EFInA Quarterly Review

(October to December 2010)

1 Nigerian Economy

According to United Nations, Nigeria is ranked 142 out of 169 least prosperous countries in the world. Nigeria is ranked among the Low Human Development countries. The Human Development Index is a comparative measure of life expectancy, literacy, education and standards of living worldwide. It is a standard means of measuring well-being of countries globally and it is used to distinguish whether a country is developed, developing or under-developed. Currently, Nigeria has a life expectancy of 48.4 years, with a Gross National Income per capita of $2,156. According to the HDI Report, Sub Saharan Africa is typically considered the region facing the greatest challenges in human development across all dimensions; it has the lowest HDI indicators for any region. However, several African countries have registered substantial progress in improving human development.

1.1 Growth Forecast

The International Monetary Fund (IMF) expects Nigeria to sustain a 7.4% output growth from 2010 till 2011. The IMF's growth forecast for Nigeria is stronger than for sub-Saharan Africa, which is put at 5% and 5.5% for 2010 and 2011, respectively. The IMF said continued strong growth in Nigeria's non-oil sector was being supported by increasing oil production. According to the Bretton Woods institution, the recovery in global demand and the strengthening of oil prices are supporting growth in Africa's oil exporting economies. The IMF noted that the primary risk to the outlook for the region is a faltering global recovery. For the oil-exporting economies, spill over from a global slowdown will be manifested primarily through its impact on oil prices.

1.2 National Minimum Wage

In November, the National Council of State (NCS) endorsed the proposed N18,000 monthly minimum wage as benchmark for all workers in the country, and advised President Goodluck Jonathan to forward the bill to the National Assembly for legislation. The minimum wage is binding on all governments and corporate bodies. The endorsement of the minimum wage was not without reservations as some governors raised concerns over their ability to pay. As a result, the Council suggested a "deregulated minimum wage system" that would allow the States pay different wages to their workers.

1.3 Inflation

Nigeria's inflation figures dropped for the third consecutive month in November to 12.8 per cent. According to data from the National Bureau of Statistics, this is significantly lower than 13.4 percent recorded in October and 13.6 per cent in September. The Statistics office, in its report for November, stated that average monthly food prices rose marginally by 0.3 percent in November when compared with October.

1.4 Sovereign Debt

The Federal Government has set a specific borrowing limit of 25% of its Gross Domestic Product till 2014. As at the end of December, Nigeria's public debt was $34.7 billion with domestic debt accounting for $30 billion and external debt contributing $4.7 billion. According to the Minister of Finance, Mr Olusegun Aganga, Nigeria's current Debt/GDP ratio is 16.5%, compared to 40% which is the approved limit for countries that are economic peers of the country. The Minister said that if the National Assembly approved the loan requested by the Federal Government, it would only raise the debt ratio to GDP of the country to 22%.

1.5 Budget

Nigeria expects its budget deficit to widen to 6.1 percent of GDP in 2010 which is more than double the level set under the fiscal responsibility Act three years ago, as government spending rises ahead of elections next April. Revenue shortfalls from the oil and gas sector, unexpected wage increases, and election costs will contribute to the widening deficit. Government revenue is projected at N3.18 trillion with expenditure expected to be N5.16 trillion. Government borrowing has risen sharply, increasing by more than 50 percent since the start of the year, compared to private sector credit growth of just 3 percent over the same period.

1.5.1 Budget 2011

In December, President Goodluck Jonathan presented a budget proposal of N4.226 trillion to the National Assembly for the 2011 fiscal year. The budget was made up of N196.12 billion for statutory transfers, N542.38 billion for debt service, N2.481 trillion for recurrent (non-debt) expenditure and N1.05 trillion for capital expenditure. According to the President "This represents 18.1 per cent contraction from the N5.159 trillion appropriated by the 2010 Amendment and Supplementary Budgets." The budget is underpinned by four pillars that are drawn from Nigeria's economic growth strategy, which are: to foster inclusive growth and job creation; optimize capital spending by rationalizing recurrent expenditure and maximizing government's revenue; accelerate the implementation of reforms to enhance the quality and efficiency of public expenditure; and reinstate greater prudence in the management of the nation's financial resources.

