

RECENT MACROECONOMIC DEVELOPMENTS AND THE
WAY FORWARD: AN ADDRESS BY THE GOVERNOR,
CENTRAL BANK OF NIGERIA, CHIEF (DR.) J. O. SANUSI,
CON, FCIB, TO THE BANKERS' COMMITTEE ON
FEBRUARY 18, 2003

Chief Executives of Banks,
Distinguished Ladies and Gentlemen.

I feel delighted to address this assembly of professionals for the first time this year, in keeping with my tradition of quarterly briefing on the developments in the economy, generally, and the banking sector in particular. For better appreciation of the role of the banking sector in the economy, it is pertinent to clearly understand where we currently stand if we are to fully appreciate where we should be heading to in the future. Accordingly, I wish to review the macroeconomic and financial sector performance in the past year, and also share my thoughts with you on the way forward. In essence, I wish to sensitize you on the need for continued collaboration in ensuring a sound financial system, which is a critical success factor for effective monetary policy implementation, and the eradication of poverty in the nation which is the cornerstone of the economic policy of the present administration

2. A review of macroeconomic developments in 2002 indicated mixed performance. The inflationary pressure moderated considerably as the inflation rate (twelve-month moving average) decelerated to 13.2 per cent in November 2002, from 18.9 per cent in December 2001.

However, the inflation rate remained above the single digit target. The main explanatory factor was the persistent liquidity overhang in the banking system, buoyed by fiscal surprises, while the impact of good agricultural harvest on food prices exerted significant moderating influence.

3. The growth in monetary aggregates was, however, excessive relative to targets. Provisional data indicated that broad money stock (M2) grew by 25.5 per cent, compared with the permissible expansion rate of 15.3 per cent for fiscal 2002. The excessive growth in M2 was induced by the expansionary fiscal operations of the three tiers of government, particularly the phased monetisation of the U.S. \$1.5 billion draw-down on external reserves and the substantial draw-down on Federal Government's deposits with the CBN. The increase, however, represented a deceleration compared with the 27.1 per cent growth recorded in 2001. Bank credit to the private sector was modest, rising by 22.6 per cent as against the growth target of 34.9 per cent for fiscal 2002 and the increase of 43.5 per cent recorded a year earlier.

4. Interest rates generally trended downward in 2002, reflecting the impact of excess liquidity in the banking system, the fall in inflation rate and the downward review of the minimum rediscount rate. The rates on deposits of various maturities fell from a range of 13.5 – 21.9 per cent in January to 8.9 – 15.0 per cent in December 2002, while the prime and maximum lending

rates fell from 25.8 and 31.2 per cent to 22.6 and 27.0 per cent, respectively, during the period.

5. As you are well aware, the re-introduction of the Dutch Auction System (DAS) on July 22, 2002 was aimed at overhauling the operations of the Inter-bank Foreign Exchange Market (IFEM), with a view to narrowing the gap between the official and parallel market exchange rates, achieving a realistic exchange rate for the naira, and conserving external reserves. Between July and December, there was relative exchange rate stability, with the official rate hovering between N127.89 and N126.88 per dollar. The rate of depletion of external reserves, which was rapid between December 2001 and end-July 2002 (from U.S.\$10.4 to \$8.3 billion) slowed considerably in the last five months of the year with reserves amounting to U.S. \$7.7 billion as at end-December, 2002.

6. The growth of real Gross Domestic Product (GDP) was estimated at 3.3 per cent in 2002. Compared with the projected growth of 5.0 per cent in 2002 and the observed growth rate of 3.9 per cent in 2001, the economy could be adjudged to have performed below its potential. The low credit growth to the private sector by deposit money banks is thus reflective of the weak performance of the real sector and the poor investment climate.

