THE GLOBAL ECONOMIC CRISIS: IMPLICATIONS IN NIGERIA

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ABSTRACT

The global economic crisis which the whole world has been witnessing in the past few years now has taken a toll on Nigeria and Nigerians. This paper examined the implications of the global crisis on Nigeria and suggests few steps to be taken to ameliorate the effects on the citizens. It also studied the steps the Federal government has taken so far to reduce the impact on the economy and the society at large most importantly, the paper highlighted the need for Nigeria to diversify its economy and look more inward into other solid minerals deposits development and agriculture so as to remove herself from the over dependence on oil.
Keywords: *Global economy, crisis, Nigeria*

INTRODUCTION

Economic crisis is a time of difficulty, danger or anxiety about the future of economics of the government policy of a country/nation. Likewise, the Global economic crisis is a time of difficulty, danger or anxiety about the future of economics of the government policy of the world usually measured or calculated with the economic policy of the United States of America (USA). The major relationship between the Economic crisis and the Global Economic Crisis is that both are directly concerned with a time of difficulty, danger or anxiety about the future of economics of the government policy.

However, while the Economic crisis deals with a time of difficulty, danger or anxiety about the future of economics of the government policy of one nation state, the Global economic crisis deals with a time of difficulty, danger or anxiety about the future economy of the government policy of the entire world or the universe. That the turmoil in the global economy has taken a toll on the Nigerian economy is no longer a matter of contention. The crisis, which has ravaged many economics around the world has caused noticeable imbalance in Nigeria. Besides depleting the country's external reserves, it has led substantially to the crash of the stock market, the erosion of the country's revenue by over 60 percent and the depreciation of the national currency, among others

The instability and high exchange rate of the naira has been particularly worrisome since November, 2008, when its value began to slide against the United State's dollar. Throughout 2007 and most of 2008, the country accumulated huge reserves owing to a large inflow of foreign exchange, which further strengthened the naira. The national currency has since depreciated sharply by over 30 percent, from N118 to N154 to the dollar, prompting the Central Bank of Nigeria, CBN, to reintroduce the Retail Dutch Auction System, RDAS, among other measures aimed at stabilizing it. Recently, the currency appreciated to about N145 to the dollar at the official market, but was still sold for about N152 to a dollar at the parallel market.

Chukwuma Soludo, former Governor of CBN has attributed the pressure on the exchange rate to the fall in the price of crude oil, from a peak of \$147 a barrel attained last July 2008 to about \$34 per barrel in recent months and de-accumulation of foreign reserves, resulting from the decline in oil price. He also identified other factors as declining capital inflow in the economy in the areas of foreign direct investment, FDI and other remittances as well as drying up of credit lines to indigenous banks and the high import dependence of the economy (Tell Magazine, February 23, 2009, pp.42-43)

At a recent forum organized by Access Bank, policymakers, regulators, economists, investment analysts and other stakeholders also examined the global economic crisis and its impact on Nigeria's economies especially as regards the foreign exchange situation. Aigoje Aigimoukhuede, chief executive officer, CEO, Access Bank, said the forum was meant to provide a possible solution to the problem and adequate information to major stakeholders like depositors, shareholders and foreign exchange end-users on the dynamics of the foreign exchange market, in order to guide them in making informed business and investment decisions. Bismarck Rewane, an economist, and CEO, Financial Derivatives Company Limited predicted at the forum that lower commodity prices, a declining world trade volume, higher inflation, reduced capital inflows and cutbacks in foreign aids would combine to weaken currencies of most African countries this year, adding that Diaspora in-flow of forex, which peaked at \$2 billion would decline by 30 percent.

Canvassing, similar views, Ashok Bhundia of Goldman Sachs international, observes that Nigeria's declining crude production level, which is far below its Organization of Petroleum Exporting Countries, OPEC, quota, and the Niger Delta crisis have combined to impact negatively on the forex situation in terms of the amount of foreign capital flowing into the country. It is believed that the lesser that foreign capital inflow into the country, the greater the pressure on the national currency. The fluctuation in the value of the naira has put many business and investment plans in disarray. And for an import dependent country like Nigeria, it is feared that it would further tilt the price scale of goods and services upwards. Already, import-dependent manufacturers and other end users of foreign currencies are groaning under the yoke of a weakening naira, which has caused disequilibrium in the system. There are concerns that the situation could get worse if urgent measures are not taken to halt the slide (Tell Magazine, February 23, 2009, p. 43)

Worrisome also is the prevailing inflation rate. Before the global crisis, the country had attained a single digit inflation rate. From an average of 17.8 percent in 2005, the inflations rate had dropped to N5.2 percent in 2007 and remained at a single digit up to May 2008 as at December 2008, the rate had risen to 15.1 percent. Explaining the situation, Soludo says, "The financial crisis was preceded by the global food crisis, which also pushed up the foods prices here in Nigeria to the extent that the single digit inflation we have achieved since 2006 up to the second half of 2008 gave way to double digit". With rising inflation rate, exchange rate continues to depreciate, while the interest rates, both lending and deposit, also go on upward trend, with their attendant negative impact on the real sector.

