

REVIEW OF DEVELOPMENTS IN THE FINANCIAL SECTOR IN THE FIRST AND SECOND QUARTERS OF 2017

1.0 INTRODUCTION

The financial sector recorded remarkable developments in the first half of 2017. Most of these were partly due to policies made by the Monetary Policy Committee (MPC) of the Central Bank of Nigeria (CBN) and broad-based initiatives of Federal Government to engender real sector growth. This chapter presents these developments and how they affect the economy, especially the financial sector. After the introduction in section one, Section 2 presents international economic developments. Section 3 discusses domestic macroeconomic and financial developments while Section 4 reviews developments in the capital market and Section 5 presents exchange rate dynamics. Movement in foreign exchange reserves is discussed in Section 6 while Section 7 reviews CBN circulars pertaining to deposit taking financial institutions and mobile payment operators.

2.0 INTERNATIONAL ECONOMIC DEVELOPMENTS

Growth outcomes in the first half of 2017 was generally stronger than expected, due to firmer domestic demand growth in advanced economies and China as well as improved performance in other large emerging market economies. The global economy grew by 2.8% and 3.2% in the Q1 and Q2 of 2017, respectively, compared to 2.6% growth recorded in Q4, 2016.

Oil price and other commodities prices declined in the first half of 2017, as against the earlier increase in Q4, 2016. Core inflation in most advanced countries and emerging markets, however, remained stable. Long term bond yields in advanced economies rebounded in Q2 from earlier contraction in Q1. Equity prices also remained strong as markets continued to be more optimistic about corporate earnings.

Exchange rate and capital flows in Q4, 2016 reversed in the first half of 2017. The U.S. dollars appreciated by over 6% in the last half of 2016, but depreciated by around 3.5% in real effective terms since Q1 2017. In contrast, the Euro appreciated by around the same percentage in this period while it weakened in the last two quarters of 2016. Also capital flows into emerging markets have increased in the first half of 2017 as against notable decline recorded in late 2016.

Generally, global growth momentum is weighed down by medium-term downside risks. However, some upside risks, such as the cyclical rebound of economic activities in Europe where the political risk has diminished and depreciation-induced export-led growth in US-trading partners, boosted global growth. Many downside risks are hinged on monetary policy normalization in some advanced economies, policy uncertainties in US over regulatory and fiscal issues, and Euro-zone post-Brexit arrangement; inward-looking policies and trade protectionism; as well as rising geopolitical tensions and other shocks emanating from weak governance and corruption.

3.0 DOMESTIC ECONOMY AND FINANCIAL DEVELOPMENTS

The Nigerian economy, like any other economy in the world, is not immune to the effects of global economic developments due to trade, financial and other linkages. As a result, there were several changes in many sectors of the economy, especially the financial sector. Some of these developments were direct effects of external sector events while others were due to policy responses by relevant government authorities. This section presents the developments with emphasis on the financial sector.

3.1 CBN Monetary Policy Committee Meetings

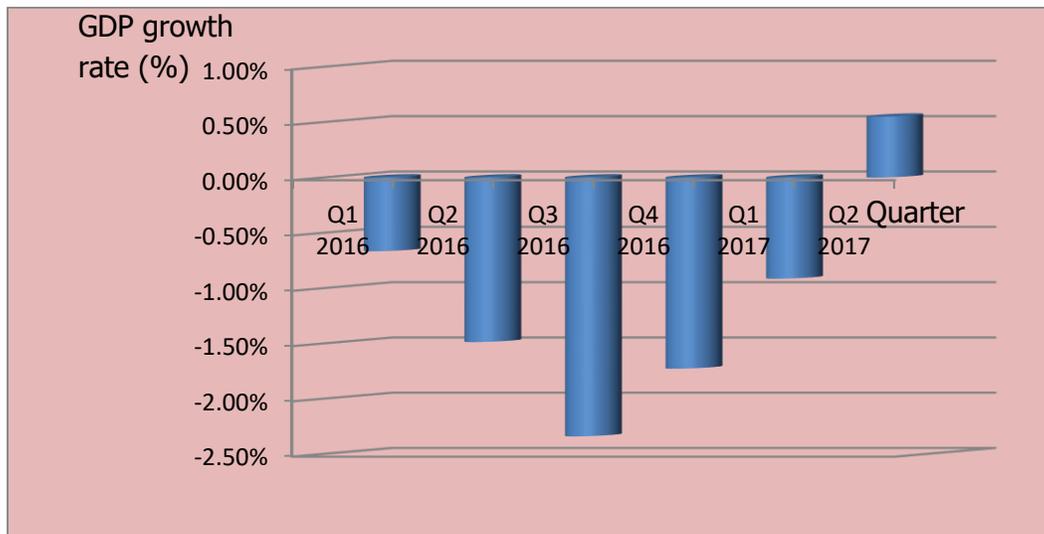
The MPC met in January, March and May, 2017 in the period under review. The Committee maintained contractionary monetary policy stance with Monetary Policy Rate