The budget is based on the following assumptions:

- Oil production of 2.3 million barrels per day
- Oil price benchmark of $65/barrel
- Exchange rate of N150/$1
- Joint venture cash call of $5.4billion
- Projected GDP growth rate of 7%

President Jonathan disclosed that the 2011 budget would amount to a deficit of 3.6 per cent of GDP, adding that new spending obligations such as the recent public service wage increases have contributed to the size of the deficit.

1.6 Foreign Reserves

In October, ratings agency, Fitch Ratings lowered its rating on Nigeria's BB-rating to "negative" from "stable", mainly based on withdrawals from the excess crude account and a drop in foreign currency reserves. The decline in reserves increases the risk to the economy from any drop in oil prices, Fitch said. As at 2 December, Nigeria's foreign reserves had dropped by 23.26% to $32.93 billion, compared with what it was at the same time in 2009.

2 Financial Sector

2.1 Stock Market

Despite government's efforts to restore confidence in the aftermath of the economic crunch that started two years ago, an assessment of the Nigerian capital market this year showed that investors' confidence in the bourse is still at low ebb.

The Securities and Exchange Commission (SEC) took action against 260 entities and individuals for alleged violations of the Investments and Securities Act to the Investments and Securities Tribunal. The SEC said, "These entities and individuals including banks and other capital market operators are alleged to have been involved in price fixing, share price manipulation, fraud, and insider trading. These activities are contrary to the provisions of the Act." Ms Oteh said the Exchange Commission has a great sense of responsibility on the integrity of the market and the protection of investors' interests. She said, "We firmly believe that the actions we are taking will lead to long term improvements in the state and activities of the Exchange, thereby safeguarding the interests of the investor. These directives reinforce the integrity of our markets and demonstrate commitment to accountability, particularly given the importance of ensuring adequate oversight at all times".

2.2 Banking Industry

The CBN said that it has disbursed the sum of N80.7 billion out of the N200 billion set aside for commercial agriculture in the country. It also said that out of the N500bn approved for power & aviation sectors as well as for the refinancing of manufacturers' portfolios, about N199bn had been released to the Bank of Industry for disbursement to the manufacturers. The CBN governor expressed satisfaction with the flow of credit from the Deposit Money Banks to the economy. He said that new credit to the economy increased from N145.46bn in April to N173.80bn in May and N345.99bn in June representing an increase of 19.49% and

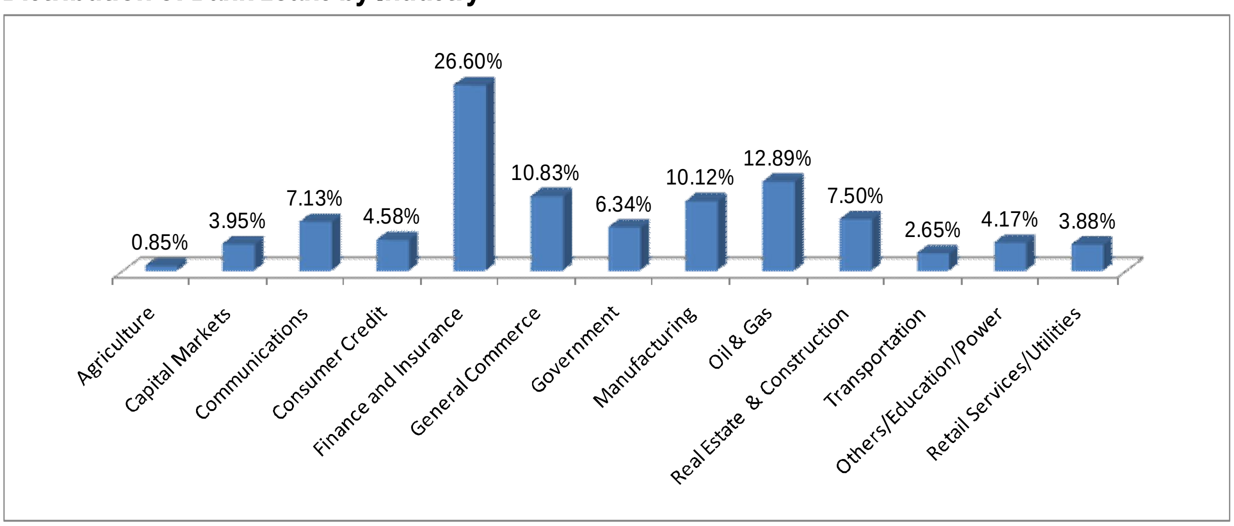
99.1% respectively. However, the governor said that the credit inflow declined to N322.27bn in October. The bulk of the credit, according to him, went to oil and gas, manufacturing, transportation and storage sectors.

