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Recent Banking Developments in Nigeria 26 pages

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Chu Okongwu*

On July 1, 1959, fifteen months before the country achieved full self-government, the Central Bank of Nigeria became fully operative. Prior to the creation of the Bank, the West African Currency Board had operated as the currency authority in Nigeria (and adjacent former British West African territories) but did not have other central banking functions. The establishment of the Central Bank has accelerated changes in the financial structure in Nigeria.

This paper is a review of the country's financial mechanism as it stands at the moment. Sections I to III describe the principal parts of that mechanism: the Central Bank, the commercial banks and the money and capital markets. Section IV examines the scope for monetary policy in the Nigerian economy. Section V discusses several areas where the monetary authorities will be required to concentrate their attention in the near future. Because the entire financial structure is relatively young, it is as yet too early to attempt a definitive appraisal of recent financial developments in Nigeria. But it does seem certain that changes in financial institutions and practices are likely to proceed rapidly in the next few years.

Section I. Central Banking

Origins of the central bank

The legislation establishing the Central Bank in Nigeria was passed on March 17, 1958. The Central Bank of Nigeria Ordinance and the Banking Ordinance of 1958 were based upon recommendations of a Bank of England official prepared at the request of the Nigerian authorities.

Earlier there had been a series of reports on the establishment of a central bank in Nigeria. The first report, prepared by Mr. J. L. Fisher, an adviser to the Bank of England, in 1952 had this to say:

> "I conclude that it would be inadvisable to contemplate the establishment of a Central Bank at the moment. It would be difficult to establish a Central Bank which could operate satisfactorily in such a narrow field. Moreover, it is hard to see how a Central Bank could function as an instrument to promote the economic development of the country. But that is not

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to say a Central Bank would not be a useful coping stone to the banking system at a future time. Given further development of the indigenous banking system and a growth in the financial mechanism, the establishment of a Central Bank would be a logical and useful step in due course."1/

Instead, Mr. Fisher suggested a three-step programme: (a) the transfer of the West African Currency Board from London to Africa; (b) the establishment of a Nigerian currency board; and (c) the establishment of a bank of issue which would gradually become a full-fledged central bank.

However, in 1954, a World Bank mission, which reported on the economic development of Nigeria, took the view that the early establishment of a central bank was to be recommended.2/ In the mission's view, much of Mr. Fisher's caution was unnecessary; the political and economic advancement of the territory called for the creation of a central bank even if its functions were limited at the outset.

Then in 1957, the Federal Government invited Mr. J. B. Loynes, an adviser to the Bank of England, to advise on the same issue. His report3/ became the basis for the promulgation of the Central Bank of Nigeria Ordinance and the Banking Ordinance of 1958. The Central Bank of Nigeria became formally operative on July 1, 1959 under the former ordinance and supervised commercial banks under the latter ordinance.4/

Central Bank Ordinance 1958

The Central Bank Ordinance of 1958 is the basic law which set up the central bank and defined its objectives, functions, and operations. In general, the legislation is similar to central banking statutes throughout the world.

Objectives -- The principal objectives of the Bank "shall be to issue legal tender currency in Nigeria, to maintain external reserves in order to safeguard the international value of that currency, to promote

1/ J. L. Fisher, Report on the Desirability and Practicability of Establishing a Central Bank in Nigeria for Promoting the Economic Development of the Country (Lagos 1953), page 18.

2/ International Bank for Reconstruction and Development, The Economic Development of Nigeria (Baltimore 1955), pages 96-101.

3/ Report by Mr. J. B. Loynes On the Establishment of a Nigerian Central Bank, the Introduction of a Nigerian Currency and other Associated Matters, (Lagos 1957).

4/ Central Bank of Nigeria Ordinance 1958, Nigeria Laws, No. 24 of 1958, A 109-124; Banking Ordinance 1958, Nigeria Laws No. 19 of 1958, A 81-91.

monetary stability and a sound financial structure in Nigeria and to act as a banker and financial adviser to the Federal Government."

