REMARKS BY MR. REMI BABALOLA, M.IoD, HONOURABLE MINISTER OF STATE FOR FINANCE AT THE MAY 2008 MEMBERS EVENING ROUNDTABLE TALKS HELD AT THE IOD NATIONAL SECRETARIAT, IKOYI, LAGOS ON MAY 28, 2008

PROTOCOL

I feel highly honoured to be invited to speak at the important monthly event of this august assembly, of which I am happy to be an esteemed member. Over the years, this forum has proved to be an important melting pot of ideas, where policy issues are often fine tuned, reviewed and inevitably translated into government action. The strategic importance of this gathering derives largely from the quality of highly qualified corporate decision makers who meet on monthly basis to reflect on issues affecting the economy. I therefore owe a great gratitude to the leadership of the Institute for inviting me to share some thoughts on policy guidelines and various challenges confronting government, especially in relation to the financial services sector of the Nigerian economy.

The Nigerian Economy

2. Prior to the recent economic reforms, Nigeria's economic performance was characterised by poor economic management, large macroeconomic volatility (for variables such as inflation, exchange rates, etc), hostile business environment for private sector

growth, poor governance, mismanaged and over-sized public sector, and overall poor economic and social indicators. Nigeria had a long history of macroeconomic instability and fiscal imbalances, occasioned by large fiscal deficits to GDP of 7.7% in 1994; 8.9% in 1999; 4.0% in 2001; 3.4% in 2005 and 2.9% in 2006, high level of inflation rate, poor productive public sector investment, debt overhang and expenditure driven by changes in international oil prices.

3. The Nigerian growth story can simply be related to a blue sky story. Despite years of prolonged economic stagnation, rising poverty levels and degradation of public institutions, Nigeria is bouncing back strongly as the third largest GDP growth economy in Africa, after South Africa and Algeria. The country is now set to break out of the 6% GDP growth group, to an economy with at least 9% GDP growth rate. In 2007 alone, the non-oil sector rose by 9.8%, reflecting the impact of reforms already completed.

International Rating

4. Last year, the International Monetary Fund (IMF) concluded its Article IV Mission to Nigeria. The report acknowledged that Nigeria achieved strong macroeconomic performance, supported by prudent fiscal policies, with the introduction of broad based economic reforms and a positive outlook for 2008. In addition to

this, fashioning out a successor programme to the recently concluded 4th and final review of the Policy Support Instrument (PSI) has commenced. This will ensure that the Federal Government can continue to benchmark our economic performance and pursue policies that will apply positively to the growth of the economy.

5. I am happy to inform you that the world acknowledged rating agency, Fitch International Ratings, recently conducted a sovereign rating exercise for the country. In a report made available to us last week, Nigeria attained a BB rating for local currency and a BB- for foreign currency. This represents an improvement on the BB- for local currency we achieved in 1997. What this means is that Nigeria is becoming more and more investor-friendly, and there is great hope that by the time the various initiatives of government begin to yield fruits, Nigeria is going to be an investors' haven.

Financial Sector Reforms

6. The primary objective of virtually every economic reform programme is to achieve high and sustainable growth. In doing this, the major drivers of such growth, e.g. agriculture, manufacturing and services, are given adequate attention. However, for the reforms to have the desired impact on the real sector, it is essential that the financial sector must be reformed as well. This is because of its critical role in the mobilisation of financial resources and as a

conduit for monetary policy actions to the real economy. Hence, many African countries have implemented financial liberalisation programmes as components of structural adjustment programmes under varying financial structures and different macroeconomic conditions.

7. Financial systems have long been acknowledged to play an important role in economic development. The financial sector is recognised as a catalyst of economic growth, provided it is well-organised, developed and healthy. The benefits accruable from a healthy and developed financial system relate principally to its savings mobilisation and efficient financial intermediation roles. Additionally, the financial system helps in:

- Creating liquidity in the economy by borrowing short-term and lending long-term.
- Reducing information costs, providing risk management services and reducing risks involved in financial transactions.
- Bringing the benefits of asset diversification to the economy.
- Mobilising savings from atomised individuals for investment.

