3 FEDERAL GOVERNMENT FINANCES

5.3.1 Retained Revenue of the Federal Government

Federal Government retained revenue increased to N2,333.7 billion or 10.2 per cent of GDP from N1,937.2 billion or 10.4 per cent of GDP in 2006. Analysis of the revenue showed that the share from the Federation Account was N1,500.9 billion; the VAT Pool Account was N43.4 billion; Federal Government Independent Revenue was N268.7 billion, the share of excess crude oil earnings was N299.1 billion, while "others" accounted for the balance. The rise in retained revenue was partly due to the substantial increase in the Federal Government Independent Revenue, which grew by 706.9 per cent over the level in 2006 as well as the increase in the shares from the Federation and VAT Pool Accounts.

Fig 5.4: Composition of Federal Government retained Revenue in 2007

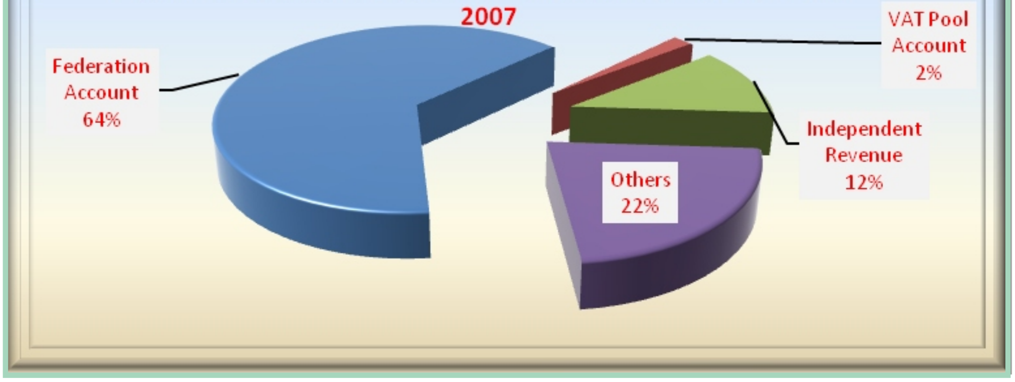
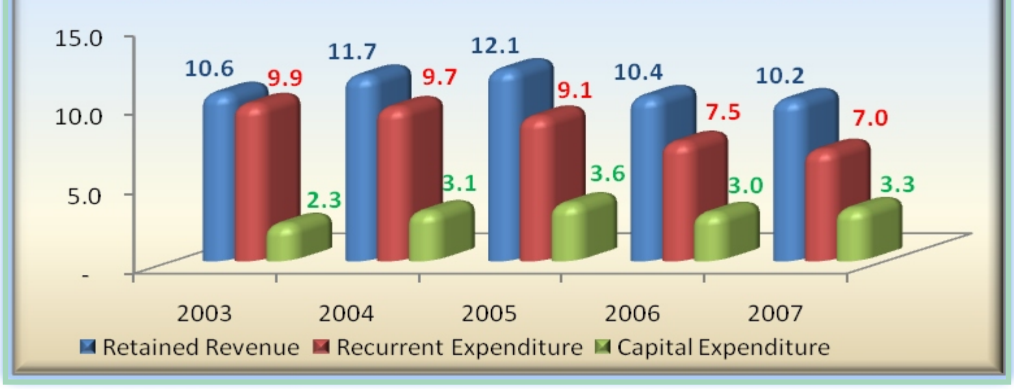


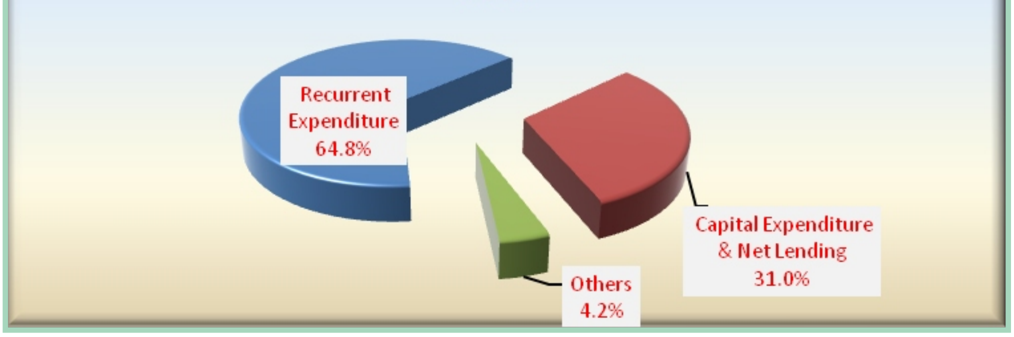
Fig 5.5: Federal Government Revenue and Expenditure (per cent of GDP)



5.3.2 Total Expenditure of the Federal Government

Aggregate expenditure of the Federal Government in nominal terms increased by 20.3 per cent to N2,450.9 billion in 2007. As a proportion of GDP, total expenditure declined to 10.7 per cent from 11.0 per cent in the previous year. Non-debt expenditure (total expenditure less debt service payments) rose by 25.1 per cent from the level in 2006 and was 11.3 per cent above the N1,983.3 billion budget estimate for 2007. Total debt service payments amounted to N213.7 billion, representing 8.7 per cent of the total expenditure.

