Banking in Nigeria at a Time of Global Financial Crisis

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I: Introduction

- Global economic crisis unprecedented in history in terms of scope and severity: global recession predicted (Africa and some others with lower positive growth)
- Global capital flows have largely frozen; credit crunch persists despite massive global liquidity injections; global aggregate demand fallen sharply (about $50 trillion value lost through capital markets, housing, etc); commodity prices collapsed; world trade shrinking; major global banks recapitalized by governments; international financial institutions without adequate resources to intervene: Global coordination failure.
- Major industrial countries and rich developing countries designing trillions of dollars stimulus packages

II: Why Worry About the Banks?

- The financial system is dominated by the banking sector (about 90% of the assets) and about 65% of market capitalization of the NSE
- It is the key driver of the economy--- supplier of oxygen– with new credit to private sector expected to exceed the combined spending by three tiers of government (this was the case in 2008 and never happened in Nigeria before). In 2009, FGN and State Governments expect to borrow approx. N1.6 trillion, and it is the banks that will provide much of this funding.
- Nigeria cannot afford a banking crisis: The non-deficit part of the FGN budget in 2009 is less than banks' capital; hence the totality of FGN budget cannot recapitalize the banks if the system should collapse. With the drying up of global finance, and non-bank investing public still nascent, the scope for funding any bank bailout in Nigeria is slim--- except by 'printing money'!

Banks: Financial Deepening

From 2003 - 2008							
Year	M2/GDP Ratio (%)	CIC/M2 Ratio (%)	COB/M2 Ratio (%)	CIC/GDP Ratio (%)	CIC/Non-oil GDP Ratio (%)	COB/GDP Ratio (%)	COB/Non-oil GDP Ratio (%)
2003	20.0	25.3	20.8	5.1	8.7	4.2	7.1
2004	19.8	24.1	20.3	4.8	7.6	4.0	6.4
2005	19.3	22.8	20.0	4.4	7.2	3.9	6.3
2006	19.5	19.3	16.2	3.8	6.7	3.2	5.6
2007	28.1	16.5	12.7	4.7	7.3	3.8	5.6
2008 /1	38.6	12.6	9.7	4.8	7.9	3.7	6.1

M2 is broad money stock (end period)

GDP at current basic prices.

CIC is Currency in Circulation (end period)

COB is Currency Outside Banks (end period)

/1 Provisional ratios

Banks: Credit to the Real Sector

(N' Billion)							
Sectors	2003	2004	2005	2006	2007	2008	Feb. 2009
Agriculture	62.10	67.74	48.56	49.39	149.58	106.53	91.16
Min. & Quarry	95.98	131.06	172.53	251.48	490.71	846.94	813.57
Manufacturing	294.31	332.11	352.04	445.79	487.58	932.80	999.45
Communications	293.70	382.76	375.73	500.24	1,158.10	1,304.85	959.31
Oil & Gas	229.23	277.53	431.39	586.48	1,266.67	1,986.16	2,165.77
Others	227.89	328.04	610.89	690.92	1,260.85	2,622.12	3,097.79
TOTAL	1,203.2	1,519.24	1,991.15	2,524.30	4,813.49	7,799.40	8,127.05

II: Impact on Nigeria and the Banking System

Impact on Nigeria:

- Reduction in capital inflows and Divestment (FDI, Portfolio, ODA, remittances, etc) leading to crash of Nigerian capital market
- ‘Confidence Trap’ in Stock market with N trillions loss in value with the associated ‘wealth effect’ on domestic aggregate demand
- Collapse of commodity prices (especially oil) leading to reduction in export earnings and government revenue
- Demand pressure on the forex market arising from divestment and repatriation of capital and dividends by foreign investors
- De-cumulation of foreign reserves and pressures on exchange rate (depreciation)
- Greater forex outflows also means liquidity mop-up and hence tightness of liquidity in the financial system, combined with greatly reduced rate of monetization of forex inflows from oil sales means drastic reduction in growth rate of money supply
- Higher Govt borrowing, and slower growth rate of credit to the private sector
- Lower Growth Rate of oil and non-oil GDP projected; inflation at 10- 15%
- Outlook of Sovereign Credit Risk rating downgraded from ‘Positive’ to ‘Negative’ (although S&P confirms the BB-)

