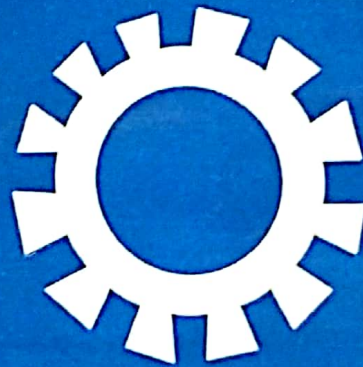


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An Overview of the Implications of the Global Financial Crisis on the Nigerian Banking sector

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Abstract

The global financial architecture is facing an unprecedented cataclysm since the great depression with a myriad of economic woes like bank losses, stock market crashes, declining real output and slowed economic growth; weakened financial systems typified by takeovers and bankruptcies, loss of jobs, loss of confidence in financial markets etc. The Nigerian banking sector is not completely immune to the crises, the paper therefore analyses the antecedents of the global financial crises and its implication on the Nigerian banking sector delving into the responses by government and regulatory authorities to curb the effects of the crises. For Nigeria banks to withstand the crisis, regulatory authorities should intensify surveillance and watch out for early warning signals of possible systemic distress and continuous efforts should be made to upgrade the accounting, reporting and disclosure format along the best practice models. Multilateral cooperation should also be upheld between Central Bank of Nigeria and other relevant bodies as well as imbibing sound corporate governance in banking operations by Nigerian banks.

Introduction

The global financial system is in the midst of deep downturn, affecting the real and financial sectors, that is taking its toll in both advanced and developing economies of the world. The International Monetary Fund (IMF) estimated that banks and other financial institutions faced aggregate losses of \$4.05 trillion in the value of their holdings as a result of the crisis. Of that amount, \$2.7 trillion is from loans and assets originating in the United States (Lander, 2009).

The current financial crisis dates back to July 2007 when a loss of confidence by investors in the value of securitized mortgages in the United States resulted in a liquidity crisis that prompted a substantial injection of capital into financial markets by the United States Federal Reserve, Bank of England and the European Central Bank. The first main event that triggered the severe global phase of the

crisis was when Lehman failed on September 14, 2008 and the U.S government declined to bail out Lehman Brothers. Subsequently on September 15, it did not open for business. Creditors suffered major losses, and these had a particularly negative effect on the markets given that through the end of the previous week, the Federal Reserve had been encouraging people to continue to do business with Lehman Brothers. Lehman Brothers is the largest bankruptcy filing in history with Lehman holding over \$639 billion in pre bankruptcy assets (Marco, 2008).

The crisis deepened, as stock markets worldwide crashed and entered a period of high volatility, and a considerable number of banks, mortgage lenders and insurance companies failed in the following weeks. The crisis actually started as financial crisis but transcended to a global economic crisis because it has

resulted in declining output growth, sharp decline in economic activities, unemployment, and deflation especially in the U.S and UK, amongst others. The crisis in real estate, banking and credit in the United States had a global reach, affecting a wide range of financial and economic activities and institutions, including the:

- Overall tightening of credit with financial institutions making both corporate and consumer credit harder to get;
- Financial markets (stock exchanges and derivative markets) experience steep declines/crashes;
- Liquidity problems in equity funds and hedge funds;
- Devaluation of the assets underpinning insurance contracts and pension funds leading to concerns about the ability of these instruments to meet future obligations;
- Increased public debt due to the provision of public funds to the financial services industry and other affected industries,
- Devaluation of some currencies (Icelandic crown, some Eastern Europe and Latin America currencies) and increased currency volatility,
- Declining real output and slowed economic growth
- Weakened financial systems typified by takeovers and bankruptcies
- Loss of Jobs

Loss of Confidence in Financial markets leading to inability to carry out their intermediation role in the economy
In a globalized world, there is hardly any country that is immune from the

shock waves of the global financial/economic meltdown, but owing to the fact that Nigeria's integration into the global economy is less, the banking sector's susceptibility is generally not very profound. However, since the reason of the current financial crisis has not been identified and the extent of contagion on other sectors has not been fully understood (Mordi, 2009), it is imperative to analyse the events to identify existing potential threats to the Nigerian banking sector.