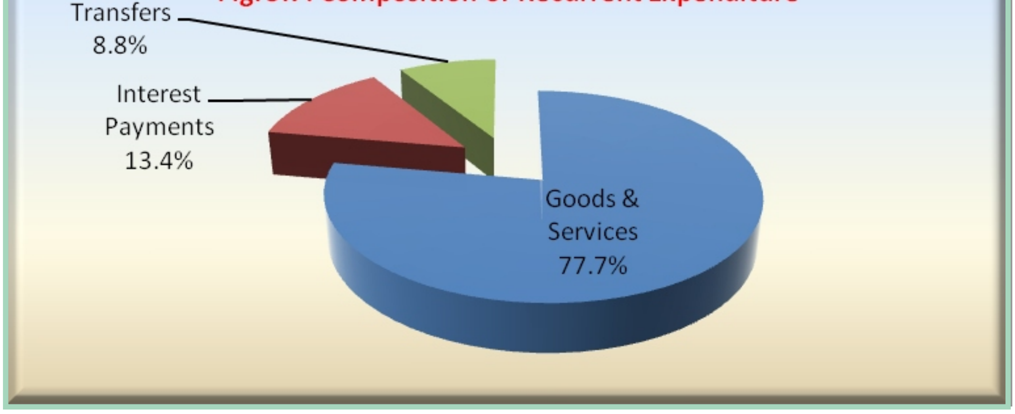
Fig 5.6: Composition of Federal Government Expenditure in 2007



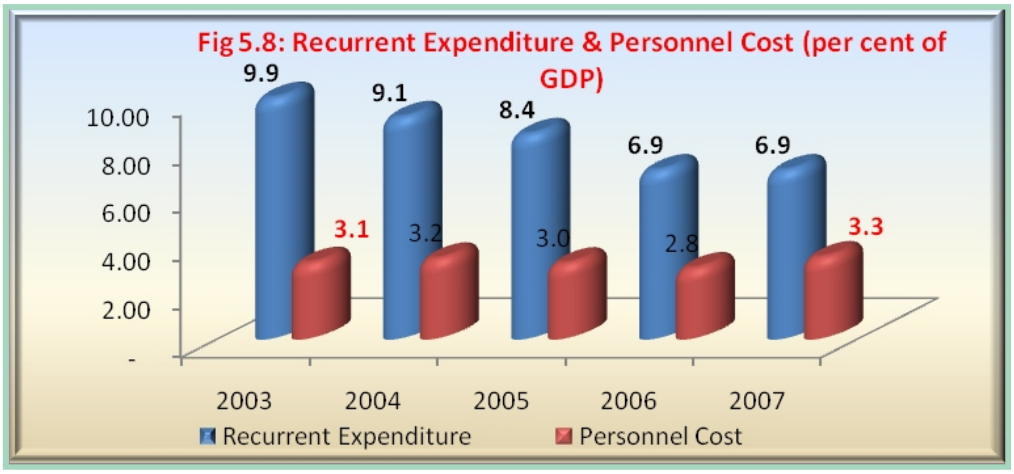
5.3.2.1 Recurrent Expenditure

At N1,589.3 billion, recurrent expenditure rose by 14.3 per cent over the level in 2006 and accounted for 64.8 per cent of total expenditure. As a percentage of GDP, recurrent expenditure declined to 7.0 per cent from 7.5 per cent in 2006. Most of the components of recurrent expenditure increased relative to their levels in the preceding year. Further analysis showed that personnel cost and pensions amounted to N867.3 billion or 54.6 per cent of total recurrent expenditure, overhead costs stood at N368.1 billion or 23.2 per cent, interest payments (external and domestic) stood at N213.7 billion or 13.4 per cent, while transfers to the Federal Capital Territory (FCT) and other transfers accounted for N140.2 billion or 8.8 per cent.

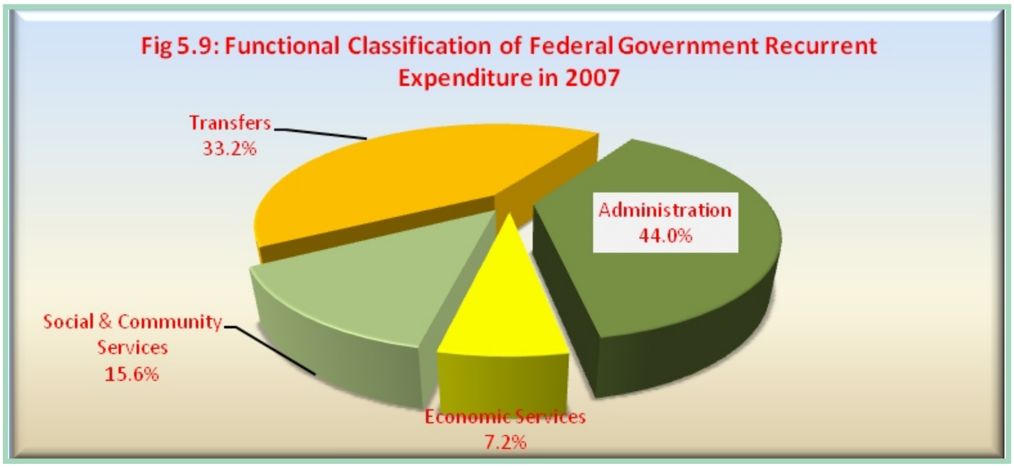
Fig. 5.7: Composition of Recurrent Expenditure