The economic situation appears gloomy and has put government on edge, especially in the last few months. But despite this, there is a growing conviction that although the economy may weaken the country is not likely to experience a recession as feared. A recession has been described as a broad-based decline in Gross Domestic Product (GDP) that lasts for several months. Analysts submit that recession usually bring inflation down as there is usually less demand for goods and services. But Nigeria is said to have a huge potential in the longer term, with its population of 140 million people representing a ready market for the consumption of goods and services. This, perhaps, explains the apex bank boss' declaration that the developing countries, including Nigeria, will come out better than the developed world in the global crisis (Tell Magazine, February 23, 2009 pp.43 and 44).

CAUSES OF THE GLOBAL ECONOMIC CRISIS

Okonjo-Iweala (2009) submitted that, "Nigeria has been hit by the global economic crisis together with developed and developing countries all over the world. We are used to crises erupting in the developing world, with their local contagion effects, as in East Asia in 1997-98. We also have a good idea of how to manage such crises. But this crisis originated with the subprime mortgage meltdown in the richest country in the world, the United

States of America, and has spread like wildfire via complex and poorly understood financial linkages. The effects of the inevitable output decline in the rich countries as credit markets froze are now being transmitted all over the globe via trade linkages. This had led to rising inventories of unsold goods and massive job losses all over the world. The US itself lost 2.6 million jobs last year 2008, the worst job loss record since 1945. Commodity prices, including oil, have fallen precipitously although food prices remain high in many poor countries, adding to their woes, and for the first time since 1982, world trade is expected to shrink this year, 2009.

For Nigeria, the crisis is a huge challenge; but embedded in that challenge is an opportunity to reposition the economy in a way which would reduce its overwhelming dependence on oil and create a diversified springboard for steadier long-run growth and job creation once the crisis abates. What led to the global crises through which for developing countries has been manifested in the four "fs" food, fertilizer, fuel and financial challenges are discussed in four perspectives.

The first is the idea that an insufficiency of aggregate demand has enveloped the world. Proponents of this view have pointed to the massive shift of income and wealth towards the top quintile in the rich countries especially in the US but also in Western Europe and Japan since 1980. Rich people tend to save more than the less rich, leading to a secular decline in aggregate demand. This was compounded by the fall in house prices in the US, which began in the summer of 2006 leading eventually to the subprime crisis. The negative wealth impact led to a fall in consumption and aggregate demand as the US consumer of last resort was able to borrow less. For the first time since 1970, the earliest year for which global numbers are available, real global GDP is expected to decline this year. It has become fashionable to say, "we are all Keynesians now", a quote attributed to President Nixon in 1971, as large fiscal stimulus packages are hastily being assembled in the US and other rich countries. But we know that the current recession was preceded by years of large current account deficits in US, with private savings dropping to low levels and public savings being eroded by the Iraq war, among other factors. This brings me to the second explanation; that of global imbalances.

Second is the global imbalance, the idea here is that no country, not even the US, can pile on current account deficits year-after-year financed by the rest of the world without a blow up at some point. What is the solution? One controversial proposal is that if China allowed its currency to sharply revalue, this would solve the problem; but there is not a consensus on this. The retort is that if the Chinese revalued the renminbi, then the US would have run current account deficits in relation to other countries because the fundamental problem was that US households were simply spending too much. Whatever the solution, the question we have to ask is whether we can go back to a regime of large US current account deficits once the crisis subsides. My guess is that the answer is probably no, although there may be a strong proclivity towards this in view of the third explanation, put forward by Richardo Cabaliero, an MIT Economic Professor: that there is an insufficient supply of safe asset in the world.

Thirdly, insufficient supply of safe assets; global saving has risen as population age of countries like China and India ramp up savings in pursuit of higher investment and growth. Some of this spills over into current account surpluses. Similarly one and other commodity exporters need a place to pay their savings. The US pretty much has a monopoly of safe, long term asset, US treasuries and so the savings tend to flow to the US, lowering interest rate and fueling US aggregate demand. Hence, addressing global imbalances in the shape of persistence current account deficits in the US may call for new funds of global insurance.

