THE IMPORTANCE OF FINANCIAL INTERMEDIATION IN SUSTAINING ECONOMIC GROWTH AND DEVELOPMENT: THE BANKING SECTOR REVIEW

BY

CHIEF (DR) J. O. SANUSI
GOVERNOR
CENTRAL BANK OF NIGERIA

A KEYNOTE ADDRESS DELIVERED AT THE BANKING SEMINAR, ORGANISED BY THE INSTITUTE OF DIRECTORS, ON THURSDAY, JUNE 13, 2002, AT THE LE’MERIDIEN HOTEL, VICTORIA ISLAND, LAGOS
THE IMPORTANCE OF FINANCIAL INTERMEDIATION IN SUSTAINING ECONOMIC GROWTH AND DEVELOPMENT: THE BANKING SECTOR REVIEW

The President, Institute of Directors,
Members of the Institute,
Distinguished Guests,
Distinguished Ladies and Gentlemen,

I feel honoured to be invited as Special Guest of Honour and to present a Keynote Address to this august assembly of professionals, captains of industry and directors of corporate entities, whose decision-making and commitments constitute a critical success factor for moving the Nigerian economy forward. The choice of the theme for this year’s Banking Seminar – The Importance of Financial Intermediation in Sustaining Economic Growth and Development: The Banking Sector Review – is appropriate, given the importance of financial intermediation in the development process, particularly the strategic role of banks as the prime mover of the economy. I should also thank the Governing Council of the Institute for its expression of support for our current efforts to ensure the soundness of the banking system. Recognising that only a
strong banking system is capable of providing sound intermediation, we shall not relent in this endeavour.

2. In this Address, I intend to share with you an insider perspective on the subject and, in the process, emphasise the need for collaborative efforts among all stakeholders to uplift the Nigerian economy, which is now characterised by low savings, low investments and low growth – depicting the vicious cycle of poverty.

3. Availability of investible funds is a key factor in the growth process of any economy. Although not a sufficient condition, resource availability is certainly a necessary condition for output and employment growth. Indeed, there is ample evidence to show that countries that have enjoyed or are enjoying economic prosperity have been linked with an efficient mechanism for mobilising financial resources and allocating same for productive investment. Efficient financial intermediation contributes to higher levels of output, employment, and income which invariably enhances the living standards of the population.

4. The banking sector remains at the centre of this process, even in economies with highly developed
financial markets. Banks provide important positive externalities as mobilisers of savings, allocators of resources, and providers of liquidity and payment services, as well as a fulcrum for monetary policy implementation.

5. Simply put, banks influence the savings–investment process in order to accelerate the rate of economic growth and poverty reduction. Towards this goal, the soundness of intermediation is as important as its volume, hence the need to have an efficient banking system.

6. You will recall that from the formative years of the nation’s financial market up to the mid-1980s, the mechanism for influencing the flow of bank credit to the growth sectors of the economy was direct control of credit allocation and interest rate structure. In those years, banks were required to allocate the bulk of their loanable funds to agriculture, manufacturing, residential building construction, solid minerals at concessionary rate of interest, in the belief that a low interest rate structure would promote investments and output growth in the economy. The weaknesses, including incidence of disintermediation, that characterised the direct
control regime informed their abolition and the adoption of market based policies in September 1986, to restore macroeconomic stability and the resumption of sustainable growth. The direct control measures essentially discouraged resource mobilisation and promoted inefficiency in its allocation, since it was difficult to effectively monitor the ultimate use of low interest credits targeted for productive investment. Thus, the driving force for the shift to market-based approach for financial intermediation was informed by the desire to achieve enhanced efficiency in the mobilisation and utilisation of resources as well as develop an efficient framework for monetary management.

7. Distinguished Ladies and Gentlemen, let me state at this juncture, that an important condition for effective banking sector intermediation is that the sector should be sound and stable. The Central Bank of Nigeria (CBN) has, over the years, made concerted efforts to ensure a sound and stable banking system through effective surveillance and enforcement of prudential standards. Also, the licensing procedure places emphasis on the proper and fit criteria, among other factors, to ensure that
bank owners are trustworthy. The CBN is determined to enthrone professionalism and enforce high ethical standards in the banking industry in order to sustain public confidence, without which the banks’ ability to mobilise and deploy savings as the means to promote economic growth and raise living standards will be short-circuited.