Governor of CBN, Mallam Sanusi Lamido Sanusi said that ongoing reforms in the Nigerian banking sector are geared towards achieving the Federal Government's Financial System Strategy (FSS) 2020. He also said that the reforms would serve as a catalyst for the emergence of the country as one of the top 20 economies in the world by 2020.

The Financial Transparency Report 2010 covers the 14 banks not affected by the Central Bank of Nigeria's change of management that are quoted on the Nigerian Stock Exchange and have published their 2009 annual reports. Analysis of bank lending portfolio provided in the Report shows that in 2009, bank lending to other financial institutions and the insurance sector is an average of 26% of all bank lending in Nigeria. This represents the highest proportion of loans by banks in the country. The report shows that of the total loans portfolio of N6 trillion for the 14 banks analysed:

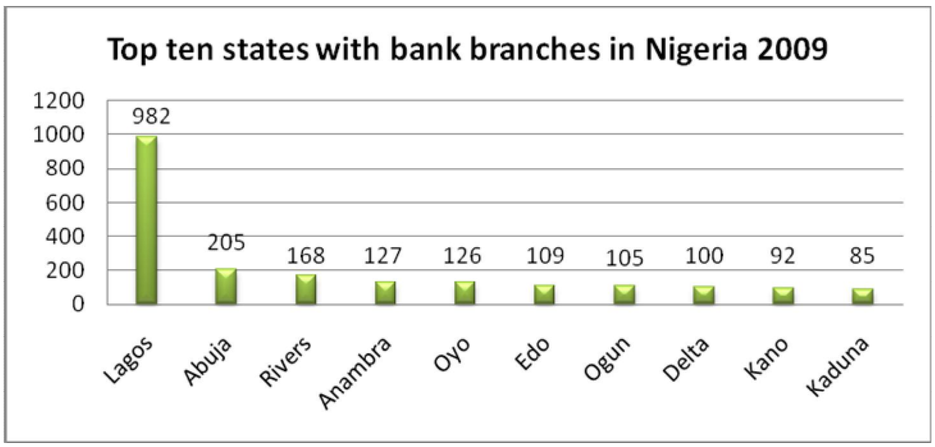
- N1.62 trillion comprised mainly interbank lending and other forms of lending to other banks and insurance firms
- Loans to the oil and gas sector ranked a distant second with N787 billion of the gross lending
- Loans for general commerce ranked third with N661 billion
- Manufacturing came fourth attracting N617 billion
- Agriculture attracted the least lending

Distribution of Bank Loans by Industry



Source: Nigerian Banks Financial Transparency Report 2010

According to the Nigerian Banks Financial Transparency Report 2010, 63% of all bank branches in the country are based in the following ten States: Lagos, Abuja FCT, Rivers, Anambra, Oyo, Edo, Ogun, Delta, Kano and Kaduna. Analysis of bank branch locations in the Report shows a heavy concentration of bank branches in Lagos with 31% of all bank branches in Nigeria. Abuja has the second highest concentration of bank branches with just 6% of all bank branches. Rivers State has the third highest concentration of bank branches with about 5% of all bank branches in the country. The bottom four states in terms of bank branch locations are: Ebonyi, Kebbi, Jigawa and Zamfara states; each with less than 1% of bank branches in the country in 2009.



Source: Nigerian Banks Financial Transparency Report 2010

2.2.1 Know Your Customer

In December, the Central Bank kick started its Know Your Customer (KYC) Initiative to compel bank customers to update their account details with their banks and particularly intensify the fight against Money laundering activities and Terrorism financing in the country. The CBN, Economic and Financial Crimes Commission as well as the United Nations Office on Drug and Crime are partnering in this exercise which officially began on 1 December 2010 and lasts until 31 January 2011. After which any customer that fails to comply will be barred from operating his/her account. Dr Kingsley Moghalu, CBN Deputy Governor on Financial Services Stability said that the initiative is in line with apex bank's 2009 Anti-Money Laundering/Combating of Financing Terrorism Regulation and the 2004 Money Laundering (Prohibition) Act which requires financial institutions to among other things identify and verify the identities of their customers and render statutory returns to regulatory bodies such as the CBN and the Nigerian Financial Intelligence Unit.