Interest payments on consolidated debt (foreign and domestic loans) as a percentage of GDP fell from 1.3 per cent in 2006 to 0.9 per cent in 2007. This reflected the exit of the Federal Government from the London Club debts as well as the restructuring of domestic debts.



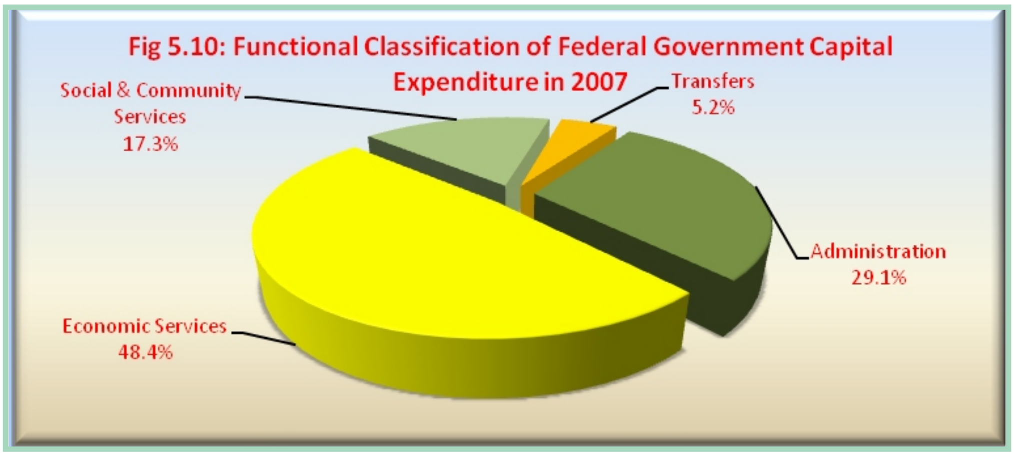
The functional classification of recurrent expenditure showed that the outlay on administration rose by 33.9 per cent to N699.5 billion and accounted for 44.0 per cent of the total. Transfer payments declined by 11.2 per cent to N527.2 billion and accounted for 33.2 per cent of the total, reflecting a significant fall in public debt charges, particularly domestic debts. Expenditure on economic services rose by 44.5 per cent to N115.2 billion and accounted for 7.2 per cent of total recurrent expenditure. Within the economic services sector, agriculture, transport, communications and roads/construction were the key areas which absorbed 62.2 per cent of the share of the sector, while expenditure on social and community services accounted for 15.6 per cent of the total.



5.3.2.2 Capital Expenditure

Capital expenditure increased in absolute terms by 37.5 per cent to N759.3 billion or 3.3 per cent of GDP, compared with 3.0 per cent in 2006. As a proportion of Federal Government revenue, capital expenditure was 32.5 per cent, exceeding the minimum target of 20.0 per cent under the WAMZ secondary convergence criteria. Furthermore, capital expenditure budgeting achieved 91.4 per cent implementation rate in 2007. The effective implementation of the “Due Process” mechanism, which ensured the release of funds on the basis of work done, facilitated the high rate of achievement.

A breakdown of capital expenditure showed that public investment in economic services accounted for N367.9 billion or 48.5 per cent of the total, compared with 47.5 per cent in the preceding year. Within the economic services sector, housing, manufacturing, mining/quarrying, agriculture/natural resources, transport/communications and roads/construction absorbed 44.1 per cent of the share of the sector. Public investments in social and community services recorded an increase of 66.6 per cent over the level in the preceding year, and accounted for 17.3 per cent of total. The expenditure on such sectors, as education and health improved by 109.0 and 29.8 per cent to N68.3 and N41.8, respectively.



Box 3: FGN Capital Budget Implementation: Its Impact on Economic Growth and Social Welfare

Public sector budgeting in Nigeria is the financial representation of anticipated government spending plans for the delivery of public goods and services, with a view to improving the material well-being of citizens over a time frame, usually one year. Thus, the capital budget is the anticipated expenditure on public infrastructure or investment. Economists categorise capital budget as productive expenditure. Public investment or expenditure (Capital Budget), therefore, is considered as an engine of economic growth and development, through the provision of necessary infrastructure to ensure adequate return to private investment and performance.

