PRESS BRIEFING

Deputy Governors, Central Bank of Nigeria
Departmental Directors and Other Executive Staff,
Gentlemen of the Press,
Ladies and Gentlemen.

It is my pleasure to welcome you all to my first press briefing this year. Let me also use this occasion to thank you for your cooperation in the past year and wish you a prosperous year 2002.

2. Ladies and Gentlemen, since the CBN issued its Monetary Policy Guidelines for fiscal 2002/2003 on January 2, the print media have been inundated with comments, including editorials, by various stakeholders in the economy. We in the CBN welcome many of such comments which we assure you will be considered in fine-tuning our policies. Let me, however, use this press briefing to elucidate on some of the monetary and exchange rate policy issues, starting with some general observations.

3. Since it would be very difficult to respond to individual comments and criticism at this press briefing, I intend to broadly address the major issues raised by the public. On a general note, the concern that the release of the CBN Monetary Policy Guidelines ahead of the approval of the Federal Government Budget was premature and distortionary appears to be misplaced. Indeed, the reverse is the
case, as the early and timely release of the guidelines has helped to reduce uncertainties and speculative activities that could destabilise the financial markets and slow-down investment decisions. Moreover, the monetary programme for the year, which formed the basis for monetary and credit targets and policy measures was predicated on major variables, including real GDP growth rate, inflation rate, oil price and projected external sector balance which were mutually agreed among the Ministry of Finance, National Planning Commission and CBN. The fiscal programme that will ensure consistency with the monetary programme and achievement of the desired macroeconomic objectives has been determined and agreed upon. Accordingly, policies shall be fine-tuned when shocks to these variables occur.

4. Let me also note that the adoption of the medium-term monetary targeting framework is consistent with the Federal Government’s perspective budgeting strategy. The new approach represents a major policy strategy, which aims at freeing monetary policy implementation from the problem of time inconsistency. It will also minimise over-reaction to temporary shocks. All things being equal, the new system will promote a more orderly behaviour in the financial market.

**Review of Macroeconomic Developments in Year 2001**

5. The overall performance of the economy in fiscal 2001 was mixed. While there
was a modest improvement in real output growth, developments in the macroeconomy was less favourable. Buoyed largely by the oil and agricultural sectors, real GDP increased by a ten-year high of 4.6 per cent, compared with the 3.8 per cent growth rate recorded in fiscal 2000. On the other hand, the rate of inflation accelerated to an estimated 19.4 per cent in December 2001 from 6.9 per cent a year earlier, while the exchange rate of the naira in all segments of the market showed further depreciation. These adverse developments were largely attributable to excessive increase in money supply, with the broad money stock (M2) and narrow money (M1) growing by 29.9 and 25 per cent, respectively. The main expansionary factors were the rapid monetisation of windfall export earnings from crude oil, government deficit spending, and bank credit expansion to the public and private sectors. It is relevant to note that lodgements in the excess crude oil reserve accounts for fiscal 2000 and 2001, receipts from GSM licensing fees, and recovered looted funds were all spent within the year. Also, bank credit inspite of the tight monetary policy and high interest rates, increased by 87.8 per cent, with about 40 per cent of the increase going to government and 60 per cent to the private sector. The resultant large increase in money supply put excessive pressure on the exchange rate and domestic price level, as has earlier been highlighted.
Thrust of Monetary Policy in 2002/2003

7. Against this background, monetary policy for 2002/2003 was formulated to restore macroeconomic stability that will be supportive of a sustainable output growth.

Banks’ Capital-Base

8. Consistent with the need to ensure sound and efficient banking system, the CBN raised the minimum paid-up capital requirement from ₦500 million to ₦1.0 billion for existing banks. You will recall that the minimum specified for new banks had earlier, in fiscal 2001, been raised from ₦1.0 to ₦2.0 billion. The increases are to ensure that a bank has sufficient equity fund to finance its start-up expenses and safeguard against unanticipated developments. Equity capital must be real, not borrowed, and legally acquired. The need for enhanced competitiveness in a global market and liberalised financial environment, requires strong and adequate capital base.

9. In the context of the Basle Accord on international standard of capital adequacy, banks’ portfolio risks are explicitly incorporated in the calculation of the ratio,
with 8.0 per cent specified as the minimum required. Equity in the Basle Agreement constitutes only a part, (Tier 1), of the required capital, while the second part, (Tier 2) is made up of debt capital and general provisions. There is therefore the need to beef up the equity component in order to strengthen the base, particularly in an environment where risks are high. It is important to emphasize that equity provides better protection against failure from any source. It also has the advantage that in the event of bank failure or closure, the burden of losses falls more on equity holders than depositors or government. Indeed, strong equity-base provides more reliable and cost-effective way to reduce the frequency of bank failures. This explains why the Central Bank has continued to specify banks’ capital base inspite of its adoption of the Basle Accord on capital adequacy. Contrary to the opinion expressed in some of the comments, reliance on risk-weighted capital adequacy ratio alone is not enough to hedge against future banking crisis, especially where the equity component (Tier 1) is judged to be low in real terms.