7. Distinguished ladies and gentlemen, while I commend your contribution to the modest progress made in the previous year, you will agree with me that

more needs to be done in order to achieve sustainable growth. I, therefore, urge you to show greater understanding and commitment in the new year, given the role of banks in facilitating financial intermediation and ensuring stability of the economy. In fact, the realization of desired objectives would depend on how well banks conduct themselves and the extent to which they observe high ethical standards in their operations. Perhaps it is necessary to further elucidate this issue in order to underscore the need for professionalism and transparency in banking business. For the avoidance of doubt, I wish to reiterate that the only asset which banks possess and which really matters is public confidence. If that confidence is undermined, banks' ability to mobilize and deploy savings will be impaired and the means to economic growth and poverty reduction will be short-circuited.

8. You will recall that the subject of "ethics and professionalism" in the industry has continued to be the focal point of my regular address to the operators. I consider this a critical issue because the banking profession stands the risk of losing credibility in the court of public opinion if we do not play according to the rules of the game. The unprofessional conduct of authorized dealers in the foreign exchange market, as exemplified by cases of round-tripping and transactions in free funds which were neither documented nor disclosed in violation of the guidelines, as well as other forms of sharp practices, compelled the CBN to impose sanctions on errant dealers in 2002, including the suspension of their foreign exchange dealership

licenses for 12 months. The dealers, however, were granted conditional pardon with effect from January 2003 as they have been allowed to deal in the inter-bank market only. They will remain under CBN's searchlight for the remaining period of their suspension, and would have their licenses fully reinstated upon satisfactory evidence of compliance with the conditions stipulated by the CBN. The CBN will continue to monitor both the money and foreign exchange markets closely, in order to sanitize the system and achieve desired objectives, in the overall interest of the economy.

9. The observed general downward movement in interest rates in the past year is a welcome development, given the fact that a sustained low interest rate regime is desirable for stimulating economic recovery. Simply put, a low interest rate regime is essential for investment, without which growth will be impossible and the war against poverty will not be won. This, therefore, underscores the need for banks to show greater commitment to the tripartite agreement on the maintenance of their lending rates at not more than 400 basis points above the minimum rediscount rate (MRR), given the deceleration in the rate of inflation and liquidity overhang in the system. As interest rate management, in particular, and monetary policy in general, has been the victim of fiscal dominance, the CBN will continue to ensure greater co-ordination with the Treasury as well as urge the government to exercise fiscal prudence to obviate the need for monetary tightening and to sustain efforts at

rehabilitating physical infrastructure, including utilities, in order to bring down banks' average cost of funds. Banks are also enjoined to re-examine some aspects of their operations so as to reduce the current high level of overhead costs. The new framework for determining banks' cost of funds, designed in 2002, will be made operational in order to reinforce the downward movement in lending rates. The essence is to minimize the cost constraints faced by producers who seek bank loans and facilitate the evolution of an investor-friendly interest rate regime that will enhance investment and output growth.

10. A related issue is the need to sustain efforts at financing the development of small and medium scale enterprises in order to raise the level of investment in the real sector of the economy, boost productivity and enhance employment opportunities in the medium-term. In this regard, it is gratifying to note that, as at end-December, 2002, 80 banks had set aside the sum of N13.1 billion under the Small and Medium Industries Equity Investment Scheme (SMIEIS), an initiative of the banks themselves. However, the investment of only N1.9 billion out of this amount as at end-September 2002 is not encouraging. While I admit that the banks are faced with some constraints in the management of the scheme, there is a need for a quick resolution of the problems so as to enhance the integrity of industry operators in this regard.

11. Distinguished ladies and gentlemen, a serious challenge faced by the CBN in 2003, being an election

year, is that of liquidity management and the maintenance of macroeconomic stability, given the prevalence of fiscal dominance and its destabilizing effects. In the context of dynamic monetary policy management, monetary, credit and financial sector developments will continue to be monitored on a consistent basis under the Bank's current medium-term monetary programme, spanning January 2002 and December 2003. This is with a view to fine-tuning policy measures to check a reversal of the gains made in the fight against inflation in 2002 as well as minimize demand pressure in the foreign exchange market.

12. With commitment and concerted efforts on the part of the bankers and other stakeholders, I have no doubt that we will succeed in our effort to promote a stable and sound banking system that will be responsive to the aspirations of the economy.

I wish you a rewarding year.

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February 18, 2003