2.2.2 E-Payments

According to Mr Kyari Bukar, Chief Executive Officer of Valucard, Nigeria: ATM transactions in Nigeria have hit N80 billion per month, whilst Point of Sales (POS) transactions across the nation have hit N1.4billion per month. Bukar said that there was a need to protect users from fraud, which had prompted the Central Bank to enable migration from the unsecured magnetic stripe cards to Chip/PIN cards. He said this move, coupled with various sensitization programmes, have helped to reduce ATM fraud across the country.

2.2.3 Asset Management Corporation of Nigeria (AMCON)

In November, the Asset Management Corporation of Nigeria (AMCON) commenced operations as the principal vehicle for the resolution of the asset quality problems that have bedevilled the banking system in the last two years. In addition to purchasing non-performing loans from the banks, AMCON is a vehicle for recapitalising the affected banks. The Senate unanimously confirmed all the board nominees. Institutional representations on the Board include: the Permanent Secretary of Finance, the Deputy Governor, Financial System Stability, CBN, the Director-General Security and Exchange Commission and the Managing Director, Nigerian Deposit Insurance Commission. In December, AMCON disclosed its plans to auction about N2.5 trillion ($16.6 billion) worth of bonds to finance the purchase of toxic assets from banks.

2.2.4 Microfinance

In December, the Nigerian Deposit Insurance Corporation (NDIC) allayed the fears of depositors in the recently closed Microfinance Banks in the country, reassuring them that provisions have been made for payment of their deposits. NDIC also disclosed that it is compiling the list of key operators responsible for the mismanagement of the closed microfinance institutions with a view to prosecuting them in line with the country's laws. The Acting Managing Director of NDIC, Alhaji Umaru Ibrahim said N1.5 billion has been set aside for the exercise. The insured sum covered under its Deposit Insurance Scheme would be N200,000 (recently reviewed upwards from N100,000), which means that 99 per cent of affected depositors will get their full deposits. Based on NDIC laws, depositors are supposed to be paid within 90 days and that is what NDIC are striving to achieve.

2.2.5 Summary of the Banking Industry in 2010

The effect of the sector cleansing which begun in 2009, leading to the sacking of some banks Chief Executives and injection of about N627 billion into some rescued banks provided a new leeway for banks to redesign their business models and learn to play by the rules. The commencement of uniform accounting year in December 2009 also helped to reveal the true state of the financial position of the banks. As a result, many banks had to make provisions for bad loans. This resulted in many declaring losses, instead of the huge profits in previous years.

By the end of the second quarter in 2010, after massive personnel cut and increased efficiency in operations, many of the banks declared modest profit. While the sector was still grappling with this, as well as the fallout of the intervention and various regulatory efforts to address the apparent loss of confidence in the Nigerian banking system, the Central Bank of Nigeria was fine-tuning the Bill for the setting up of an Asset Management Corporation of Nigeria. The Bill was finally passed on 19 July 2010 and the board was inaugurated at the end of August. AMCON has already released its modalities for its operations and what category of debt will qualify for takeover. It has also reached a compromise with the banks on the valuation of the assets to be taken over.

In September, the Central Bank revoked the licenses of 224 microfinance banks across the country, on the following grounds: they were not properly capitalised, poor corporate governance and the promoters were not ethical in running the operations.

In November, the CBN also revoked the licenses of Class 'A' Bureau de Change in a bid to check currency speculation and abuse. The move was as a result of the fallout of the increasing demand for foreign exchange which the regulator perceived not to be genuine demand. The pressure on the currency was affecting the foreign reserves, as the country struggled to maintain the value of the naira.

All these efforts were part of the drive to maintain a tightly regulated financial environment whilst ensuring that the economy thrives and also to achieve manageable inflation, exchange and interest rates.

2.3 Remittances

According to a World Bank report, Nigeria was the top remittance recipient in sub-Saharan Africa, accounting for an estimated $10 billion in 2010. It represented a slight increase over the previous year, where migrants sent home $9.6 billion (representing 5.6% of GDP). The report also stated that remittance flows to sub-Saharan Africa would reach $21.5 billion in 2010 after a small decrease in 2009 due to the global financial crisis. In absolute dollars, Nigeria accounts for nearly half of all the money sent to sub-Saharan Africa. Other top recipients include Sudan ($3.2bn), Kenya ($1.8bn), Senegal ($1.2bn), South Africa ($1bn), Uganda ($0.8bn), Lesotho ($0.5bn), Ethiopia ($387m), Mali ($385m) and Togo ($302m).