8. Let me now dwell briefly on the important issue of high lending interest rate, which has raised serious concern among real sector operators and other stakeholders in the economy. The major factors responsible for the current high lending rates include the expansionary fiscal policy, which has fuelled inflation and the concomitant tightening of monetary policy, the oligopolistic structure of the banking system, and the inadequacies of infrastructural facilities that tend to drive up the cost of financial intermediation. Some of these major problems are being comprehensively addressed by the Government. In addition, steps are being taken by the CBN to enhance the soundness and competitiveness of the banking system, since it has been established that a sound banking system, in a competitive market environment, provides financial
intermediation at low cost because individual banks will have limited scope to charge higher interest rates and increase interest rate spreads. It is therefore, expected that the current high interest rate will be lowered as monetary conditions normalise and the financial system becomes more competitive.

9. Meanwhile, the CBN continues to appraise developments in the economy with a view to fine-tuning its policies. In this regard, you may wish to note the recent downward review of the pricing of Nigerian Treasury Bills and the adoption of a new framework for determining banks' cost of funds. The essence is to reduce the cost of borrowing and, thereby, stimulate investment and output growth in the real sector.

10. In a continued effort to stimulate growth, incentives are being provided to encourage medium to long-term lending to the productive sectors and thereby expand and diversify the production base of the economy. With effect from 2002, for example, the CBN established a refinancing facility at concessionary interest rate to encourage the flow of credit to the productive sectors of the economy. Furthermore, the banks under the aegis of the
Bankers’ Committee, have decided to set aside 10 per cent of their profit before tax for equity investment in small and medium-scale industries. Under the Small and Medium Industries Equity Investment Scheme (SMIEIS), which was launched in August 2001, banks’ contributions have amounted to about ₦7.0 billion as at end-April, 2002.

11. Distinguished Participants, recent efforts by the government to bridge the gap in the term structure of credit to agriculture and manufacturing culminated in the restructuring and merger of development finance institutions in the country, to make them more effective in the allocation of financial resources and delivery of advisory services to enterprises. Thus, the erstwhile Nigerian Agricultural and Cooperative Bank, Peoples’ Bank of Nigeria and the Family Economic Advancement Programme have been merged into the Nigerian Agricultural, Cooperative and Rural Development Bank (NACRDB), while the Nigerian Industrial Development Bank, Nigerian Bank for Commerce and Industry and National Economic Reconstruction Fund were restructured into a new Bank of Industry (BOI). Similarly, the housing sub-sector is being
restructured to make the Federal Mortgage Bank more effective.

12. Distinguished Ladies and Gentlemen, I have attempted to outline some of the recent measures designed to facilitate the flow of financial resources to the productive sectors of the economy. But before I conclude, may I remark that the growth and development of the economy is a challenge, which can be met by taking appropriate steps at four different levels, as a collaborative endeavour between the government, the monetary authorities, financial institutions and producers.

13. A conducive environment for business would be fostered if the government sustains current efforts at revamping social and economic infrastructure. In addition, government’s budgetary operations should remain within tolerable limits in order to ensure low inflation, which in turn would facilitate the reduction in bank lending rate. On the part of the CBN, efforts will be sustained at sanitising the financial sector to ensure the desirable stability. The Bank will also continue to promote competition to ensure efficient delivery of financial services. In this context, the CBN surveillance activity will be further strengthened and
extended to adequately cover other financial institutions, including the community banks in order to ensure their soundness and effective contribution to a more competitive financial environment. Moreover, the introduction of the National Savings Certificate (NSC) as an additional savings instrument, is being vigorously pursued. These initiatives are expected to engender greater competition and contribute to improved capital formation.

14. The banks are expected to maintain high ethical standards and professionalism in their operations as well as focus more on their financial intermediation role, which is at the core of the business they are licensed for. For manufacturers and producers, it is expected that bank credits will be used for the purpose they are granted for and not diverted to activities, which have little or no value-added. In this way, the economy will be put on the proper path of recovery and sustainable growth.

15. This address has only set the stage for your discussions at this seminar. My expectation is that participants will be able to come up with useful initiatives on the way forward to enhancing the efficiency and effectiveness of the banking sector,
capable of supporting sustainable growth and development in the Nigerian economy.

16. I wish you useful deliberations and thank you for your kind attention.

CHIEF (DR.) J. O. SANUSI
GOVERNOR
CENTRAL BANK OF NIGERIA
ABUJA.
June 13, 2002