(MPR) kept at 14% and Cash Reserve Ratio (CRR) at 22.5% as some of the steps taken to improve price and foreign exchange-rate stability.

3.2 Gross Domestic Product (GDP)

GDP recorded a growth rate of 0.55% in Q2 of 2017, in contrast to negative growth in the previous five quarters. Figure 1 presents year-on-year GDP growth rates and shows that the economy emerged from recession in Q2, 2017. The emergence from recession was partly driven by improved price of crude oil from \$46.39 per barrel in February to \$52.94 per barrel in April, and improved productivity in the nonoil sector which grew by 0.7% and 0.41% in Q1 and Q2, 2017, respectively. Also, indicators of domestic economic activities such as Purchasing Manager Index (PMI) and Composite Economic Index of Economic Activities (CIEA) showed that economic activities were on significant increase in Q1 2017 and heralded positive GDP growth in Q2 2017.

Figure 1: GDP growth (Q1 2016 - Q2 2017)



Source: National Bureau of Statistics

The Fairly stable and higher levels of oil production also contributed to the promising economic performance in Q2 2017. Oil production was estimated to have averaged 1.84 billion barrels per day (bbpd) in Q2 2017 as against 1.69 bbpd in Q1 2017. That, combined

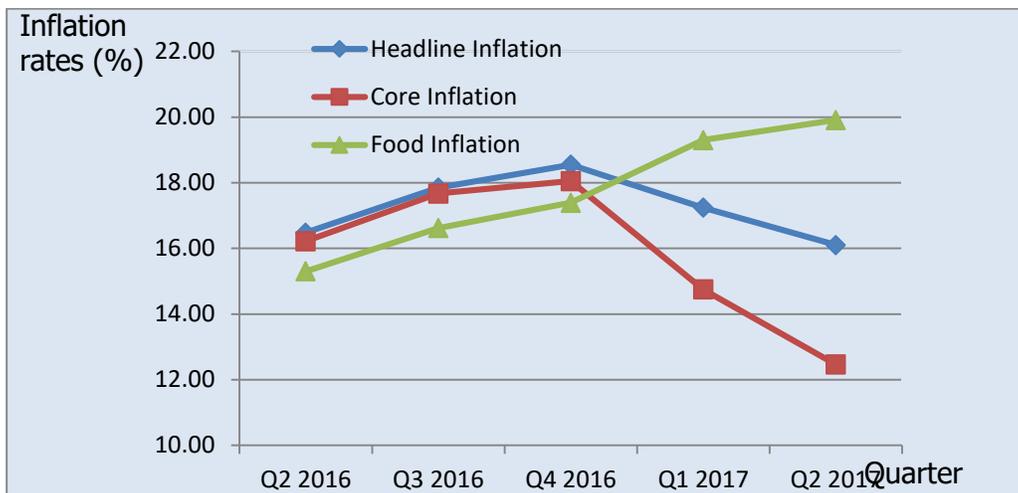
with improving oil price, led to 1.64% year-on-year and 7.52% quarter-on-quarter growths. Nonoil sector growth of 0.72% and 0.45% in Q1 and Q2, 2017 respectively, also contributed to overall economic growth in Q2 2017.