Impact on Nigeria and the Banking System

The Banking System

- Tightening of liquidity due to net forex outflows and lower monetization of oil earnings
- Further tightening of liquidity as lines of foreign credits enjoyed by Nigerian banks were called in.
- Depression of the capital market and drop in the quality of part of the credit extended by banks for trading in the capital market (liquidity pressures as loans not fully serviced or repaid)
- Greater loan-loss provisioning both due to capital market exposures and decline in growth of economic activities
- Potential exchange rate risks on foreign lines due to depreciation of the exchange rate
- Liquidity pressures push up domestic interest rates which if not addressed could pose systemic threat
- Global credit crunch and re-pricing of risks push up interest rates on lines of credit for Nigerian banks
- Slower growth rate of banks’ balance sheet in response to the crisis and higher provisioning, leading to lower profitability

Impact on Nigeria....

Pressure Points for Banks?

- Liquidity pressures
- Potential Toxic Assets due mainly to capital market lending
- Economic meltdown: Impact on quality and growth rate of balance sheet (higher loan-loss provisioning, lower profitability, and depletion of capital)
- Possible contagion effects of global crisis of confidence
- Exchange Rate risks
- Counter-party risks
- Challenges of frozen global capital flows, including overpriced lines of credit
- Surviving the unguarded media onslaught/de-marketing campaign

III: Responses So Far and Outcomes

- Nigeria's responses so far include:
  - Implementation of the 7- Point Agenda of Mr. President
  - Stimulus Budgeting: FGN and State Govts expect to borrow N1.6 trillion (deficit spending as in many other countries)
  - Presidential Steering Committee on the Global Economic crisis
  - Proactive measures to conserve the foreign reserves, and also allowing the exchange rate to depreciate as a shock-absorber
  - Injection of Liquidity into the banking system
  - Tightening of regulation and supervision
  - Stimulating the dormant growth reserve—agriculture–through Special Agric Fund

Responses So Far….

- **Liquidity Management**
  - reduction of the MPR from 10.25 to 9.75 per cent (below inflation rate)
  - reduction in CRR from 4.0 to 2.0 percent
  - reduction of liquidity ratio from 40.0 to 30 per cent
  - directive to banks that they have option to restructure margin loans (if necessary) until December 2009
  - expanded discount window, which allows banks to borrow for up to 360 days (currently at interest rate not exceeding 500 basis points above the MPR)
  - Suspended aggressive mop–up of liquidity since September, 2008

Responses So Far...

- ***Foreign Exchange/Exchange Rate Management***
  - Exchange rate adjustment to preserve foreign reserves
  - Reversion from Whole Sale Dutch Auction System (WDAS) to Retail Dutch Auction System (RDAS) to check speculative demand for forex
  - Introduction of a band of plus or minus 3 percent to ensure stability
  - Temporary suspension of inter-bank forex transactions
  - Restructuring of the Bureaux de Change operations--- two classes ‘A’ and ‘B’
  - Reduction in Net Open Position of banks from 20% to 1%
  - Sale of cash forex only through bank BDCs
  - Revision and enlargement of transactions that are eligible under the RDAS window

Responses So Far….

Tightening of Regulation and Supervision

- Greater emphasis on enforcement of Code of Corporate Governance
- Resident Examiners have been deployed to banks since January 2009
- Standby teams of target examiners being deployed to any bank at any time to ensure timely regulatory actions if necessary
- Review of Contingency Planning Framework for Systemic Distress in Banks
- Introduction of Credit Bureau
- Advice to banks on risk management--- extra conservatism during time of crisis--- capital conservation, cost minimization, de-emphasis on size, salaries/bonuses, etc
- Strengthening of institutional coordination through the Financial Sector Regulatory Coordinating Committee (FSRCC)