Banks and the Business of Banking in Nigeria

Banks are financial institutions licensed by Central Bank of Nigeria under the appropriate laws to carry out banking business in Nigeria. Such laws include; CBN Act No. 24 of 2001 as amended Act No. 41 of 1999 and Banking and Other Financial Institutions Act No. 25 of 1991 (BOFIA) as amended by Act. 40 of 1999. Encarta Encyclopaedia (2008) defines banking as the business of providing financial services to consumers and businesses. However, for the business of banking to have taken place, there must be acceptance of money on current account and the collection of cheques or other instruments for the customer as well as payment by the Bank of cheques or other instruments drawn by them by the customer to an extent of monies deposited or up to an agreed overdraft limit. The basic services a bank provides are checking accounts, which can be used like money to make payments and purchase goods and services; savings accounts and time deposits that can be used to save money for future use; loans that consumers and

businesses can use to purchase goods and services; and basic cash management services such as check cashing and foreign currency exchange.

In Nigeria, under the current Universal Banking system, banking business is re-defined as:

- The business of receiving deposits on current, savings or other accounts.
- Paying or collecting cheques drawn or paid in by customers.
- Provision of finance, consultancy and advisory services relating to corporate and investment matters.
- Making or managing investment on behalf of any person and
- The provision of insurance marketing services and capital market business or such other services as the Governor of

CBN, may by gazette, designate as banking business.

Deposit Money Banks are the largest entity in all financial services in Nigeria. They serve as intermediary between the Central Bank of Nigeria and the general public in the processing, sales and purchase of banking products and monetary policy instruments. They operate under the general guidelines provided by the monetary authorities and are involved in the business of providing financial services to individuals/households, corporate bodies and the government. Several Deposit Money Banks (DMBs) have offices in both urban and rural areas of Nigeria. Central Bank of Nigeria (2009) identified DMBs in Nigeria. The list is presented in table 1.

Table 1: Deposit Money Banks in Nigeria

S/No	Name of Deposit Money Bank
1	Access Bank
2	Afribank
3	Diamond Bank
4	EcoBank
5	Equitorial Trust Bank
6	First City Monument Bank
7	Fidelity Bank
8	First Bank Plc
9	Guaranty Trust Bank
10	Intercontinental Bank
11	Nigeria International Bank
12	Oceanic Bank
13	Platinum Habib Bank
14	Skye Bank
15	Spring Bank
16	Stanbic IBTC Plc
17	Standard Chartered Bank
18	United Bank of Africa
19	Sterling Bank
20	Union Bank
21	Wema Bank
22	Zenith Bank Plc
23	Unity Bank
24	First Inland bank

Source: Central Bank of Nigeria (2009) www.cenbank.org

The Emergence of a Re-capitalised Banking Sector in Nigeria

The Nigerian banking sector has passed through different stages namely; pre-consolidation, consolidation and post consolidation eras. During the Pre-Consolidation era (1995 – 2004), Nigerian banks were characterized by weak capitalization and poor Management quality with poor and declining capacity utilization, unfavourable economic climate to attract investment and weak financial systems. Also, the era was typified by low Capital base, Poor Corporate Governance culture and risk management practices as well as low capacity for credit creation (Soludo, 2006).

The consolidation era (2004-2005) was ushered in with an announcement of a consolidation plan designed to reform and increase capacity in the Nigerian Banking Industry in July 2004. This was contained in the 13 point agenda announced by Professor Chukwuma Charles Soludo had two major sector elements: (i) Minimum shareholders fund raised to ₦25 billion from the former level of ₦2 billion with effect from December 2005 and (ii) Consolidation through Mergers and Acquisitions. Furthermore, there was phased withdrawal of public sector funds from banks as well as provision for banks to capitalize through private placement, rights issue and public offers. The Post-Consolidation era (2006-till date) then followed with the liquidation of 14 banks in January 2006 and the emergence of 24 mega banks with world-class status. There was also the adoption of risk focused and rule-based regulatory framework with an accompanying increase in number of

banks branches from 3,200 in the pre-consolidation era to over 3,866 in the post-consolidation era. Further voluntary increase in capital base, more mergers and acquisition and expansion into the international financial market then followed with the Deposit Money Banks standing at 24 (www.cenbank.org).