Authorized capital -- The Bank's capital is set at £1.5 million, wholly-owned by the Federal Government.5/ A General Reserve Fund is to receive part of the Bank's net profit. Half of any remaining earnings are to be used to retire the Federal Government obligations to the Bank arising from the financing of the Bank's initial stock of currency, and the balance is to be paid to the Federal Government.

Bank's management -- The Board of Directors include a Governor and Deputy-Governor appointed by the Governor-General, and five other directors appointed by the Prime Minister. An Advisory Committee made up of the Federal Minister of Finance and the Regional Ministers meets with the Governor and his deputy at least twice a year.

Monetary regulations -- The Nigerian pound is set at parity with the British pound, thus preserving the link with sterling. The Bank has the sole right of issue.

The Bank must keep a 60 per cent reserve against notes in circulation and a 35 per cent reserve against other demand liabilities for the first five years; after that, a 40 per cent reserve against all demand liabilities has been established. The reserves can consist of gold and sterling deposits, U.K. Treasury and commercial bills, or gilt-edged bonds of not more than five-year maturity.

The Bank's rediscount rate structure accords a preferential status to Federal Government Treasury bills to encourage wider dealings in them. The minimum rediscount rate for Treasury bills is to be at least one per cent lower than those for advances secured by other collateral.

Margin requirements are also prescribed in respect of some advances: 75 per cent for advances secured by Federal Government securities maturing within 20 years, 75 per cent for eligible bills of exchange and promissory notes, and 60 per cent for those secured by warehouse warrants or their equivalents.

Among prohibited activities, the Bank may not engage in commercial activities or grant loans upon the security of any shares or pay interest on deposits. On the other hand, the Bank is empowered, subject to the Finance Minister's approval, to hold shares in any official institution for promoting the development of the country's financial mechanism -- e.g., in the money or capital markets -- provided that funds thereby involved do not exceed 20 per cent of its General Reserve Fund.

5/ Thus, regional governments are excluded from holding direct interests.

As banker to the Federal Government, the Bank will issue and manage Federal loans and can grant temporary advances to the Federal Government up to a total of 12-1/2 per cent of estimated recurrent budget revenue.

Unlike the old West African Currency Board, the Central Bank is specifically charged with supervisory authority over the commercial banking system, including the establishment of a uniform minimum liquidity ratio.6/

Operations of the Central Bank

Because the Bank cannot now take the external convertibility of the currency as given, as could the former Currency Board, the Bank has been very cautious in reducing the proportion of external assets held against domestic liabilities. The reserves have been slightly less than 100 per cent of these liabilities since July 1959, as may be seen in Table 1. Thus, the Bank has not radically departed from the reserve pattern of the Currency Board. In order "not to cast any doubt on the strength of the currency," "in the first three years or so, the introduction of the fiduciary element would be limited and it would only gradually approach the permitted margins."7/

Table 1

Liabilities and Reserves of Central Bank of Nigeria
(In millions of pounds)

	Currency liabilities	Total demand liabilities	External reserves	Per cent reserves of: Currency	Demand liabilities
1959					
July 15	9.9	10.0	10.0	100.1	99.1
Dec. 31	54.4	57.5	54.5	105.5	99.9
1960					
July 15	51.3	53.0	50.1	97.6	94.5
Dec. 31	77.1	79.9	77.6	100.6	97.1
1961					
July 15	65.1	67.8	63.9	98.0	94.2

Source: Central Bank of Nigeria Returns.

6/ The requirement that the banking system maintain a uniform liquidity ratio is an attempt to avoid a discriminatory policy. But since the expatriate banks are in a stronger liquidity position than the indigenous banks this requirement may actually prove to be discriminatory.

7/ Central Bank of Nigeria Report, March 1960, pages 6-7.