Responses So Far.... Regulation/Supervision

- Greater emphasis on e-FASS as a tool for banks' returns analysis for speedy identification of early warning signals
- Consolidated Supervision and Risk Based Supervision have been adopted and arrangements are being made to migrate from the current fragmented sub-sectoral supervision to all-inclusive financial sector supervision
  - All banks are to be examined in 2009 by consolidated teams
- Adoption of common accounting year end for all banks with effect from end-Dec. 2009, aimed at improving data integrity and comparability
- Adoption of the International Financial Reporting Standards (IFRS)
- Review of BOFIA to strengthen regulatory capacity

Responses So Far…

- Interest Rate Regime:
  - To reduce pressure on interbank rates, CBN reduced rates on Expanded Discount Window (EDW) to max. of 500 basis points above MPR effective from March 16, 2009.
  - Also as temporary measure, and to ensure that the liquidity pressures and run up to common year end do not drive banks to ‘race to the bottom’, Bankers’ committee decided to peg the maximum deposit and lending rates at 15% and 22% respectively from April 1, 2009 until end of 2009. This would also have salutary effects on the real economy.

Responses So Far…

- Confidence Building:
  - Assurances about the state of the banks and that Govt/CBN would not allow any bank to fail
  - Advice to banks to ensure greater disclosure to the public
  - Bankers Committee increasing emphasis on maintaining high ethical standards in the operations of banks: using service delivery as key instrument of competition.

Outcomes: Interbank Interest Rates and Borrowing

Date: March 2009	OBB Interest rate %	Non-collaterized Interbank %	Total Inter-bank N' billion	Expanded Discount Window (EDW) N'billion
17	9.69	30.47	26.95	nil
18	9.61	27.08	33.25	72.10
19	9.20	15.78	46.56	Nil
20	9.31	15.04	65.68	Nil
23	9.66	17.0	48.97	46.75
24	9.75	16.59	42.10	68.93
26	9.0	10.67	54.85	nil

Outcomes...

- No bank has failed or gone out of clearing
- Total outstanding borrowing on Expanded Discount Window as at March 26: N370 billion
- Banks total exposure to Capital market as at end January 2009 is N784 billion or 10% of total loans
- Banks total risk assets as at end of Feb. 2009 = N12.78 trn.
- Non-performing risk assets as at end Feb. 2009 = 4.74%
- Banks total loans as at end of Feb. 2009 = N7.8 trn
- Total Non-performing loans as percentage of total as at Feb. 28, 2009 = 6.2%
- Estimated non-performing loans as at end of December 2009 = about 7.4%

Outcomes...

- Amount banks are prepared to turn over to an Asset management company (AMCON) if such were set up by end of the year = N350– N400 billion or approx 4 – 5% of loans as at Feb. 2009
- About 15 banks would have no need for AMCON
- Of those that indicated interest in AMCON, there is hardly any for which it would threaten their solvency
- CAMELS rating of the banks as at end-December 2008, showed an average composite score of 62 per cent and average industry rating is satisfactory
- Total shareholders' fund as at end of December 2008 was N2.8 trillion
- Average capital adequacy ratio of 22 per cent, among the highest in the world

IV: Contingency Plans

Objective? No bank will fail (Avoiding the Lehman brothers' phenomenon as contagion effect of any bank failure at this time will be catastrophic for the economy)

- Strengthen CBN's contingency planning framework for systemic distress
  - Keep vigilance on early warning signals through rigorous examinations
  - If chronic liquidity problems--- provide term loans; target examination, and seek restructuring of balance sheet and management
  - If solvency problem: Could change Management, and strategic plan to recapitalize bank, including possibility of merger with/acquisition by stronger bank
- Encourage banks to strengthen/ review bank-specific contingency plans
- Reviewing the draft Asset Management Company of Nigeria (AMCON) bill--- to be established to buy up toxic assets of banks (if necessary)

V: Conclusion

- Collective Action required for the banking system to continue to survive the global shocks
- Financial System Strategy 2020 (FSS 2020) as long-term strategy to build an international financial centre and Africa's financial hub.
- Call for open and constructive dialogue on how the banks, the public, the media, the Government and monetary/regulatory authorities could help Nigeria navigate the global financial crisis.

THANK YOU FOR LISTENING