The consolidation exercise has yielded benefits which according to Soludo (2007) include reduced danger of bank collapse and elimination of family banks, majority of banks are now quoted on the Nigerian Stock Exchange (NSE), a rise of more competitive and profitable banks due to resulting economies of scale and shareholders enjoying better returns on investment. Furthermore, consolidation has made banks to be in position to finance huge projects, an improved capacity to create loan assets, reduction in non-performing loans and adequate capacity to support the real sector of the economy through access to long term funds and reduced interest rates. Nigerian banks are also better enhanced ability to compete both domestically and internationally and enjoy better international ratings. Despite the benefits of consolidation, Nigerian banks are also yet faced with fresh challenges arising from the current global economic meltdown.

Implication of the Global Financial crises on Banking in Nigeria

Deposit Money Banks constitute the largest entity of all financial services in Nigeria. They serve as intermediary between the CBN and the general public in the processing, sales and purchase of banking products and monetary policy instruments. They operate under the general guidelines provided by the monetary authorities and are involved in the business of providing financial services to

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providing financial services to individuals/households, corporate bodies and the government.

Nigerian banks may not be affected deeply by the global financial meltdown because, the crisis is driven by failed financial products that led to the systemic distress. Most of these institutions had in their books a very huge loss, arising from the deteriorated quality of assets they had accumulated without being sure of the fundamentals of those assets in the market. Nigerian banks are not yet into such kind of exotic products that led to the problems of those institutions and therefore may be shielded from the global financial meltdown. In addition, the affected institutions in the US and Europe were not adhering to prudential regulations guiding the operations of the mortgage industry, hence the abrupt collapse of the sub-sector. In Nigeria, the CBN has been implementing policies that compel

financial institutions in the country to adhere strictly to regulations by fortifying their assets appropriately in order to stabilise the sector for the overall growth of the economy.

However, the situation overseas as well as other banks in other parts of the world may have partial negative effects on some Nigerian banks because of their trading relationships with some of these banks. These could occur in the following ways among others:

- (i) **Partnerships with Foreign Banks**
Following the successful conclusion of the first phase of the consolidation in the Nigerian banking industry, some Nigerian banks were given the opportunity of managing the nation's external reserves by partnering with their foreign correspondent banks in the US and Europe as follows;

	Asset Manager	Nigerian Partner
1	Black Rock	Union Bank of Nigeria Plc
2	J.P. Morgan Chase	Zenith Bank Plc
3	H.S.B.C	First Bank of Nigeria Plc
4	BNP Paribas	Intercontinental Bank Plc
5	UBS	United Bank for Africa Plc
6	Credit Suisse	IBTC – Chartered Bank Plc
7	Morgan Stanley	Guaranty Trust Bank plc
8	Fortis	Bank PHB Plc
9	Investec	Fidelity Bank Plc
10	ABN Amro	Access Bank Plc
11	Cominvest	Oceanic Bank Plc
12	ING	Ecobank Plc
13	Bank of New York	Stanbic Bank Plc
14	Crown Agents	Diamond Bank Plc

Source: Central Bank of Nigeria (2006) Annual Report and Statement of Accounts

It is therefore expected that if any of these correspondent banks is affected by the global financial crisis, the corresponding local bank will be

equally affected. For example, Fortis which is partnering with Bank PHB was nationalised by the Belgian Government following the global financial meltdown

(Wikipedia, 2009). This has a far reaching implication.