It is expected that current growth momentum will be sustained. There are expectations that, implementation of the 2017 Economic Recovery Growth Plan (ERGP) will further strengthen growth and generate employment in the future.

3.3 Inflation

Headline inflation declined, as shown in figure 2, from 18.55% in Q4 2016 to 17.24% and 16.10% in Q1 and Q2, 2017, respectively. Core inflation moderated to 14.75% and 12.46% in Q1 and Q2, 2017, respectively, from 18.05% in Q4 2016. The MPC attributed the moderation to partly relative stability of exchange rate. The moderation could also be attributed to increasing economic activities and the engendered increase in supply of goods and services in the domestic markets.

Figure 2: Inflation rates (Q2 2016 – Q2 2017)



Source: Nigeria Bureau of Statistics

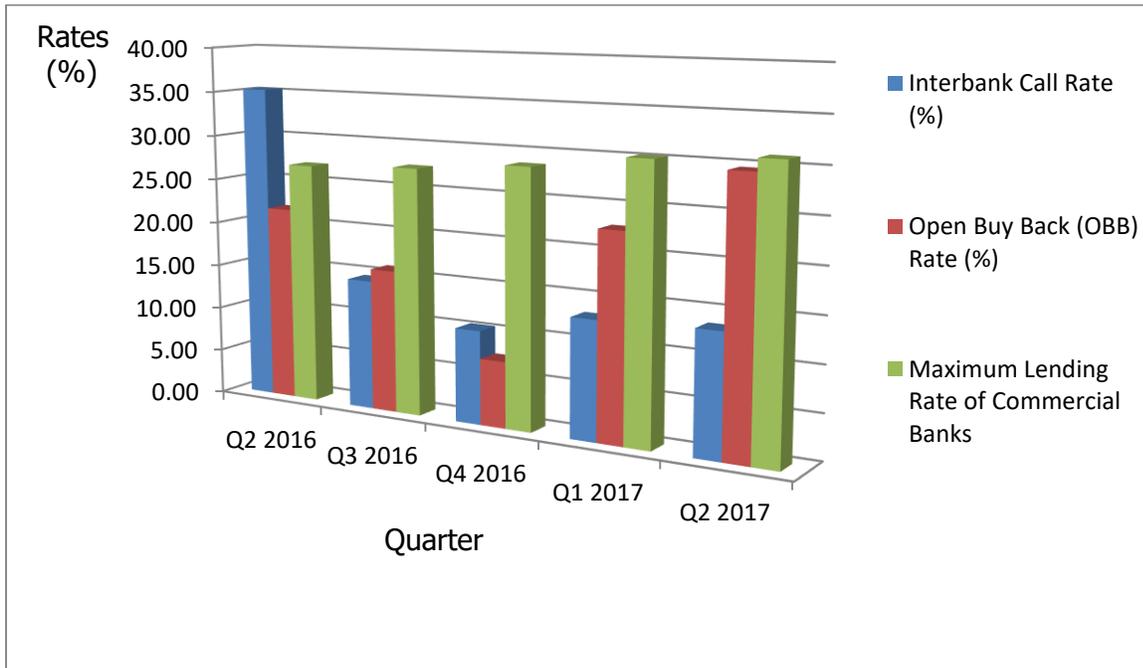
Food inflation however rose from 17.39% in Q4 2016 to 19.30% and 19.91% in Q1 and Q2, 2017, respectively. That was largely attributed to insecurity in the North East and other seasonal farming effects.

3.4 Money Supply and Rates

Broad money supply (M2) declined by 5.83% and 1.59% in Q1 and Q2, 2017, respectively from ₦23.34 trillion in Q4 2016. Narrow Money supply (M1) shared a similar growth trajectory. It declined by 10.06% and 0.71% in Q1 and Q2, 2017, respectively, against expansion by 12.60% in Q4 2016. Contraction in money supply stocks in the first half of 2017 was connected with the contractionary monetary policy stance of the CBN.