The fourth explanation, which would favour combined element of the three principles centers on the financial system. This would say that low global interest rate after 9/11 catalyzed a search for high returns. In US this leads to a situation where risk was price too low, leading to a lowering of lending standard on the sowing the seeds of the subprime mortgage crisis. This crisis is frightening in that it is a perfect storm caused by everything that could possibly go wrong with the modern-day financial system: credit rating agencies which did not do their job; executive compensation structures, including the giant mortgage Government Sponsored Entities, Fannie Mae and Fredddie Mac, which shorten horizons and encouraged excessive risk-taking; financial innovation and globalization, which enabled originators to lay off the risk by securitizing the subprime loans they made and selling them, complex loans they made and leading to a proliferation of toxic assets in the shape of asset-backed securities; outright fraud in the shape of teaser interest rates, complex loan products and imprudently high loan-to-value rations; and a relaxation of regulatory stringency in the mistaken belief that it was in the interest of the large financial institutions to self-regulate even as special investment vehicles contributed to opacity in financial dealings by taking risky transaction off-balance sheet. And now, as fiscal stimulus and bailout packages are put together in the US and rich countries, the problem of moral hazard and rising public indebtedness must also be dealt with. This is an opportunity to draw these parallels for Nigeria.

First even though we can't know exactly when the crisis will end, we can be reasonably sure that exiting it will require a one-two punch: sharing up the financial system to ensure credit flows even as fiscal policy is geared towards raising aggregate demand. The chairman of the Board of Governors of the Federal Reserve System of the US, Ben Bernanke, noted in a recent speech at the London School of Economics that believe that fiscal actions would lead to a lasting recovery without getting the financial system in order. For Nigeria, this means ensuring those banks and the financial systems stay robust even as drawdowns are made from the 'excess crude account' to enable an affordable fiscal stimulus.

Second, the global question of whether we can simply return to the status quo ante after this crisis with its implications not just for global imbalances but also soaring food and fuel prices and concerns about the impact of rapid global growth on climate change, has its echo in Nigeria: Can we place all our trust in oil or should we take steps to diversify our economy? Fortunately, this question is easier to answer for Nigeria than for the world! The answer is that Nigeria must take steps to diversify its economy as part of its response to the current crisis. And the good news is that it has several important strengths which would facilitate this process, including low external and public debt, high reserves and above all, a measure of policy credibility which must be preserved and nurtured.

Third, it means drawing lessons from the global financial crisis for better regulation and supervision of banks and the broader financial system as we look to the future.

IMPACT OF GLOBAL ECONOMIC CRISIS ON NIGERIA

Nigeria is being affected by the global financial crisis through the familiar channels of the labour market and remittances. FDI; and commodity markets, the oil price in particular. Direct financial links with the rest of the world are limited and therefore likely to exact a smaller toll. Let me take each channel in turn.

Labour market and remittances: Employment consequences of the crisis are hard to predict: formal wage employment in the private sector is only about 2 percent of the labour force with another 8 percent in public service. Most Nigerian workers are employed as casual labourers in agriculture or the informal urban sector. The Information and Communications Technology (ICT) and financial services sectors have continued to post strong profits and there is no indication yet what might happen to jobs in these sectors. Remittances rose from $1.3 billion to $3.5 billion in 2005, and have subsequently remained stable at this level, although they are expected to fall over the next two years. This will have an adverse impact on consumption, especially in rural areas, as well as investment in SMEs. Many households in Nigeria have family members abroad and their remittances pay for everything from school fees and health expenditure to house construction and investments in small businesses.

FDI and capital flows: Net FDI more than doubled from an annual average of around $3 billion over 2001-2004 o $7.25 billion over 2005-2007; it dropped to $4.7 billion in 2008 and is projected to decline in 2009 and 2010. The bulk of FDI goes into oil and gas, banking and telecoms, so a sharp slowdown should not be surprising.

Commodity markets: With negligible non-oil exports, the main external effects of the global crisis are not surprisingly going to be transmitted to Nigeria through the oil price. Oil and gas have stranglehold on both merchandise exports and fiscal revenues, which has remained steady over time, as shown in the table below.