According to the report, the top destination countries for migrants from Nigeria are the United States, the United Kingdom, Chad, Cameroon, Italy, Benin, Cote d'Ivoire, Spain, Sudan and Niger. However, it is estimated that over one million people immigrated to Nigeria in 2010, primarily from Benin, Ghana, Togo, Mali, Niger, Chad, Cameroon, Liberia, Mauritania and Egypt.

Worldwide, remittance flows are expected to reach $440 billion in 2010, up from $416 billion in 2009. About three-quarters of these funds or $325 billion will go to developing countries. The World Bank estimates that flows to these countries as a whole will rise further over the next two years, possibly exceeding $370 billion by 2012.

Remittances are a critical lifeline for families and entire communities across Africa, especially in the aftermath of the global crisis. The fact that remittances are so large, come in foreign currency, and go directly to households' means that these transfers have a significant impact on poverty reduction, providing funding for housing and education, basic essential needs, and even business investments. There is pressing need to make it easier and cheaper to send and receive remittances in Africa. The average cost of sending money to Africa is more than 10%, which is the highest among all the regions. The cost of sending money within Africa is even higher.

2.4 Cooperatives

Being able to save out of one's salary can be quite challenging; so finding opportunities to pool resources together through co-operative societies goes a long way in helping many achieve their savings target. Partnership for wealth creation was the theme of an interactive business luncheon session hosted by Royal Exchange Finance and Investment Limited for major cooperative societies in Lagos state in October. The meeting was designed to explore ways in which co-operative societies could take advantage of product offerings of the company to enhance the welfare of their members. Speaking at the occasion, Allan Walmsley, Group Managing Director of Royal Exchange, stated that there were two very important pillars for national development in any society - a savings culture using co-operative societies and a vibrant insurance industry with its ability to underwrite risk. According to Walmsley, "The cooperative movement is one of the oldest means of enhancing a savings culture and it has, and will always be, a very vibrant industry in Nigeria. It therefore makes a lot of sense for the insurance sector and cooperative societies in Nigeria to partner with each other for the mutual benefit of the nation". Lanre Oki, president of the Lagos State Cooperative Federation also noted that "Cooperative societies cannot do it alone as they seek to develop their members, because their income cannot satisfy their needs. Therefore they need a strong partner that will enable members to achieve their financial goals and aspirations".

2.5 Housing Finance

The World Bank has estimated that the cost of bridging Nigeria's 17 million housing deficit is N59.5 trillion, underlining the vast and untapped investment potential of the country's real estate sector. Experts have however identified the Land Use Act of 1978 which resides ownership of land in state governors, and a cumbersome property registration process as major barriers to housing development and home ownership, leading to the country's huge housing deficit. The World Bank also noted that Nigeria's mortgage industry remains underdeveloped because interest rates on mortgages are ridiculously high, making the mortgage business in Nigeria unattractive. According to Fortune Ebie, former Managing Director of the Federal Housing Authority, until the Act is reviewed or amended, improved housing development will continue to be a pipe dream.