Nonetheless, the assets of the Central Bank have grown rapidly in its two years of operations as the Bank began to issue its own currency in redemption of notes of the former West African Currency Board and to acquire the assets held by the Board against these notes. From July 31 to December 1959, the Bank's assets grew from £17 million to £58 million as may be seen in Table 2. By March 31, 1961, total assets amounted to £76 million. The dampened expansion since the end of 1959 reflects in part seasonal shifts in the Nigerian economy as well as reduced redemption of Currency Board notes.

The Bank's assets are mainly in the form of external reserves. These consist mainly of British securities, balances held in British banks, other sterling assets and minor Currency Board notes and coin.

The Bank first invested in Federal Government securities with a purchase of £2 million of Treasury bills in March 1961. Since then, Treasury bills have been issued at approximately monthly intervals. These investments introduce a fiduciary element into the currency and will be gradually expanded in keeping with the Bank's cautionary approach to the permitted reserve minimum.

Two technical regulations now limit the extent to which the fiduciary issue can be expanded. In the first place, the outstanding securities of a maturity exceeding two years in the possession of the Bank shall not exceed 20 per cent of its total demand liabilities; secondly, the total amount of Treasury bills outstanding at any time is limited by the Treasury Bill Ordinance 1959 to no more than 10 per cent of the estimated revenue of the Federal Government during the current fiscal year.

Rediscount and advance facilities of the Bank were first used by the commercial banks in March 1960. The pattern of borrowings show that the use of this credit was at a peak in the harvest months of November-December (1960), and thus helped to finance the produce-buying activity of that period. The downturn began in December, was very sharp in January but began to turn up in March, as may be seen in the following changes in the Bank's rediscounts (in thousands of pounds):

1960:	March	0	1960:	Nov.	+1,730
	April	0		Dec.	- 90
	May	0			
	June	0	1961:	Jan.	-1,320
	July	+ 970		Feb.	- 370
	Aug.	- 320		Mar.	+ 40
	Sept.	- 650		Apr.	+ 700
	Oct.	+ 150		May	+ 220

Source: Central Bank of Nigeria Returns.

Table 2

Central Bank of Nigeria: Assets and Liabilities, 1959 to 1961
(In millions of pounds)

	1959			1960				1961
	July 31	Sept. 30	Dec. 31	Mar. 31	June 30	Sept. 30	Dec. 31	Mar. 31
1) U.K. Govt. securities and balances with U.K. banks	15.45	28.49	52.81	49.88	49.32	61.90	76.47	65.24
2) WACB notes and coins	1.44	2.46	4.65	4.83	1.56	1.29	1.10	1.02
3) Total external reserves i.e. (1)+(2)	16.89	30.96	57.46	54.71	50.87	63.19	77.56	66.26
4) Federal Govt. securities	--	--	--	2.00	2.52	2.00	1.58	3.74
5) Rediscounts and advances	--	--	--	--	--	--	1.79	.14
6) Balances with banks in Nigeria	.08	.16	.04	--	.08	.07	.06	.18
7) Other assets	.21	.26	.45	1.14	1.08	1.15	1.47	5.88
Total assets = total liabilities	17.18	31.38	57.95	57.86	54.56	66.41	82.44	76.20
a) Paid-up capital	.30	.30	.30	1.25	1.25	1.25	1.25	1.25
b) General reserve	--	--	--	--	.05	.05	.20	.20
c) Nigerian currency in curculation	16.82	30.28	54.44	52.35	52.24	58.18	77.08	68.47
d) Govt. deposits	--	--	1.99	1.52	.34	.53	1.08	3.84
e) Bankers' deposits	--	--	1.01	1.91	.26	5.61	1.45	1.33
f) Other deposits	--	--	.07	.62	.28	.19	.25	.16
g) Total deposits = (d)+(e)+(f)	.01	.69	3.07	4.04	.87	6.32	2.78	5.33
h) Other liabilities	.05	.11	.14	.22	.14	.60	1.14	.94

Notes: Discrepancies in totals are due to rounding. (d) includes both Federal and Regional Government deposits.