Table 1: Predominance of Oil in Nigeria's Economy

	1990	2000	2008	2009
Oil as % of total GDP	37.5	47.7	36.3	26.4
Oil/gas as % of total exports	95.5	97.2	98.8	98.2
Oil/ gas as % of total revenues	82.8	82.8	82.4	72.7

Source: World Bank staff estimates: projections for 2009

Assuming a production rate of 2.1million barrels of oil per day, a $10 per barrel fall in the oil price would lower exports by about $7.7 billion and fiscal revenues by approximately $6.2 billion. In contrast, the sum of FDI and remittances is expected to fall to around $6 billion in 2009 from %8.2 billion in 2008, a drop of some $2 billion. Thus, from a balance-of-payments perspective, a $10 per barrel drop in the oil price has thrice the impact of the drop in FDI and remittances combined! Now consider that oil prices averaged $97 per barrel in 2008 and are forecast to average $50 per barrel in 2009 a stunning drop of $47 per barrel, and it is easy to see that source of impact on Nigeria as a result of the global crisis. This $47 drop in the oil price is the equivalent of approximately 18 percent of 2009 GDP in revenues! If in addition oil production falls below the level of 2.2 million barrels per day assumed for the 2009 very recently, the IMF World Economic Outlook oil price forecast itself has been lowered from $50 to $44 per barrel.

Managing the fiscal and balance-of-payments consequences of the oil price collapse is therefore going to be an immense challenge for Nigeria. However, it is not the sole challenges. The banking sector is also facing difficulties. And as a result of slowing credit growth and the large oil price decline, which will place limits on public spending non-oil GDP growth is projected to slow to 4 percent over 2009 and 2010 compared to 9.5 percent in 2007 and 7.7 percent in 2008. Against this background, the macroeconomic policy response to the economic crisis and the financial system are discussed.

NIGERIA'S RESPONSE TO THE CRISIS

Responding to the Oil Price Collapse: The oil price collapse is by far the biggest component of the external shock that has hit Nigeria. Policy makers face two challenges: (i) how to respond to the down-cycle of oil prices: and (ii) how to ensure that the economy emerges stronger and more diversified after the crisis ends. In particular, what should be done in continued pursuit of a foundation for sustained long-run growth and economic diversification? The two main vehicles for responding are fiscal and exchange rate/monetary policy. But first let me emphasize that priority numero uno at this point is to engender confidence, in the public as well as investors in the real and financial sectors. The message must be strongly conveyed that there is coherence across fiscal, monetary, exchange rate and financial sector policies and that the government is wedded to transparency and good governance, the principles of (a) emphasizes Nigeria's macroeconomic strengths, both on fiscal fundamentals and low indebtedness as well as its high reserves cushion and rainy day' funds in the form of the excess crude account'. (b) acknowledge and learn from past mistakes and avoid repeating them, (c) deflect attention from the near-obsession with the spot naira/dollar rate. A healthy dose of realism would indicate that, like for other commodity exporters, a depreciation of the currency is not so unusual given the size of the external shock: a depreciation may be desirable to avoid running down reserves or developing an unsustainable current account position, the key issue is how the CBN gives direction on exchange rate policy and manages the situation.

Fiscal Policy Responses: A good starting point for crafting policy response is Nigeria's own past experience. As a result of tying government spending to current oil revenues and running large fiscal deficits during the oil boom years of the 1970s, Nigeria became one of the most volatile countries in the world over 1960-2000 in terms of output, real exchange rate and the terms-of-trade. To make matter worse, Nigeria had developed an external debt overhang by the mid-1980's which would have deterred even, profitable private investment because of the resulting macroeconomic uncertainty and the fear that the profits would be taxed away to service the debt.

It is not hard to imagine that the combination of high volatility and a debt overhang would have seriously hurt the investment climate, intensifying oil dependence. Looked at this from this lens, the adoption of the oil price-based fiscal rule (which delinks government spending agreement with the Paris Club debt of $30 billion) must both be seen as historic accomplishments. The oil price rule helped dampen the transmission oil price volatility to the rest of the economy while also permitting reserves and excess crude to be built up. The Paris Club debt agreement (facilitated by the savings related to the oil price-based fiscal rule, as oil prices were consistently above reference prices for 2004-2008) eliminated the debt overhang. The improvement in credit worthiness showed up in the sovereign credit ratings Nigeria subsequently received and provided a sound basis for attracting both domestic and foreign investments into the country prior to this crisis.

Fiscal policy reform and relative stability improved the investment climate, with the reduction in volatility helped the non-oil sector. Non oil GDP, agriculture in particular has been growing impressively since 2004 in sharp contrast to its dismal performance over the 1980s and 1990s and was an important driver of growth over 2004-2007 as shown on Table 2.