(ii) Limited Foreign Trade Finances for Nigerian Banks

Nigerian top banks have, prior to the financial meltdown, been tapping from international market to raise credit in order to finance big projects. If the credit crunch or freeze in the credit market does not liquefy soon, then credit lines for most banks may dry up. In other words, Nigeria's Deposit Money Banks may find it increasingly difficult to gain access to international credit lines. This is consequent upon the higher global liquidity and the more likelihood that investors lend to emerging market countries (Zanfolin, 2007). The consequence is that Nigeria banks would no longer get the sort of relatively cheap financing available to it as was the case a few years ago. Non-availability of credit may make it difficult for commercial banks to carry out their financial intermediation role effectively (i.e. channelling funds from the 'have' to 'have not'). Further implication of this is that it may result in loss of confidence in Nigerian banks.

(iii) Indirect effects from a general economic down turn

Apart from its impact on the financial sector, the Nigerian economy as a whole is likely to take considerable pounding from the financial crisis rocking the globe. As a matter of fact, the US economy constitutes more than 20 per cent of the global Gross Domestic Product (GDP) and consumes more than 20 per cent of the global oil supply. With the US economy contracting, there is bound to be considerable drop in demand for oil which would impact negatively on prices with negative effect on the

Nigerian economy and indirect effects on Nigerian Banks.

(iv) Depreciation of bank share prices and loss of investor confidence

The Nigerian capital market has been affected by the current financial meltdown. From August, 2008, the value of the share trading on the capital market has dropped astronomically from about ₦ 13trillion to just a little over ₦4trillion. The problem was partly caused by foreign investors who withdrew more than \$20 billion from the stock market in 2008. Banks are the most affected since they hold about 90% of assets and 65% of market capitalization of the entire Nigerian stock market (Accenture, 2009). Banks are desperately sourcing for money, having being affected in the stock market with an exposure estimated at ₦1 trillion. Also, capital market downturn might have second round effects on the balance sheet of banks by increasing provisioning for bad debt and decrease in profitability. These declining fortunes of Nigeria capital market have made many investors to be risk-averse. There is reduced appetite for risk among investors. The implication of this is that many investors would be willing to invest their capital in bank shares and other financial products with reduced risk such as government bonds.

Implication of the Global Economic Meltdown on Central Bank of Nigeria's Activities

The Central Bank is the apex regulatory authority of the Nigerian financial sector. It was established by the Central Bank Act of 1958 and commenced operations on 1st July, 1959. Among its primary functions, the

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Bank promotes and maintains monetary stability and a sound and efficient financial system in Nigeria. It issues legal tender currency notes and coins in Nigeria and maintains Nigeria's external reserves to safeguard the national value of the legal tender. The Bank is a banker and financial adviser to the Federal Government of Nigeria as well as lender of last resort to banks. It also has the responsibility of formulating and implementing the monetary and Exchange Rate Policies for Nigeria. The global financial crisis has some potential and existing implications on the activities of the Central Banking of Nigeria. These among others include the following;

(i) Pressure on exchange rate:

There is pressure on the exchange rate due to drastic fall in oil price from a

peak of \$147 to \$37.57 per barrel (this is shown in figure 1 below), dwindling capital inflows, and decline in commercial lending to Nigeria banks, increasing importation, capital outflow as well as exiting by foreign investors and speculators who believe that exchanges rate may depreciate further amongst others. So, the pressure is two sided, namely on the supply side and the demand side as well. Curbing demand pressure on exchange rate could push up rates and increase pressure to depreciate the naira to boost government revenue, exports and curtail speculative demand and dwindling external reserves. This in turn will reduce the use of reserves as intervention tool in exchange rate management.