Net Domestic Credit (NDC) grew by 1.08% and 0.26% in Q1 and Q2, 2017, respectively, compared to 2.58% in Q4 2016. The marginal growth in net credit derived mainly from net credit to government which grew by 26.31% and 2.80% in Q1 and Q2, 2017, respectively. Credit to private sector shrank by 3.26% and 0.31% in the same period. The figures suggest that credit to private sector was crowded out by credit to government over the periods.

During the period under review, money market interest rates fluctuated with the level of liquidity in the banking system. Figure 3 shows that average Inter-Bank Call Rate and Open-Buy-Back (OBB) Rate closed at 13.46 % and 29.57% respectively at the end Q2 2017, as against 10.39% and 7.35% in Q4 2016. Maximum lending rate also rose from 28.55% in Q4 2016 to 30.94% in Q2 2017. Increase in the rate reflected the contractionary monetary policy effects.

Figure 3: Money Market Rates (Q2 2016 - Q2 2017)

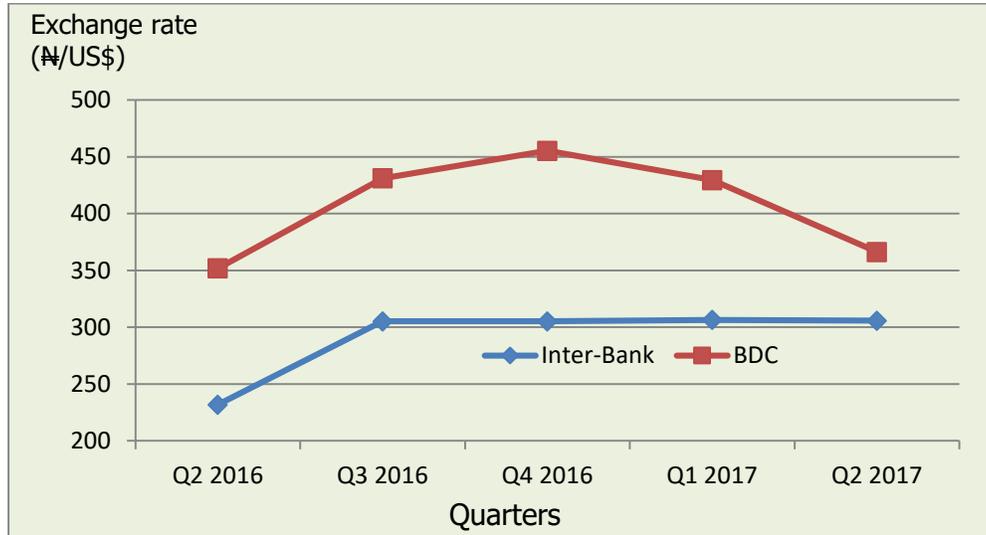
Source: CBN

4.0 CAPITAL MARKET

The Nigerian Stock Exchange All Share Index (ASI) rose by 29.79% from 25,516.34 in Q1 2017 to 33,117.48 in Q2 2017. That contrasted with a negative growth of 5.2% in Q4 2016. Similarly, the equities market capitalization rose by 29.71% from ₦8.83 trillion in Q1 to ₦11.45 trillion in Q2 2017; against the 5.0% negative growth in Q4 2016. The performances signal economic recovery as the indicators were on the decline in Q4 2016.

5.0 EXCHANGE RATE

During the quarters under review, the average Naira exchange rate remained relatively stable at the inter-bank segment of the foreign exchange market. The rate at the parallel market declined. Figure 4 shows that exchange rate at the interbank market was ₦305.22/US\$ in Q4 2016, and closed at ₦306.40/US\$ and ₦305.72/US\$ in Q1 and Q2 2017, respectively. Exchange rate at the parallel market continually fell from ₦455.26/US\$ in Q4 2016 to ₦366.25/US\$ in Q2 2017, showing some form of convergence to the interbank rate.