Table 2: Contribution to Non-Oil Growth

	(in percent)			
	2004	2005	2006	2007
Agriculture	46.7	45.3	42.8	40.6
Solid Mineral	0.5	0.4	0.4	0.4
Manufacturing	6.3	5.5	5.0	4.5
Telecommunication & post	5.0	5.5	5.0	4.5
Finance & Insurance	2.0	1.8	2.8	3.1
Wholesale and Retail Trade	21.3	27.3	29.4	29.4
Building and Construction	2.5	2.7	2.8	3.0
Others	15.7	11.3	10.0	10.1
Memo: Non-oil GDP growth (%)	13.2	8.6	9.4	9.5

Source: Employment and Growth in Nigeria, World Bank Staff draft note, 2009.

Wholesale and retail trade, telecom and manufacturing have been next in line. Analysis by World Bank staff indicates that the key features of Nigeria's growth performances since 2001 are the followings:

(a) 70 percent of growth can be explained by agriculture and wholesale and retail trade.

(b) Relatively new sectors, such as construction, the financial sector, telecommunications and ICT have initiated a structural shift towards the services sector.

(c) Macroeconomics and structural reforms have spurred confidence, boosting FDI and remittances, raising aggregate demand and private investment.

(d) Growth has largely resulted from factor accumulation. In particular, agricultural productivity has stagnated, with growth coming largely from increased land use.

The last point is worrisome in spite of being the 'engine' of non-oil growth, productivity in agriculture has stagnated; lack of economic diversification, including the concentrated export and tax boxes, remains a serious source of macroeconomic vulnerability. Can fiscal policy help? But now for the first time since the adoption of the oil-price based fiscal rule in 2004, actual oil prices could fall below the $45 per barrel budget reference price for 2009, the government is going to have to draw upon the 'excess crude' account, (ECA) this year and very likely next year as well.

Three principles should guide the use of funds from the ECA, first, this is the right time to the use ECA money. The reason for setting up the ECA was precisely for a rainy day like this, when oil prices fall below the average level one might expect will prevail over time. Second, use ECA money wisely to spur long-run growth and diversification. Since oil revenues are the counterpart of the depletion of a non-renewable asset, ECA funds should ideally be used in the creation of assets such as infrastructure investments, which could support long-run non-oil growth as well as the economic diversification. This is where the composition of government spending comes into play. Dipping into the investment projects especially those which alleviate constraints to private investment in the non-oil sector would be good for diversification while also providing a fiscal stimulus at this time of crisis.

An example is the $5.3 billion investment envisaged in the Nigerian Integrated Power Project which will make a difference provided it goes into the designated activity. Investments in human capital would also help; these will take time to yield visible returns but are an essential under-planning of diversified long-run growth. A World Bank study is being done on employment and growth. Its strategy is to focus on sectors which are already growing and look for ways to make them grow even faster. The sectors include ICT, construction, food processing, wholesale and retail trade. Agriculture could also be given support to R & D to boost productivity help with poverty alleviation.

The effectiveness of fiscal policy in spurring non-oil growth and diversification will be greatly enhanced if combined with regulatory reform. Let me illustrate this with an example: As you know, Nigeria is ranked 108 out of 178 countries globally by Doing Business. The National Economic Summit Group, supported by the World Bank and IFC, did a pilot Doing Business exercise in 2008 covering eleven Nigerian states and the FCT. Here is something astounding. If one were to take the best score on each of the ranking criteria from the surveyed states and aggregate these, the imaginary country thus created would be ranked 51, alongside the likes of Taiwan, Italy, Kuwait and Botswana. The lesson is clear: major progress can be made simply by learning from each other at home. A good example is that the cost of a construction permit for a warehouse is 25 percent of per capita income and takes 46 days in Sokoto, 4th best in the world!

Third, look ahead on fiscal policy and budgetary management. There is currently $20 billion in the excess crude account (ECA). According to the rules, I trillion naira (about $6.7 billion at prevailing exchanging rates) must remain in the account. This leaves about $13.3 billion to cushion shocks, provide projects a deficits of a little over 3 percent of GDP at a reference oil price of $45 per barrel. However, it is likely that the fiscal deficit of the consolidated government (the federal plus the states) will be higher, in view of the least, much lower oil price forecast of $44 per barrel for 2009. Thus, drawing upon the ECA as a financing source is going to be unavailable this year. However, one must provide for the contingency that oil prices could be low in 2010 as well. This needs to be addressed transparently and decisively by formulating a 2-year fiscal plan to take into account the possibility that the ECA may need to be drawn upon in 2010 as well.