**Small and Medium Industries Equity Investment Scheme (SMIEIS)**

10. Gentlemen of the Press, I am happy that we are making meaningful progress towards achieving the lofty goals of the Small and Medium Industries Equity Investment Scheme (SMIEIS) officially launched in August, 2001. The
fiscal authorities are concretising the President’s accent to tax concession as proposed under the Scheme. Similarly, we have received returns from some banks detailing their equity investments under the Scheme. We hope the pace of activities will accelerate this year after the initial doubts and problems have been settled.

11. Ladies and Gentlemen, a number of policy measures adopted this year is designed to promote savings and investments in order to boost output and employment growth. These initiatives include the introduction of National Savings Certificate, which has been in the pipeline for a couple of years, Rediscounting and Refinancing Facility (RRF) for medium to long-term bank credit, and removal of the embargo on foreign guarantees/currency deposits as collateral for naira loans. Let me say at the outset that these initiatives would complement rather than substitute for the stock market resources.

**National Savings Certificate (NSC)**

12. The introduction of National Savings Certificate has the potential to raise the level of domestic savings and ensure availability of loanable funds, which would eventually influence a downward movement of interest rates, contrary to the impression created that it would only drive up interest rates. It is instructive to note that at about 12 per cent of Nigeria’s GDP, our national savings rate is unacceptably low, when compared with the 27 per cent average for developing economies. While it is recognized that factors other than interest rate could influence the growth of personal savings, it is obvious that the low interest rate paid, and the
high minimum deposit required by banks for household savings by Nigerian banks constitute a major disincentive to growth in financial savings in the country. Essentially, the NSC is a savings instrument, designed to meet the time preference of various classes of savers and is intended to foster a more competitive financial environment. The savings mobilized under the scheme will be channelled to finance productive activities in the real sector, through development finance institutions and participating deposit money banks. A secondary effect is that it will help address the problem of excess liquidity on a more sustainable basis. It will in this regard, increase the size of the formal market and reduce the level of currency outside banks.

**Rediscount and Refinancing Facility (RRF)**

13. The introduction of the RRF is designed to encourage medium to long-term bank lending to the productive sectors of the economy. Currently, deposit bank lending is predominantly short-term, of less than one year maturities, to finance mainly general commerce and distributive trade. Apart from the excessive pressure which such financing exert on the foreign exchange market, consumer goods imports so financed, crowd out domestic investments and production. The facility, which is similarly implemented by the Nigerian Export-Import Bank (NEXIM) for exports financing, is supportive of the growth objective of government. The catalytic role of this facility in development financing is intended to complement, rather than compete with the capital market funding. The RRF is, therefore, not inimical to the growth of the capital market as some believed; it is a monetary policy initiative to encourage the banks to lend to the real sector, and accelerate the pace of economic recovery.
**Removal of restriction on foreign guarantees for domestic loans**

14. The need to promote foreign investment inflow into the country cannot be over-emphasized, recognising that the benefits derivable are not only in terms of financial flows, but also in the form of modern technology, entrepreneurship as well as the development of managerial and technical skills, which are presently inadequate in Nigeria. We need all the investments we can get and none should be lost because of prohibition of foreign guarantee, which provides security against loss to a local bank. It is in this context that we view the lifting of the embargo on foreign guarantees for naira loans as appropriate. The CBN, however, shares public concerns about the risk of abuses and the need for transparency. Hence, adequate safeguards have been put in place by the CBN to forestall sharp practices and ensure that beneficiaries are fit and proper borrowers engaged in genuine and productive activities in the real sector of the economy.

**Central Bank of Nigeria (CBN) Certificate**

15. The CBN Certificate introduced in February 2001, has been viewed as having the potential to drive up the cost of funds. This is largely true but inevitable in a circumstance requiring the tightening of monetary policy. We, therefore view it as a necessary and proactive measure aimed at addressing, in a sustainable manner, the problem of excess liquidity in the banking system, which is fast becoming intractable, following the sustained expansionary fiscal operations of the three tiers of government. It is important to note, however, that the CBN Certificate is a child of circumstance, not a regular or permanent financial market instrument, and its issuance will be discontinued as soon as monetary conditions improve.

16. Generally, in a market-based system, the tightening of monetary policy would initially
involve interest rate hike. This, indeed, is the price for re-establishing macroeconomic stability, without which the attainment of sustainable growth will be elusive. Once stability is established and inflation is subdued, an environment for low interest rate regime will emerge.