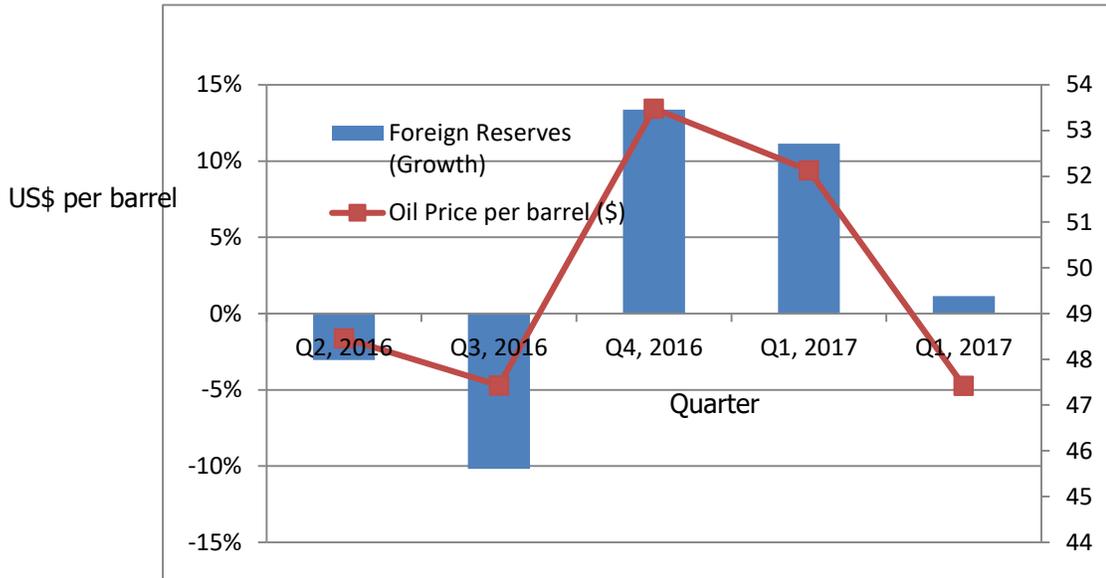
Figure 4: Exchange Rates of Naira (Q2 2016- Q2 2017)

Source: CBN

6.0 FOREIGN RESERVE MANAGEMENT

Gross official reserves consistently improved in the first half of 2017, rising by 11.1% and 1.14% in Q1 and Q2, 2017, respectively. Figure 5 shows that the improvement in the Reserves position in 2017 started from growth of 13.37% in Q4 2016, marking departure from decline in previous quarters. The movement in Reserves appeared to be driven by oil price changes, as Reserves started to grow positively when the oil price rose above \$50 per barrel in Q4 2016. However, the growth slowed down over the last three quarters as oil price closed at \$47.42 at end of Q2 2017.

Figure 5: Foreign Exchange Reserves (Q2 2016- Q2 2017)



Source: CBN

7 CBN CIRCULARS

The CBN issued many Circulars and Guidelines in the period under review.

7.1 Circular to Banks and Other Financial Institutions on Virtual Currency (VC) Operations in Nigeria

The CBN, in the circular referenced ***FPR/DIR/GEN/CIR/06/010*** and dated 12th January, 2017, alerted the banks and other financial institutions on the risks inherent in Virtual Currency transactions and directed them to desist from engaging in VC, put in place effective AML/CFT controls and report suspicious transactions by customers who are VC exchangers to the Nigerian Financial Intelligence Unit (NFIU). The circular posits that VCs are not legal tenders in Nigeria and institutions transacting in them do so at their own risk.

7.2 Payment Of Annual License Renewal Fee Through Electronic Channels

In the circular *FPR/LAD/CON/BDC/01/006* dated January 16, 2017, the CBN informed all Bureau De Change and Finance Companies to timely comply with annual licensing renewals policy and pay the fees into designated accounts with the CBN through Real-Time Gross Settlement (RTGS).