Once again, the past provides a good starting point when oil prices collapsed instead of letting the naira depreciate. This had two pernicious effects: (1) a high parallel market premium emerged which served as a ruinous implicit tax on agricultural and manufacturing output and exports. Over time, this intensified oil dependence; and (ii) it gave an impetus to rent-seeking and corruption because those who got import licenses at the official exchange rate made a lot of easy money.

The process has been managed far better this time around although some problems have appeared. This is what has happened so far. FX reserves (which include excess crude of approx $20bn) fell from $26 at end of August 209 to about $57 billion in December 2009 and then to a little under $50 billion in February 2010. The naira/dollar rate was kept at about 117 (its level when oil prices were at their peak in July) until close to the end of November in spite of the sharp fall in oil prices. As a result, CBN lost rest reserves defending exchange rate but also because portfolio investment were exiting.

The naira was allowed to depreciate at the end of November. Subsequently, CBN restricted FX sales in banks net open FX positions and made a decision to discontinue interbank trading should the naira depreciate by more that 5 percent on any one day. The naira dropped to a low of 161 per dollar around January 10, 2010. January 19, 2010, the wholesale Dutch auction system (WDAS) was suspended with a reversion to the retail Dutch auction system which preceded it (RDAS) effectively short-circuiting the interbank market. FX is being offered only for eligible goods and the limit on net open FX positions for commercial banks was reduced further.

Subsequently, further restrictions have been placed on the net open positions of banks. The naira is now at about 147 per dollar but with a significant parallel market premium. What should be done about exchange rate policy? Let me point to a key decision and a key objective. The key decision is how much reserve to use up in defending the naira. Depreciation is evitable given the magnitude of the fall in oil prices and in fact the naira has depreciated by some 25 percent since August 208. In further depreciation happens, it is better to let it occur in an orderly manner instead of using up precious reserves, with CBN providing guidance to the market. Take the case of Russia, which had also accumulated reserves and fiscal savings during the recent oil boom period. It has a little over a third of its reserves since the end of August 2008, approximately $200 billion, a significant part of which was used in defending the ruble. Eventually, the Central Bank of Russia has let the ruble depreciate. It is now trading around 36 per dollar, a 3-year low and a depreciation of more than 45 percent since the end of August 2008. Russia is not alone in having seem its currency depreciate rapidly as the oil price fell. The currency of another oil exporter, Kazakhstan, has dropped by 26 percent against the dollar since last August. And over this period, other major emerging markets have also witnessed large depreciations of their exchange rates against the dollar: Brazil, Korea and Mexico over 40 percent; Indonesia and South Africa a little over 30 percent; and India 17 percent.

The key objective should be to prevent the re-emergence of a parallel market by removing the restrictions on the interbank market. Multiple exchanges rates with a high premium on the parallel market will only serve to distory foreign exchange allocation by creating an incentive for rent-seeking and finding innovative ways of profiting from the premium. The consolidation of excess crude into general foreign exchanges reserves might also be worthy addressing. With excess crude now included in FX reserves, drawing upon it for fiscal reasons might give the impression that reserves are shrinking and fuel panic. Though could be given to separating FX reserves from ECA. This highlights the need for a joint communications strategy on both fiscal and exchanges rate policy to give the market the needed guidance.

Nigeria Banks reform: A wave of reform and consolidation reduced the number of Nigerian banks from 86 in 2006 to 25 in 2008, which greatly strengthened capital positions. Financial soundness was bolstered by the reforms, as shown in Table 3, which compares Nigeria to other emerging market countries. Nigeria's capital adequacy ratio (CAR) was second only to Indonesia's although its share of non-performing loans (NPLs) was on the high side with relatively low provisions.

Table 3: Financial soundness indicators for 2007

Country	CAR %	NPL/Total Loans %	Provision/NPLS %	ROA	ROE
Brazil	18.4	3.1			
Ghana	15.8	7.9	182.4	2.7	27.8
Indonesia	21.3	10.9	n.a.	4.3	24.2
Malaysia	13.5	6.6	62.6	1.4	n.a.
Nigeria	18.6	7.7	59.5	1.8	13.8
South Africa	12.2	1.2	n.a.	1.4	18.4

Source: 2007 IMF GFSR.

Notes: CAR capital adequacy ratio: NPL: non-performing loans: ROA: return on assets: ROE: return on equity.