In 2004, the Federal Government adopted the Medium-Term Expenditure Framework (MTEF) to address the challenges of capital budget planning and implementation process in Nigeria. The MTEF is a multi-year programme which links capital spending plans of government to its macroeconomic objectives.

Despite these improvements in the capital budgeting framework, capital budget design and implementation continued to be plagued by low performance in terms of releases by the Office of the Accountant General of the Federation (OAGF) and the utilisation by the executing agencies. A review of the Federal Government's capital budget implementation record shows an unimpressive performance in relation to available revenue. For instance, the years 2004 to 2006 show a budget release of an average of 82.2 per cent of the approved budget while the amount released in 2007 stood at 45.1 per cent of total capital appropriation. A more serious issue is the partial utilisation of funds released to executing Ministries, Departments and Agencies (MDAs). At an average of 73.0 per cent, the execution of planned capital budget supports the view that capital budget implementation in Nigeria is low. This figure fell substantially to 62.0 per cent in 2007.

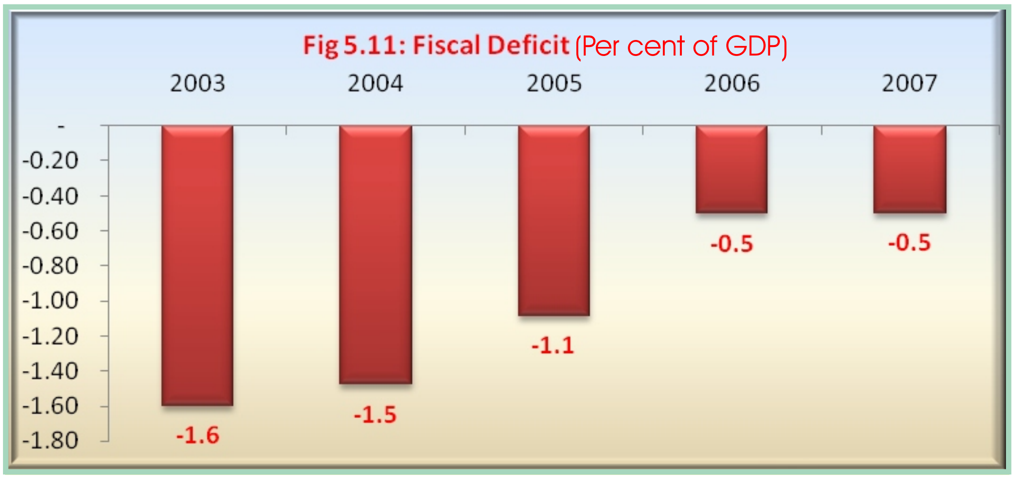
Several reasons adduced for this include the late approval of budget by the National Assembly, bureaucratic bottlenecks, the long process for obtaining a due process certificate, lack of capacity of executing ministries and the problems of cash flow management leading to idle government funds. The major implication of this is the low level of construction and rehabilitation of basic public infrastructure needed especially by the private sector to propel economic activities. This has been one of the major obstacles to achieving a sustainable growth rate and poverty reduction in the economy.

This situation has brought to the fore, the urgent need to improve the capital budget implementation framework to realise the stated budget objectives. Therefore, the following measures are recommended:

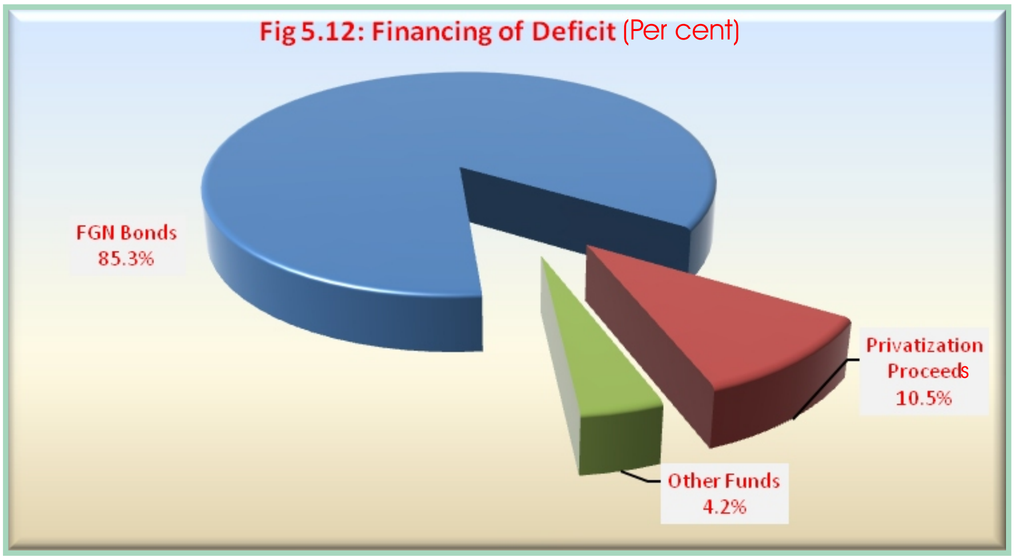
- Entrench a more harmonious relationship between the Executive and the Legislature to facilitate the timely release of the budget;
- Involve the National Assembly during the budgets' pre-preparatory stage for their input;
- Appreciate the timely rendition of budget to the Legislature (end-September);
- Budget funds should be tied to project requirement and funds should not be thinly spread over many projects;
- The "Due Process" mechanism should be redesigned in a manner that it does not cause obstruction;
- Government should improve on fiscal transparency by providing regular and accurate information;
- Government should institute proper monitoring and evaluation of capital budgets.