8. The main objective of financial sector reform in Nigeria, as part of the structural reforms, was to increase the size, improve the efficiency and raise the diversity of the financial system of the Nigerian economy. This objective was to be attained through

financial liberalisation, which could be viewed as the process of moving towards market determined interest rates, as well as market-determined prices on all classes of financial products; a banking system characterised by symmetric entry and exit conditions to all participants; increasing internationalisation or the opening up of domestic markets to international competition; and limited barrier to the introduction of new financial products.

9. Ultimately, this reform initiative is meant to produce a sound and healthy financial services sector, which is crucial if the country must avail itself of the windows of opportunities opened up by globalisation, to develop the economy and further the country's industrialisation process.

Banking Sector

10. At the inception of comprehensive financial sector reform in 1987, the banking sector was highly repressed. Interest rate controls, selective credit guidelines, ceilings on credit expansion and use of reserve requirements and other direct monetary control instruments were typical features of the pre-reform financial system in Nigeria. Entry into banking business was restricted and public sector-owned banks dominated the industry. However, the reform of the foreign exchange market which hitherto was also controlled, began a year ahead of the general financial sector reform.

11. It may be necessary to comment on the antecedents to the reforms in this sector. As at the end of June 2004, there were 89 banks with many banks having capital base of less than USD10million, and about 3,300 branches. Structurally, the sector was highly concentrated as the ten largest banks account for over 50 percent of the industry's total assets/liabilities. Even the largest bank in Nigeria as at then had a capital base of about US$240 million compared to US$526 million for the smallest bank in Malaysia.

12. The apathy of banks towards small savers, particularly at the grass-root level, not only compounded the problems of low domestic savings and high bank lending rates in the country, but also reduced access to relatively cheap and stable funds that could provide a reliable source of credit to the productive sector at affordable rates of interest. The structure of the banking system promoted tendencies towards a rather sticky behavior of deposit rates, particularly at the retail level, such that, while banks' lending rates remain high and positive in real terms, most deposit rates, especially those on savings, are low and negative.

13. Today, we have 24 well-capitalised deposit taking banking institutions, some with equity base in excess of $1 billion, and shareholding by major international financial institutions. We now

have banking institutions that are well-positioned to take advantage of globalisation, operating with branches in major financial capitals of the world. Nigerian banks have thus become avenues of inflow of foreign investments into the country. Given their significant capital bases, they can tap into global financial markets, enabling them to partake in big-ticket transactions in infrastructural development, energy, communications, construction and the hospitality business.

Pensions Reform

14. The 2004 Pensions Reform Act established a uniform, contributory, private sector-managed, and fully funded pension system for both the public and the private sectors of the country. The expected outcomes include:

- Pension Fund Administration - compulsory savings would mobilise long term funds in the country. The size of the pension funds market is estimated at N300bn [$25bn] with a projected growth rate of about 15% per annum.
- Corporate Finance and Financial Advisory - creation and development of market for long-term securities such as bonds, mortgages and other asset backed securities.
- Asset Management - development of expertise in Asset management and Custodianship.
- The pension reforms would create a pool of long-term funds which could be channeled into the market to further deepen it.

Capital Market

15. The Capital market has been largely affected by the reforms that took place in the banking and pensions sectors. Significantly, over $1bn has been raised in the capital market by banks who are seeking to recapitalise, leading to a deepening of the market. More and more companies are beginning to see the benefits and are going to the Capital market to raise both debt and equity. Of interest, is the high number of foreign investors that are quite willing to take advantage of the above average returns obtainable in the market.

Insurance Sector

16. The insurance sector, which has traditionally been poor allies of the banking sector in Nigeria, has been rejuvenated under this present Administration. With the recertification of the 49 companies licensed to carry on insurance business and the release of their equity funds trapped in CBN escrow account, life has returned to the insurance sector. Their strengthened equity base is expected to enhance their underwriting and risk retention capacities. The challenges of poor image, low awareness, low end supervision and weak regulation are being pro actively addressed by the regulatory authorities and government.