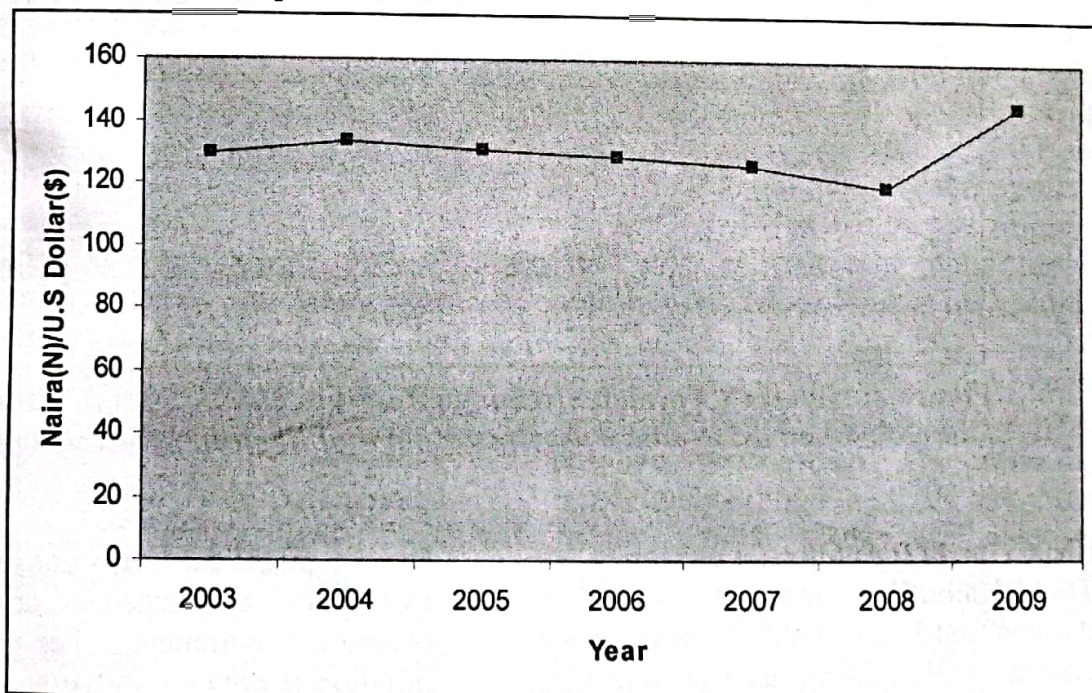


Figure 1: Official Naira Exchange Rate Rates

Source: Plotted using data from Central Bank of Nigeria. www.cenbank.org

(ii) De-accumulation of Nigeria's foreign reserves

Nigeria's foreign reserve has gone down from over \$50 billion to about \$47 billion (CBN, 2009^a). This is shown on figure 2. Several factors, including fall of oil price are responsible. It could deplete further if there is political pressures to spend the excess crude. The loss in valuation of Nigeria's reserves may result from counterparty risk, frequent and large intervention to smoothen volatility of

the Naira increases drawdown and uncurtailed withdrawal by the fiscal authorities and servicing of foreign commitments. In addition there will be resultant effect of low accretion to the external reserves due to the fall in crude oil prices as well income generation and safety concerns on external reserves. The tendency of renewed external debt accumulation and the resultant effect of debt servicing on the external reserves is also not unlikely in this case.