17. There is a general misconception that the regime of tight monetary policy is the main, if not the only, contributory factor driving up bank lending rate. Shortage of loanable funds resulting from low level of financial savings as well as high rate of inflation also influence the level of interest rates. Indeed, given the high rate of inflation and inflationary expectations in Nigeria, reported interest rates are low, if not negative, in real terms. Moreover, it is erroneously believed that the prevailing high interest rate regime is the main and only disincentive to investment in Nigeria. I would like to reiterate that it has been empirically established that, while interest rate is recognized as a factor influencing investment decision, it is by no means the only or most important factor, particularly in the Nigerian case. The poor state of physical, social, and institutional infrastructure and near absence of supportive externalities, which are taken as given in other economies, far outweigh the interest rate factor, because they drive up the cost of doing business in the country and render domestic products very uncompetitive, even in our home market.

18. Nevertheless, the CBN is not oblivious of the fact that a low interest rate regime is desirable for stimulating investment and output growth, provided that inflation is subdued and sustained at an acceptable level. Meanwhile, banks are being encouraged to devise strategies for reducing their costs and moderate their lending rates to reduce the unacceptably wide margins between savings and lending rates. With the licensing of new banks and sanitising
of existing ones, we hope that a more competitive banking environment will soon emerge, that will force down the margin.

19. The current tight monetary policy, and the attendant high interest rate is a challenge to the capital market in Nigeria. If it is true that money market instruments with high yield will attract resources from the capital market, it must be appreciated that such resources if applied in the stock market will only, except new securities are made available, result in price increases of the existing equity securities in the stock market without any corresponding increase in the production level of the economy. On the other hand the high bank lending rates should discourage borrowing from the banks and encourage new and existing quoted companies to seek long term stable resources in terms of equity from the capital market. The growth of the stock market will be in terms of more securities being made available to the stock market. New companies seeking quotation and existing ones asking for funds to finance expansion or refinance expensive funds from the banking system have recourse to the stock market. In other words, encouraging new subscriptions, especially those quoted by viable enterprises, equity investment in the stock exchange is of importance particularly in the current Nigerian situation as such investment is known to be a strong hedge against inflation.

Banking Soundness and Monetary Policy

20. Ladies and Gentlemen, let me reiterate that a sound banking system is central to effective conduct of monetary policy and economic prosperity. Indeed, banking is a public good in which official intervention is justified. In this regard, the strengthening of prudential regulations and supervisory framework for banks are very important to ensure that banks are
adequately capitalized and restructured financially to ensure their solvency, liquidity and profitability in order to bolster public confidence in them. This is a responsibility, which the CBN, as a regulatory and supervisory authority must accept if the distress of the 1990s in the banking system is to be avoided.

21. In this endeavour, efforts of the regulatory and supervisory authorities should be reinforced by individual banks’ internal governance and market discipline. If regulation and supervisory guidance are flagrantly ignored and internal governance is weak, the incidence of failure may be difficult to avoid. In the word of Michel Camdessus, former Managing Director of IMF speaking on the role of the supervisory authorities in the maintenance of banking soundness, “they should make sure that banks are operated in a prudent manner by fit and proper owners and managers; that risks are managed professionally; that prudent norms regarding self-dealing and risk exposures are adhered to; that deviations from sound banking practices are promptly corrected; and that failing banks exit the market before their capital has been exhausted. Indeed, the objective of supervisors should not be to keep a problem bank alive, but rather to initiate an early, orderly, and efficient exit when banks become severely undercapitalized.”

22. As I had earlier said, the CBN will strive to avoid bunching of failed banks. therefore, as soon as any bank is seen to be irredeemably under-capitalised and there is little hope that the management will be able to redress the situation, the CBN will not hesitate to see such a bank out of the system. I will therefore remark that in the case of Savanah Bank, though action was delayed to give enough opportunity to the management and the owners to turn the bank around, the action taken has been timely, and we are confident that the depositors are likely
to get their deposits back. As the Managing Director of NDIC has said, immediate arrangement will be made to pay the insured depositors and others will be paid as soon as the assets of the bank, are realised. We shall do this with minimum delay and inconvenience to the depositors.

23. In a competitive environment, it is inevitable that there will be some failures. There must be free entry and exit. The inefficient ones must be made to exit with minimum damage to the banking system.

24. In conclusion, I must say that fiscal 2002 will be a most challenging year in Nigeria for monetary policy, in view of the:-

(i) dwindling revenue of Government, due to declining oil price and production levels with little or no savings from the past to cushion the decline;

(ii) substantial increase in recurrent expenditure driven by inflation and wage increases; and

(iii) exigencies of an election year, with the temptation for various tiers of government to show performance.

Government will be strongly advised to show restraint and ensure fiscal prudence because monetary policy will remain non-accommodating. The CBN will continue to take all needed steps that will be required to promote monetary and financial stability. The key to macroeconomic stability is that all tiers of government should live within their resources. This can lead to a reinforcing cycle of improvements. If governments spend less, and more efficiently, there will be greater cost effectiveness and greater productivity, there will be less pressure on the financial sector, inflation rate will decelerate and interest rate will fall and outlay on government domestic debt service will reduce. This is difficult, but it is the
reasonable thing to do.

25. I thank you all for your attention.

Chief (Dr.) J. O. Sanusi  
Governor,  
Central Bank of Nigeria  
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