A period of explosive growth followed the 2005 consolidation between June 2006 and June 2008, the number of branches grew by 54 percent, the numbers of deposit accounts by 39 percent and total loans and advances by 60 percent in 2007 and another 90 percent in 2008, reflected in the growing wedge between total assets and deposits in 2006 and 2007 (Table 3). We know from experience that such a rapid credit growth; Nigerian banks have largely avoided two problems which amplified the vulnerability to a banking crisis in other countries.

The first problems Nigeria avoided is a rapid increase in private external borrowing by banks, which then on-lend in dollars but to businesses which are not in the export sector, then a currency mismatch would develop on the balance sheet of the borrower. And if banks on-lends in domestic currency, the mismatch would appear on the balance sheet of the bank itself. This would make either the bank or its clients vulnerable to large depreciations in the exchange rate such as have occurred throughout emerging market and low-income countries as the global financial crisis intensified. For example, if as in the case of Hungry, people were given bank loans in Swiss francs to buy houses, the burden of these loans would rise with the depreciation of the forint or if house prices fell, or both.

Nigeria's banking situation is thus relatively solid as it has managed to avoid the twin complications of burgeoning private external debt and currency mismatches. However, its banking system is not without challenges.

External banking supervision and upgrading the commercial banks' own internal risk management and accounting system have not kept pace with the rapid growth of credit. The fastest growing sectors of bank loans has been for finance and insurance and a vaguely-defined general' category, which accounted for some 35 percent of total loans by June 2008; combined with finance and insurance, the share was 50 percent.

Credit has gone into so-called margin lending for buying stocks. The Director-General of the Securities and Exchange Commission and recently that the amount of such lending amounted to some N388 billion. In principle, this is an eminently manageable number; it is the equivalent of $2.6 billion, and accounts for 5.2 percent of the private sector and approximately 1.6 percent of 2009 GDP. A more recent interview with the Governor of the Central Bank reported in the Financial Times on March 5 notes that the exposure of Nigeria banks to the stock market is a much higher N900 billion; but the Governor also notes that even if all this were to be written off, capital adequacy would still be a healthy 15 percent. They key at this stage from an impact perspective is how this number is distributed across banks and whether additional amounts may be at stake. Two questions arise against the preceding background: First, what should be done immediately to help the banks? Second, what needs to be done over the longer term to enhance the resilience of the banks and in pursuit of the goal of the financial system strategy FSS 2020 to establish Nigeria as an international financial center?

Some proposals have already been floated on what should be done to help the banks weather the current storm; including creating a state backed Asset Management Company to buy bad loans. Any such move should be preceded by a transparent face; without this, funds could be misused and the Nigerian government could end up with a big increase in public debt with minimal social benefits. If banks are seen to go scot-free in spite of making ill-advised loans, this would reinforce moral hazard and create incentives to do the same again in the future. The lessons from East Asia and even during the early months of the Troubled Assets relief Program in the US wherein some 300 billion dollars of public funds have been spent without restoring confidence are clear; determine the size of the problem transparently; don't confuse insolvency with illiquidity and don't put money into insolvent financial institutions; don't bailout shareholders not especially in a country, with Nigeria's income level. Fortunately, the balance sheets of Nigeria banks are unlikely to be interlinked via complex derivative (Such as credit default swaps) and it should be possible to isolate banking sector problems.

On the theme of transparency, two questions need clear answers, what has happened to the value of capital and capital adequacy in view of the big fall in share prices over the pasty few months?

What is the outlook for Non-performing Loans?

- The recent credit spurt has been concentrated in the corporate sector especially in oil, gas and telecom. In oil and gas, a significant amount of loans has been extended to second-and third-tier suppliers of goods and services, who will be hit first as oil prices decline and the pace of exploration slow.
- Banks have either expanded or are planning to expand into relatively new sectors such as retail banking SME finance and infrastructure, where their experience is limited.
- Banks are also exposed to the recent sharp decline in the Nigeria Stock market via loans to their own or independent capital market intermediaries. At the same time, loans made to corporate and retail customers for 'general' purposes may have been channeled into share purchases.
- Banks may have lent to state governments which may not be fully able to service their loans and this bears monitoring.