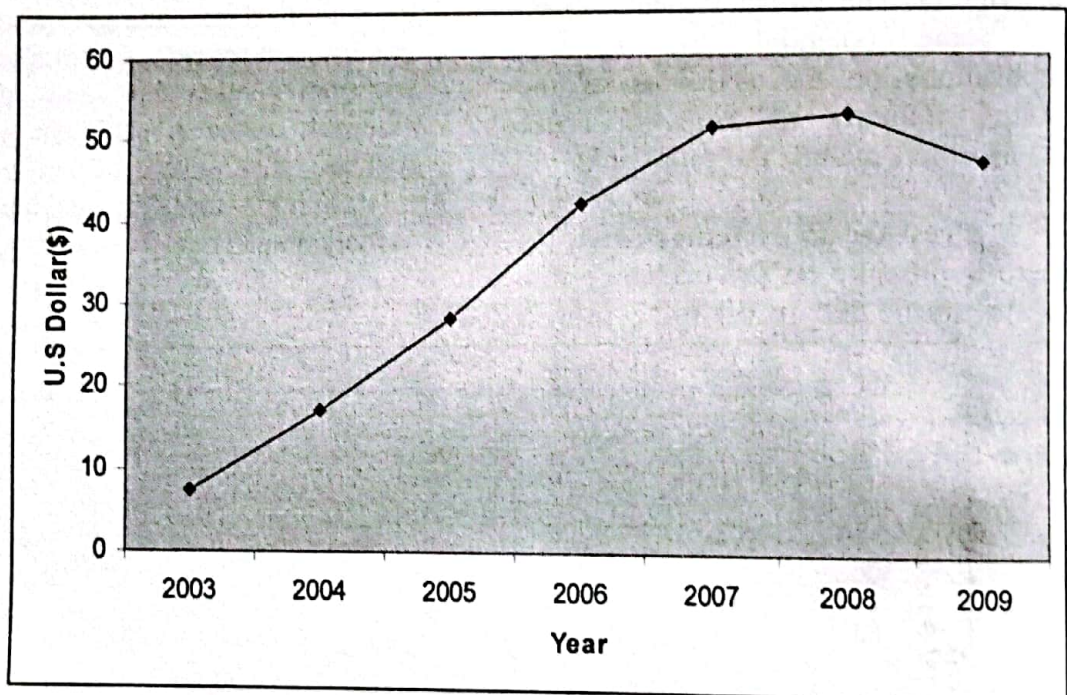


Figure 2: Nigeria's Foreign Exchange Reserves 2003 – 2009 (\$'billion)

Source: Plotted using data from Central Bank of Nigeria. www.cenbank.org

(iii) Criteria for common currency

The Economic Community for West African States (ECOWAS) convergence criteria is the criteria used in assessing the degree of country performance in the implementation of the agreed policy measures under the ECOWAS Monetary Cooperation Programme (EMCP) to achieve a single monetary zone (Englama and Sanni, 2007).

Nigeria might miss two out of the four ECOWAS convergence criteria for common currency. For instance, inflation is now at double digit as there was an upward swing of the year-on-year headline inflation from 14.0 per cent in January to 14.6 per cent in February 2009 (CBN, 2009^a). Also, GDP growth rate projection for Nigeria as at March 2008 was 5.30 % for the

year 2008 and 3.30% for the year 2009 (Accenture, 2009) which were all below the required ratio.

(iv) Difficulty in Credit Management

Credit management difficulties are likely if a slow down in foreign credit line to domestic banks due to the vagaries of the financial crisis may the Securities and Exchange Commission (SEC), the Nigerian Stock Exchange (NSE) and all capital market operators have reduced fees by 50%,

Response by Government

The Federal Government in its response to the Global Financial Crises has constituted various bodies to assess the impact of the crisis and to advise the government accordingly. These include:

- Presidential Advisory team which was set up to deliberate on measures to reverse the declining fortunes of the Nigeria capital market (set up in Aug., 2008).
- The Presidential Steering Committee on Global Economic Crisis (set up on the 16th of January, 2009) to assess the impact of the recession on Nigeria's economy with special reference to the 2009 budget.
- National Economic Management Team (inaugurated on the 2nd of Feb., 2009) was constituted to design and execute the Federal Government's economic policies, and to support the work of the Presidential Steering Committee on Global Economic Crisis (PSCGEC).
- Government recently approved N200 billion special agricultural fund

result. This may lead to higher cost to the Central Bank of Nigeria if it engages in credit guarantee and reduced savings by the public. In addition, fiscal deficit and crowding out of private sector credit may result and the tendency of the financial sector hoarding cash if liquidity squeeze occurs (Mordi, 2009).

for large scale agriculture.

- Government has also proposed to inject N3trillion safety net into the economy to serve as shock- absorber.