7.3 Exposure Draft On "The Guidelines For Direct Debit Scheme And Bill Payments In Nigeria"

The CBN in the circular *BPS/PSV/GEN/CIR/01/001* dated January 30, 2017 informed banks, other financial institutions, service providers and the general public of the release of the exposure drafts of the "The Guidelines for Direct Debit Scheme" and "Bill Payments in Nigeria" for comments.

The Guideline supersede the previous Guidelines for Direct Debits issued by the CBN. The Draft, amongst others, recognizes the existing and emerging multi-channel options (Online platforms, Instant Payments etc.) applied for Direct Debit instructions in Nigeria.

7.4 Exposure Draft On "The Guidelines On Instant (Inter-Bank) Electronic Funds Transfer Services In Nigeria"

The CBN in the circular *BPS/PSV/GEN/CIR/01/003* dated February 3, 2017 released an exposure draft on "the guidelines on instant (inter-bank) electronic funds transfer (EFT) services in Nigeria" for comments in furtherance of its mandate of development of the electronic payments system in Nigeria.

The Guideline prescribed standards to guide the provision and implementation of instant EFT services in Nigeria and stipulated procedures geared towards the enhancement of the soundness of instant EFT services, while adequately protecting the interests of instant EFT customers and operators. The Guideline also provided minimum operational

standards and streamlined the operations of the various Instant EFT platforms operating in Nigeria.

7.5 Circular On Nationwide Implementation Of Cashless Policy

In the circular ***BPS/DIR/GEN/CIR/04/001***, the CBN informed banks on the cashless policy review which occurred at the bankers' committee held on 8th February, 2017. In the Circular, Charges on deposits were re-introduced, Rates of deposit and withdrawal charges were reviewed effective from 1st April, 2017, depending on the category of states and 40:60 sharing of income generated between CBN and the banks. Also, existing exemptions remain sustained for government accounts, embassies, NGOs and banks were also advised to enlighten customers, train staff and communicate through media on cashless policy and e-payment options available.

7.6 Circular to All Banks on Regulatory Guidelines for the Redesigned Credit Risk Management System (CRMS) for Commercial, Merchant and Non-Interest Banks

The CBN, in a circular referenced FPR/DIR/GEN/CRM/06/012 and dated 27th February, 2017, released a new Guideline on rendition requirements of CRMS reports regarding loan disbursement by Commercial, Merchant and Non-Interest Banks. The Guideline stipulated that the rendition requirement came into effect on 21st of February, 2017 when the system became operational, and that any breach of the requirement from 3rd April, 2017 would be appropriately sanctioned.

7.7 Immediate adoption of examiners' recommended provision and audit adjustment by the OFIs

In a circular referenced ***OFI/DIR/CIR/GEN/17/070*** to all Other Financial Institutions, the CBN directed the boards of each OFI to immediately pass into their ledgers, all necessary entries i.e. audit adjustment and/or examiners' recommended provision in the latest examination report and the same should also be reflected in the next monthly

report sent to the CBN. Adoption must be on immediate receipt of report by the board, failure of which will attract appropriate sanctions as applicable to the type of OFI.

7.8 Guidelines for the Regulation and Supervision of Non-Interest (Islamic) Microfinance Banks in Nigeria

The CBN issued a guideline in a circular referenced *FPR/DIR/GEN/CIR/06/016* with respect to the regulation and supervision of Non-Interest (Islamic) MFBs in Nigeria. The Guideline was developed to provide a common playing field between the conventional and non-interest MFBs as well as address issues covering the operations of Non-interest Financial Institutions (NIFIs); and drive financial inclusion by integrating to the formal sector, individuals, organisations and communities not covered by the conventional MFBs.

7.9 Guide to charges by banks and other Financial Institutions

In its effort to address the gap in the Guide to Bank Charges issued in 2013, the CBN in the circular referenced *FPR/DIR/GEN/CIR/06/017* released a reviewed Guide, which addresses the charges on various products and services that banks, other financial institutions and mobile payment operators offer to their customers. The reviewed Guide replaced the 2013 guide and took effect from May 1, 2017.