Thus, while Nigerians banks have avoided the vulnerable combination of burgeoning private external debt and currency mismatches and have concentrated their lending to corporate rather than households, the above factors suggest that the risk of deteriorating loan quality in the near term needs to be carefully monitored. Looking forward, what are the priorities for maintaining the resilience of the bank? As you well know, transparency and confidence are the cornerstones of finance, and a healthy banking system and financial sector are essential for the smooth functioning of any economy. We are now learning from the global financial crisis that supervision and regulation even for the most sophisticated financial systems, the US being a prime example, are in constant need of review and upgrading. Financial innovation which is accomplished by opacity and inadequate regulation could lead to a disaster. The Nigerian financial system is relatively young and considerably simpler and this is the time to lay the groundwork for sound supervision and regulation. Here are some suggestions:

Nigeria needs to adopt rather than adapt international Financial Reporting Standard (IFRS). This would facilitate the Financial System Strategy FSS 2020 objective of transforming Nigeria into an international financial center. As part of this process, bank supervisors will need to ensure that regulation conforms to IFRS and that bank inspectors are trained in the application of IFRS. This is a process that could take 3-5 years and needs to start now.

The conglomerate structure of Nigeria banks might have contributed to opacity. It is important that bank supervisors in Nigeria get a complete picture of the consolidated balance sheets and exposures of the banks. The idea of creating a new financial supervisory authority has been raised. This is something that needs to be looked at cautiously in the light of international experiences, which my Bank colleagues can share. Whatever decision is made in this regard, it is critical that CBN play a crucial and central role, because of the fact that Nigeria financial system is likely to be bank dominated in the years to come and the need to factor in monetary policy. Nevertheless, CBN would need to concentrate on its core supervisory and monetary policy functions.

One lesson for the future inspired by margin lending for stacks is that it might be necessary to have restrictions on the volume of loans for such purposes as well as enhanced provisioning in view of the volatility of stock markets. Likewise, with Nigerian banks still well-capitalized, this might be a good time to think of upper limits on leverage (debt-to-equity rations) for banks as well as minimum liquidity requirements as is now being recommended for US banks to avoid a dangerous fire sale of assets in the event of a sharp downturn. This may not be a hugely pressing issue for Nigeria now, but given the inevitable boom-bust cycles associated with the oil price, this is a good time to think of such precautionary measures.

Now that the banking system has undergone a consolidation process, it is important to identify systematically significant banks and financial institutions and subject these to special scrutiny. This is one of the lessons emerging from the subprime crisis in the US. The Congressional Oversight Panel set up under the "Emergency Economic Stabilization Act of 2008" to provide guidance on regulatory reform as well as monitor the use of funds spent to shore up the financial system has recommended that systematically important institutions namely, those deemed 'too big to fall' when a crisis hits, be identified in advance and subjected to heightened regulatory requirements.

Thus, looking ahead, Nigeria's relatively young banking system would benefit from a two-pronged approach: first, ensuring that the basic infrastructure for accounting, financial reporting, regulation, collateral registration and credit rating is upgrade and established; and second, preparing for the next oil boom to avoid mistakes such as those which occurred in emerging market such as Kazakhstan or in the much advanced industrial countries (Economic Confidential Magazine, April 2009, pp 20, 21, 30, 31, 39-44.)

CONCLUSION

Much is riding on how Nigeria responds to the impact of the global financial crisis, given its status as a regional player, which accounts for 60 percent of West African GDP, and its aspirations of being an international player. Nigeria has distinct economic strengths, unlike in the 1980s: public and external debts are both low, reserves are high and the budget has been managed reasonably well since 2004. The 2003-2006 fiscal reforms paid off handsomely and the consolidation of the banks has boosted their resilience. All this has raised credibility. This credibility is an important asset which should be protected and grown further even as this crisis is managed, including a transparent assessment of the problems of the banks.

The crisis is not merely a challenge but also an opportunity to diversify and re-position the economy for steadier long-run growth. This can be built into the fiscal stimulus from excess crude account withdrawals by choosing public investments which will relax infrastructure and other constraints to non-oil growth.

Nigeria should not simply return to its pre-crisis growth path, which would hold it hostage to good lock in the shape of high oil prices. Indeed, with all the attention being paid to greener technologies, a greater focus on energy independence in the US via new kinds of renewable energy and the emergence of hybrids in the automotive sector, Nigeria may not be able to return to the status quo ante. A strategy which sets targets for diversifying the export and tax bases would be highly desirable. This could include greater value-added products in agriculture and related supply-chain management. Other sectors such as retail trade and construction also offer diversification opportunities as do solid mineral and manufacturing. We know the constraint these sectors face and we must act to relax these in a market-friendly manner. Nigeria has been hit by the global crisis. But Nigeria has significant strengths and must respond to the challenges it faces transparently and in a way that engenders confidence in the private investor community while at the same time repositioning its economy onto a more diversified growth path after the crisis subsides. This can definitely be done and have no doubt that as a country we shall rise to the occasion.

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