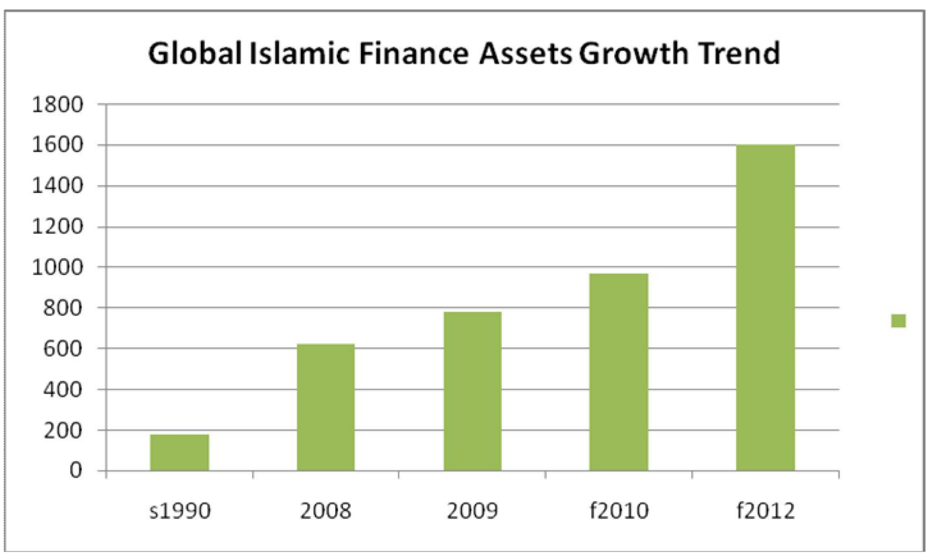
Currently, Nigeria's real estate industry accounts for between four and five percent of total GDP, growing by 10.48 percent in the second quarter of 2010. Bismarck Rewane, Chief Executive Officer, Financial Derivatives Company Limited, in his November monthly economic report, said the minimum interest rate on mortgages in Nigeria is as high as 17 percent as against between three and five percent in developed countries; the result of which is that mortgage affordability is difficult for the low and middle-income class. It is however expected that the review of the Land Use Act, which is currently on the floor of the

National Assembly, will bring the needed improvement and growth in both the housing and mortgage industry in the country. Other anticipated benefits of the Land Use Act review, according to experts, include improved mortgage transactions; land security; poverty reduction; employment creation; easy access to land; and stress free acquisition of property titles.

2.6 Non-Interest (Islamic) Finance

The concept of Islamic banking does not really have anything to do with the religion. It only means an inclusive financing package that is aimed at lifting the burden of interest rates off the people, especially the poor, or the low income or better still people that have no access to formal banking.

Therefore, as the alternative to interest-based lending, Islamic finance adopts asset backed financing. These involve the transfer of assets and are not based on making money from money alone as is the case with interest-based transactions. Namely, these were Musharakah, Mudarabah, Salam, Istisna, Murabana and Ijarah. The Islamic banking sector worldwide has grown at a strong rate of 15 to 20 per cent annually over the past decade, from about $150 billion in the mid 1990s to an estimated $780 billion in 2009. In 2010, the Islamic banking sector assets are expected to grow by more than 20 per cent to $950 billion and to reach $1.6 trillion by 2012, as depicted by the graph below.



Source: Global Islamic Finance Forum, Country and Business Guide 2010

Analysts have always believed that non-interest banking would have significant impact on the Nigerian banking system and the economy as a whole. The introduction of non-interest banking will herald the entry of new market and institutional players such as the Islamic

Money Markets, Islamic Asset Management companies, Takaful (Islamic insurance) companies, etc., thus deepening the financial market. It will also enable a larger proportion of the Nigerian population to participate actively and effectively in economic development.

In November, the Nigeria Deposit Insurance Corporation (NDIC) announced that a framework to guide the implementation of the Deposit Insurance Scheme for Islamic banking would soon be released. Umaru Ibrahim, acting Managing Director, NDIC explained that NDIC's determination to extend deposit insurance protection to non-interest (Islamic) banks was in line with its statutory mandate and CBN's new bank licensing regime. According to him, "NDIC believes that non-interest (Islamic) banks should enjoy the benefits of deposit insurance protection right from the day they are licensed.

2.7 SME

In December 2010, the Federal Government set aside N75bn ($500m) as a special intervention fund for the development of small and medium-scale enterprises. The policy setting up the Micro Small and Medium Enterprises defines a micro enterprise as a business unit that employs less than 10 workers with an asset base of less than N5m. It defines a small business as one which has between 10 and 49 employees with an asset base of between N5m and N50m. The policy also stipulates that businesses with between 50 and 199 employees, with total assets of between N50m and N500m, should be categorised as medium-scale businesses. The factors that currently inhibit the growth of the sector include the inability to gain access to credit due to lack of training and capacity and the high cost of doing business in the country, owing to infrastructure problems.

3 Telecoms Sector

As at November, there were 78.9 million active GSM subscribers, as shown in the table below.

	Number of connected lines	Number of active lines
Mobile GSM	**92,829,229**	**78,927,333**
Mobile CDMA	**12,053,055**	**6,280,675**
Fixed Wired/Wireless	**2,749,993**	**1,102,696**
Total	**107,632,277**	**86,310,704**

Source: NCC