Responses by Central Bank of Nigeria (CBN) and Securities and Exchange Commission (SEC)

The CBN has been reacting to the global economic and financial crisis by: relaxing monetary policy conditions; adjusting the exchange rate; and strengthening of supervision in the banks. The following specific policy measures were taken; active use of Open Market Operations (OMO) to achieve effective liquidity management and manage the exchange rate within a band of +/-3 percent until further notice. Also, the difference between the CBN buying and selling rates shall not be more than 1%; while that of banks and Bureaux De Change (BDCs') will not be more than 1% and 2% respectively around the CBN rate. From January, 2009, CBN also deployed resident examiners to the head offices of all the banks in recognition of the need to enhance its regulatory and supervisory efforts. CBN also released guidelines for credit bureau that would compile the credit information on individuals and entities regarding their credit repayments, court judgments, bankruptcies etc and subsequently create a databank of such for sale to

lending institutions. Also the CBN allowed repo transactions against eligible securities for 90 days, 180 days and 360 days as well as the buying and selling of securities through the two-way quotes. The CBN expanded lending facilities to banks up to 360 days and also issued a directive to banks that they could restructure margin loans up to 2009.

Recently, in further reaction to the global economic crisis, the CBN at the end of its monetary policy meeting on the 8th of April 2009 took further measures as follows; Monetary Policy Rate (MPR) cut from 9.75% to 8%, Cash Reserve Requirement cut from 2.0% to 1.0%, Reduction of liquidity ratio from 30.0% to 25.0%. All these measures were taken to enhance liquidity in the system (CBN, 2009^a).

In the same vein, SEC has released guidelines on market makers. Also, three market makers were appointed towards the end of 2008 namely: Greenwich Trust, Chapel Hill Denham, and Diamond Capital. They were appointed to stabilize the market by ensuring continued liquidity; facilitate a smooth trading atmosphere, and to promote price discovery. Furthermore, there is now strict enforcement of NSE' listing requirements and NSE also de-listed 19 inactive companies. The market-oriented measure such as share buy-back to refuel the capital market has been adopted.

Conclusion and Recommendations

The effect of the recent global financial crisis will be felt in different ways by different countries. In particular, the impact of the meltdown on countries would depend on how far the countries concerned are integrated

in the global financial system. The excess liquidity and financial integration that preceded the crisis has made many countries more vulnerable to financial contagion.

The impact of the meltdown on Nigerian financial system will not be seriously felt because Nigerian financial system has not gone far with the financial integration. In addition, the successful implementation of the banking consolidation and recapitalization of 2005 placed Nigeria's financial system on a good footing to withstand the shock. Nigeria has well capitalized banks with capital adequacy ratio of 22% which is one of the highest in the world. The banking sector is the bedrock of the economic system. Therefore, the banking sector should intensify effort at playing their intermediation role by reducing the over-inflated interest rate and curb their excesses

Finally, the regulatory and supervisory bodies should implement necessary reforms aimed at strengthening the resilience of the Nigerian financial system in the long term. Based on the aforementioned, the following recommendations are deemed appropriate in reducing further impact of the economic crisis on Nigeria economy.

(i) Renewed vigor in implementation of vision 2020, 7- point agenda of the current administration, and Financial Sector Strategy (FSS) 2020.

(iii) Regulatory authorities should intensify surveillance and watch out for early warning signals of possible systemic distress and either act proactively to prevent such or advice government on possible responses.

- (iv) Further consolidation and recapitalization process of the banking industry will help banks to expand their activities which will in turn result in rapid economic development.
- (v) Continuous efforts should be made to upgrade the accounting, reporting and disclosure format along the best practice models.
- (vii) CBN has to take a realistic tack to regulating banks' operations, scrutinize closely the quality of their assets and regularly revisit their lending portfolio to determine whether their composition reflects the correct book value.
- (viii) The regulatory and supervisory agencies should regularly re-evaluate their supervisory approach and firm up polices and then ensure strict compliance with the polices in order to deepen regulation and supervision of financial system.
- (ix) Multilateral cooperation is vital: In addition to policy responses by individual countries due to their peculiar challenges, the international communities should act in a coordinated and supportive fashion to ease the task of individual countries. Central Banks can come together to mobilize large scale financing.
- (x) CBN should stabilize the exchange rate by ensuring market determined but stable exchange rate regime.

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