7.10 Circular to All Deposit Money Banks, Other Financial Institutions and Mobile Payment Operators on Guide to Charges by Banks and Other Financial Institutions

The CBN, in a Circular referenced *FPR/DIR/GEN/CIR/06/017* dated 21st April, 2017, provided a Guideline on charges on various product and services that banks, other financial institutions, and mobile money operators offer to their customers. The Circular required these financial institutions to present any other product, services and/or charge not covered by the guideline to the Central Bank of Nigeria for prior written approval.

7.11 Letter to all Other Financial Institutions (OFIs) on rendition of returns on Anti-money Laundering and Combatting of Financial Terrorism (AML/CFT)

In its efforts to address the low level of submission of the above mentioned returns, the CBN in a circular referenced ***OFISD/DIR/CIR/GEN/17/28***, reiterated the various types of returns, frequency and deadline of submission and a remainder of sanctions to be attracted upon failure to comply with the directive issued in the circular ***FPR/DIR/CON/BOF/01/036*** dated August 12, 2012.

7.12 Data Exchange Agreements with at Least Two Licensed Credit Bureaux in Nigeria

In a circular referenced ***OFI/DIR/CIR/GEN/17/151***, the CBN drew attention of OFIs to the penalties attracted for non-compliance with the provisions of circular ***BSD/DIR/GEN/CIR/04/014*** of April 30, 2010 and circular ***BSD/DIR/GEN/LAB/06/051*** of November 14, 2013, which required all OFIs to establish Data Exchange agreements with Credit Bureaux, obtain credit reports prior to granting any facility, periodically determine each borrower's current exposure to the financial system and submit credit information on all customers, staff and directors to Credit Bureaux respectively.

The Central Bank also advised the OFIs to include a disclosure clause in the terms and conditions of account opening packs to obtain consent for continuous credit information sharing with Credit Bureaux.

7.13 Exposure Draft on the Framework for Licensing, Regulation and Supervision of Private Asset Management Companies in Nigeria

Further to the developments in the Nigerian banking industry, which necessitated the need for the licensing of Private Asset Management Companies (PAMCs), the CBN developed and released an exposure draft of the Framework for the licensing, regulation

and supervision of the PAMCs. The framework defined PAMCs, its scope of activities for PAMCs, licencing requirements, ownership and board composition, corporate governance, et cetera. The objectives of the framework are to:

- i. assist the regulatory authorities in promoting soundness and stability of the Financial System,
- ii. create a vehicle to acquire eligible assets of banks, Other Financial Institutions (OFIs), and Banks In-Liquidation,
- iii. create an alternative source of liquidity for banks and OFIs,
- iv. provide a platform for restructuring acquired eligible assets of banks, OFIs and banks in-liquidation,
- v. minimize the systemic consequences of delinquent assets on banks and banks in-liquidation and;
- vi. Allow private institutions to complement the role of AMCON.

7.14 Exposure Draft On The Regulatory Framework For Bank Verification Number (BVN) Operations And Watch-List For The Nigerian Financial System

In furtherance to its mandate for the development of the Nigerian Electronic Payments System, the CBN in a circular referenced ***BPS/DIR/GEN/CIR/04/005*** dated July 3, 2017, released the exposure draft on the Regulatory Framework for Bank Verification Number (BVN) operations and watch-List for the Nigerian financial system for review and comments by stakeholders. The Framework provides the Standard Operating Guidelines and Framework on Watch-list (for confirmed fraudulent banks' customers) for the Nigerian Financial System, while also identifying the participants and their roles in the BVN operations. The objectives of the Regulatory Framework are to:

- Clearly define the roles and responsibilities of stakeholders,
- define the Bank Verification Number operations in Nigeria,
- outline the process/operations of the watch-list and;

- Define access, usage and ownership of the BVN data, requirements and conditions.