5.3.3 Overall Fiscal Balance and Financing

The current account surplus of government increased by 36.1 per cent to N744.4 billion or 3.3 per cent of GDP, while the primary balance recorded a surplus of N96.5 billion or 0.4 per cent of GDP, compared with the surplus of N148.5 billion or 0.8 per cent of GDP in 2006. However, the overall fiscal operations of the Federal Government resulted in a notional deficit of N117.2 billion or 0.5 per cent of GDP, compared



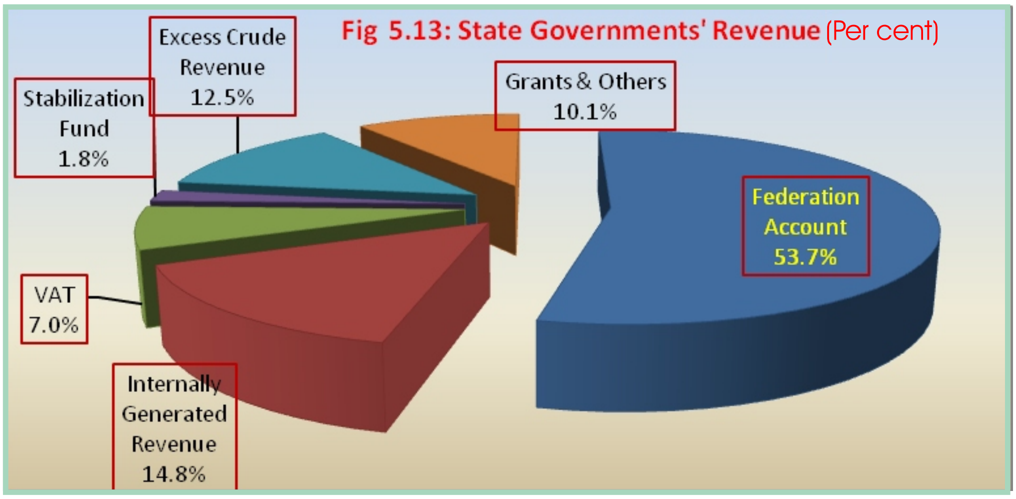
with the deficit of N100.8 billion or 0.5 per cent of GDP recorded in 2006. At 0.5 per cent of GDP, the deficit outperformed the WAMZ's primary convergence criterion target of 4.0 per cent maximum. The overall budget deficit was financed entirely from domestic sources, with N40.2 billion from the non-bank public, N12.3 billion from privatisation proceeds and the balance from the banking system.



5.4 STATE GOVERNMENTS' FINANCES[1]

5.4.1 Fiscal Balance

Provisional data on state governments' finances indicated a modest increase in the overall deficit from N43.0 billion or 0.2 per cent of GDP in 2006 to N50.7 billion or 0.2 per cent of GDP in 2007. The higher deficit was attributable largely to the increased capital expenditure which rose by 46.4 per cent and transfers, notably transfers to Local Governments, which recorded an increase of 252.3 per cent.



[1] The provisional data included CBN survey returns from 35 states and the FCT, excluding Jigawa state.

5.4.2 Revenue

Total revenue of state governments rose by 33.8 percent to N2,065.41 billion or 9.0 percent of GDP, compared with N1, 543.8 billion or 8.3 percent of GDP in 2006. The analysis of the revenue indicated that allocations from the Federation Account, including the 13.0 percent oil derivation fund, was N1,109.34 billion or 53.7 percent, the VAT pool Account (N144.4 billion or 7.0%), Internally Generated Revenue- IGR (N305.7 billion or 14.8%), stabilization account (N37.7 billion or 1.8%), share of excess oil revenue (N258.9 or 12.5 percent); and grants and others (N209.4 billion or 10.2%), constituted the major sources of state governments' revenue. The performance of IGR improved in 2007 as reflected in a higher IGR/GDP ratio of 1.3 per cent when compared with 0.7 percent in 2006. Lagos state maintained the highest internally generated revenue, amounting to N 141.9 billion. This was followed by Rivers and Delta states with IGR amounting to N 23.1 billion and N 12.0 billion, respectively.