Important Role of the Private Sector

17. The Federal Government believes that the role of the private sector in the development of the country is unquestionably critical. Hence, the views of industry captains like yours remain pivotal as the engine for sustainable growth and development. A workable and practical cooperation between government and the private sector is a critical factor for any meaningful development. A climate of trust between these two actors will continue to be encouraged. This is important, given that political and economic stability are prerequisites to commitments for long-term investments. As a government, we will pursue policies which foster greater role for the private sector and encourage entrepreneurship.

18. My presence here amongst the cream of corporate leaders of your calibre provides a veritable opportunity for me to continue advocating for Public Private Partnership (PPP) projects with governments across all tiers. The Federal Government is keen on supporting and promoting initiatives, such as the ultra-modern Murtala Mohammad Airport 2 and the ongoing development on Lekki Expressway, amongst others.

19. In the next few months, the PPP legal/regulatory framework will be launched. This will state clearly the project areas of interest, the bidding and approval processes, amongst others. We are all

eagerly awaiting this, most especially when we have already started receiving a record number of proposals for PPP projects, even without any framework in place.

Challenges

20. In spite of these impressive economic indices, there are still significant socio-economic challenges. These include:

- Inadequate infrastructure, epileptic power and water supply, poor roads, insecurity of life and property and youth restiveness in the Niger Delta region of the country. These challenges have adverse effects on productivity in the entire economy. According to the Manufacturer's Association of Nigeria (MAN), about 30% of the country's manufacturing companies are moribund, 60% of are in distressful situation, while only 10% are currently operating at any meaningful capacity. I am however pleased to inform you that the Yar'Adua Administration is strongly committed to reversing the trend and Nigerians will soon experience the impact of current efforts.

- We appear to have achieved macroeconomic stability and fiscal stabilisation. We are at least covered substantially from the external shocks and fluctuations in oil prices. The success index of this reform will be the volume of net domestic credit to the private sector. We need to "crowd in" the private sector without risking high inflation rates. If we look at the flow of credit to the private sector as a percentage of non-oil GDP, its level of 5% is low compared to what obtains in the (Goldman Sachs) High Growth Nations of over 10%.

- We need to enhance the ability and willingness of our banks to lend more to the private sector. While using the banking sector to dynamite the next level reforms, we need to upscale the game for insurance, capital market and pension for a wholesome financial system strategy. We need to examine the use of various incentives (e.g. tax credits and similar fiscal measures) that could be extended to banks for mortgage finance, project and development lending.

- One of the aims of the Financial System Strategy (FSS) 2020 is to ensure Nigeria becomes the financial hub of Africa and that our financial system propels the Nigerian economy to Nigeria Vision 2020 (becoming one of the 20 largest economies by 2020). The financial services sector has a very critical role to play in its attainment.

Going Forward

21. In terms of what our focus should be, in the Short-Run, we intend to consolidate the gains of the various economic reforms through continued pursuit of sound macroeconomic management and fiscal prudence. In the Medium-Term, we intend to empower micro units of productive activities to utilise the benefits from the macroeconomic reforms. In the Long-Run, we hope to reduce poverty by 30% by 2011, attain annual GDP growth rate of 13% and make Nigeria one of the 20 largest economies in 2020. This is based on the report by Goldman Sachs, which recognized Nigeria as one of the 11 countries in the world with the people and resources that have the potential of being one of the 20 biggest economies by the years 2020; hence the tag Vision 2020.

Conclusion

22. Ladies and Gentlemen, I believe all of us here have significant roles to play in ensuring that our dear nation occupies the pride of place it deserves in the comity of nations. This can only be possible through economic empowerment and sustained development. The future of the country rests squarely on all our shoulders and we all have roles to play; both individually and collectively.

23. I thank you all for inviting me here tonight. I wish you happy deliberations.

REMI BABALOLA

Honourable Minister of State for Finance