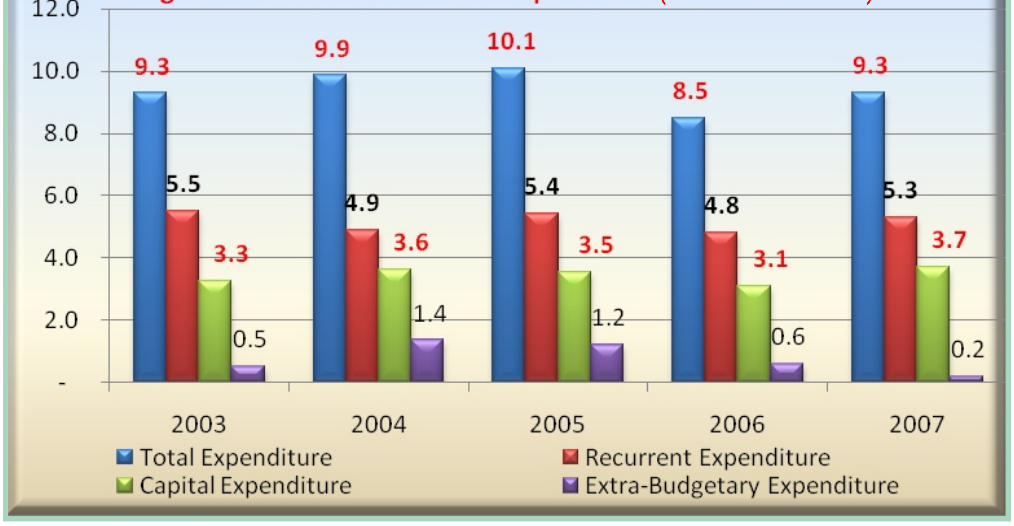
Table 5.1: State Governments' Revenue

Item	State Governments' Revenue				As % of GDP	
	2006		2007		2006	2007
	Amount (N' Billion)	Share (%)	Amount (N' Billion)	Share (%)	%	%
Federation Account	1,016.10	65.8	1,109.3	53.7	5.6	4.9
VAT	110.6	7.2	144.4	7.0	0.6	0.6
Internally Generated Revenue	125.2	8.1	305.7	14.8	0.7	1.3
Stabilization Fund	11.9	0.8	37.7	1.8	0.1	0.2
Excess Crude Revenue	154.7	10	258.9	12.5	0.8	1.1
Grants & Others	125.3	8.1	209.4	10.2	0.7	0.9
Total	**1,543.80**	**100**	**2,065.4**	**100.0**	8.5	9.0

5.4.3 Expenditure

The consolidated expenditure of the state governments in 2007 increased by 33.4 percent to N2,116.14 billion or 9.3 percent of GDP. A breakdown showed that, at N1,217.43 billion or 5.3 percent of GDP, recurrent expenditure was 36.1 percent higher than the level recorded in the preceding year and accounted for 57.5 percent of total expenditure.

Fig 5.14: State Governments' Expenditure (Per cent of GDP)



At N854.79 billion or 3.7 percent of GDP, capital expenditure was 46.4 percent higher than the level in 2006 and accounted for 40.4 percent of total expenditure. The extra-budgetary expenditure of the states accounted for 2.1 percent of total and decreased by 59.5 percent to N43.9 billion in 2007.

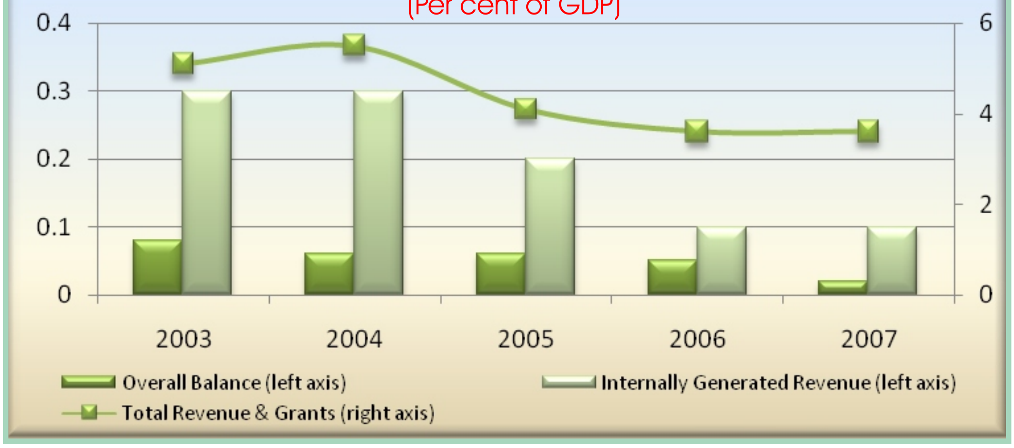
The analysis of consolidated spending on primary welfare sectors indicated that expenditure on education and health declined by 7.3 and 16.5 percent below the levels in 2006 to N164.25 billion or 0.7 percent of GDP and N85.87 billion or 0.4 per cent of GDP, respectively. However, expenditure on agriculture increased by 11.5 percent over the level in the preceding year to N72.63 billion or 0.3 percent of GDP. The outlay on housing and water supply decreased by 2.3 percent and 8.0 percent, respectively, to N36.96 billion or 0.2 percent of GDP and N48.66 billion or 0.2 percent of GDP. On the whole, aggregate expenditure on key welfare sectors amounted to N408.37 billion or 1.8 percent of GDP and accounted for 19.3 percent of the consolidated total expenditure of the state governments.

5.5 LOCAL GOVERNMENTS' FINANCES

5.5.1 Fiscal Balance

Provisional data on local governments' finances indicated that the fiscal operations of the 774 local government councils recorded a surplus of N4.9 billion, compared with N8.4 billion in 2006. The surplus achieved was attributable, largely, to the increased revenue allocation to the Local Governments in 2007. The fiscal surplus as a percentage of GDP fell from 0.05 per cent in 2006 to 0.02 per cent.

Figure 5.15: Local Governments'Revenue & Overall Balance (Per cent of GDP)

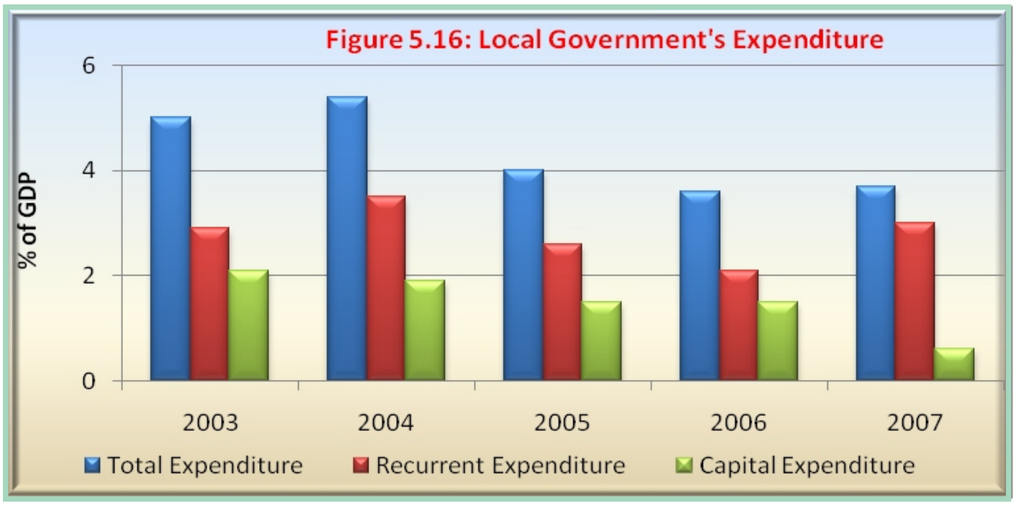


5.5.2 Revenue

Total revenue of local governments rose by 23.4 per cent from N674.3 billion in 2006 to N832.3 billion. Similarly, the revenue/GDP ratio remained unchanged at 3.6 per cent in 2007. Local government councils' revenue comprised allocations from the Federation Account and excess crude (N568.3 billion or 68.3 per cent), the VAT pool account (N105.1 billion or 12.6 per cent), IGR (N21.3 billion or 2.6 per cent), stabilisation account (N3.7 billion or 0.4 per cent), grants and others (N3.8 billion or 0.5 per cent), state government allocations (N3.0 billion or 0.4 per cent), and the share of excess oil revenue (N127.1 billion or 15.3 per cent). The low contribution of IGR persisted in 2007 as reflected in the IGR/GDP ratio of 0.1 per cent, reflecting continued dependence on funds from the Federation Account.

5.5.3 Expenditure

Consolidated expenditure of the local governments increased by 24.3 per cent to N827.4 billion in 2007. However, the expenditure/GDP ratio dropped slightly to 3.5 per cent from 3.6 per cent recorded in the preceding year.



A breakdown of the total expenditure showed that recurrent expenditure, at N683.6 billion or 3.0 per cent of GDP, was higher than the level recorded in the preceding year by 71.7 per cent and accounted for 82.6 per cent of the total. Capital expenditure at N143.8 billion or 0.6 per cent of GDP was lower than the level recorded in 2006 by 46.6 per cent and represented 17.4 per cent of the total expenditure.

5.6 CONSOLIDATED GOVERNMENT DEBT

The stock of the consolidated public debt, at end-December 2007, was N2,597.7 billion or 11.4 per cent of GDP, compared with N2,204.7 billion or 11.9 per cent of GDP in 2006. The increase in the stock of consolidated debt was traceable to the rise in domestic debt arising from the issuance of new FGN bonds in 2007 to meet pension arrears and other contractual obligations of government. Consequently, the FGN bonds stock of domestic debt grew from N1,753.3 billion in 2006 to N2,169.6 billion or 83.5 per cent of total consolidated debt in 2007. At end-December 2007, external debt outstanding amounted to N428.1 billion (US$3.6 billion) and constituted 16.5 per cent of total consolidated debt. The stock of external public debt (in US dollars) declined by 5.2 per cent, while that of domestic public debt increased by 23.7 per cent.

5.6.1 Domestic Debt

The domestic debt stock of the Federal Government outstanding at end-December 2007 stood at N2,169.6 billion, representing an increase of 23.7 per cent over the level in 2006. The increase was due mainly to the issuance of new FGN Bonds (4th Series FGN Bonds) worth N530.5 billion and Special FGN Bonds amounting to N11.7 billion to settle outstanding pension arrears and other contractual obligations. The banking system remained the dominant holder of Federal Government securities in 2007 with holdings which exceeded the preceding year's level by 39.8 per cent. The total holdings of the non-bank public declined by 12.9 per cent to N466.0 billion. Further analysis revealed that the banking system (CBN and DMBs) held 78.5 per cent of the total outstanding debt, while the non-bank public accounted for the balance of 21.5 per cent. A decomposition of the banking system's holdings indicated that N1,410.0 billion or 82.8 per cent and N293.6 billion or 17.2 per cent were held by the DMBs and the CBN, respectively.

Table 5.2: Maturity Structure of Federal Government Domestic Debt (N' Billion)

	2003	2004	2005	2006	2007
Debt by Composition					
i Treasury Bills	825.1	871.5	854.8	695.0	574.9
ii Treasury Bonds	430.6	424.9	419.3	413.6	407.9
iii Development Stocks	1.5	1.3	1.0	0.7	0.6
iv FGN Bonds	72.5	72.6	250.8	477.2	1,007.7
v Special FGN Bonds	0.0	0.0	0.0	166.8	178.5
Class of Holder					
Banking System	1,114.2	1,072.5	1,134.6	1,218.4	1,703.6
CBN	613.8	403.5	408.4	335.5	293.6
DMBs	500.4	669.1	726.2	882.9	1,410.0
Non-Bank Public	215.5	297.8	391.3	534.9	466.0
Debt by Maturity					
2 Years and Below	836.9	938.6	983.7	897.1	709.8
2-5 Years	89.9	71.2	163.9	431.2	820.9
5-10 Years	83.0	184.5	107.0	194.0	252.9
Over 10 Years	319.9	176.0	271.2	231.0	386.0
Total Debt Outstanding	1,329.7	1,370.3	1,525.9	1,753.3	2,169.6

The analysis of the maturity structure of domestic debt showed that instruments with a tenor between two (2) and five (5) years accounted for N820.9 billion or 37.8 per cent, compared with N431.2 billion or 24.6 per cent, in the preceding year. This was followed by instruments with a tenor of two (2) years and below which accounted for 32.7 per cent or N709.8 billion. Instruments with a tenor of over ten (10) years accounted for 17.8 per cent or N386.0 billion, while those with tenors between five (5) and ten (10) years accounted for N252.9 billion or 11.7 per cent.

5.6.2 External Debt

Nigeria's external debt was substantially reduced following the pay-off of the outstanding debts owed to the London Clubs of Creditors in the first quarter of 2007. Consequently, the external debt stock outstanding at end-December 2007 stood at US$3.63 billion, representing an increase of 2.4 per cent over the level in 2006. This reflected the contracting of new concessional loans amounting to about US$84.1 million. The share of multilateral debts was US$3.06 billion in 2007 and accounted for 84.2 per cent of the total. Other commercial debts at US$0.57 billion, accounted for the balance of 15.8 per cent of the total.

5.6.3 Debt Service Payments

Total debt service payments in 2007 stood at N323.5 billion. This comprised N128.7 billion or US$1.0 billion for external debt service and N194.8 billion for domestic debt service. Overall, the debt service payments to GDP ratio fell from 2.5 per cent in the preceding year to 1.4 per cent in 2007.

5.7 FISCAL OUTLOOK FOR 2008

The fiscal prospects for 2008 appear bright, given the market fundamentals, the expectation of high levels of oil prices in the international market and fiscal discipline in the economy. It is envisaged that the accumulation of savings from excess crude proceeds, arising from the expected rise in oil revenue, aimed at sustaining the single digit inflation recorded in 2007, would support the actualisation of the FSS 2020. The campaign against corruption coupled with the current drive for accountability and transparency, would improve the quality of government expenditure and further enhance the transformation of the economy, through the provision of the required socio-economic infrastructure for the achievement of the Millennium Development Goals (MDGs). The performance of the judiciary is also vital in sustaining political stability in the economy. The pent-up demand in the United States of America (USA) and the new industrial economies of East Asia including China and India, would continue to put pressure on demand for crude oil in the international market and provide the needed incentives for higher production quotas by the Organisation of Petroleum Exporting Countries (OPEC). Consequently, with substantial oil revenue accruing to the Federation, coupled with enhanced non-oil earnings, the prospect is high that the Federal Government fiscal operations during fiscal year 2008 may result in further moderation in the overall notional fiscal deficit. Moreover, the expansion in capital market activities provides greater avenues for non-inflationary financing of the fiscal deficit through the domestic sources with positive implications for compliance with the WAMZ convergent criteria.