Source: Central Bank of Nigeria Returns.

Currency outstanding is the major item in the Bank's liabilities. Deposit liabilities consist mainly of government deposits, arising out of the Bank's role as banker to the Federal Government (and those Regional Governments which establish similar relationships with it) and of deposits of the commercial banks.

On seasonal grounds, the use of rediscount facilities will reflect the level of bank deposits with the Central Bank or rather the liquidity position of the banks. If, as in Nigeria, much of the increase in the money supply is manifested in increases in currency rather than demand deposits especially in the harvest months November-December, then increased bank borrowing will be needed to finance currency drawings. The reserves of the banks at the Central Bank will be reduced to the same extent that bank loans are converted to currency, if no contrary action is taken. At the same time, however, in order to improve their liquidity position the banks will increase their discounting with the Bank. Thus, as reserves fall, the use of rediscount and advance facilities at the Bank increases until loans are paid back from January to March and the reserve position of the banks consequently improves. Before and after the harvest months, therefore, the reserve position of the banks would tend to be high and the use of rediscount facilities reduced.

Section II. Commercial Banking System

Dual commercial banking system

Nigeria has a dual banking system consisting of expatriate and indigenous banks.[8] The expatriate banks[9] arose out of expanding trade relations with the outside world, particularly Europe. They are branches of banks domiciled outside Nigeria and their West African business usually makes up only a small portion of their total business. They tended to concentrate on financing external trade and providing services for

8/ See W. T. Newlyn and D. C. Rowan, Money and Banking in British Colonial Africa (Oxford: 1954), pages 72-122, for a fuller discussion of both the expatriate and indigenous banks. Also D. C. Rowan, "Native Banking Boom in Nigeria," The Banker (London) October, 1951, pages 244-249; idem, "Banking in Nigeria: a study in colonial financial evolution," Banca Nazionale de Lavoro, No. 22, July-September 1952, pages 158-175.

9/ The most important are Barclays (D.C.O.), and Bank of West Africa. Other banks include British and French Bank; Banque de l'Afrique Occidentale, Berini /Beirut Riyad (Nigeria)/ Bank, Chase Manhattan Bank, Bank of America.

foreign-based trading firms. As a result, they concentrated their businesses at the main commercial centers. Their loans were mainly short-term financing in keeping with British banking traditions.10/

In general, they were concerned with the provision of services rather than the extension of credit. They obtained the monopoly of government and quasi-government business. Their contacts with African traders and with the population both as to deposits and advances were limited. They restricted the use of their funds in Nigeria and relied instead on external capital markets.

African commercial banks -- African commercial banks11/ were set up to serve African traders and businessmen who could not obtain loans from the expatriate banks and complained that the banks adopted a racially discriminatory credit policy towards them.12/ Furthermore, the African needed medium- and long-term finance rather than short-term finance and also required institutions to collect and employ the small savings of the African population.

The need was, in short, to provide such functions as would draw upon and promote a potential African market. The expatriate banks were not interested in developing this business. African banking therefore emerged in response to these demands.13/

10/ The larger trading companies (e.g., United Africa Company) were usually able to finance themselves.

11/ The most important are the African Continental Bank, the National Bank of Nigeria, the Muslim Bank and the Agbonmagbe Bank.

12/ The expatriate banks usually countered that the African borrowers could not meet their credit requirements. However, see the African banks' view expressed in the National Bank of Nigeria advertisement in the Tribune (Ibadan, February 20, 1952):

> By a concerted and well planned process of discrimination the African Merchants were gradually eliminated from the position of middlemen between the big European firms and the African consumer and in their place was substituted the alien immigrants. The Africans, according to plan, became small retail traders and Civil Servants. This economic strangulation could not have been possible if the African had had a strong financial institution of his own.
> PATRONIZE THE NATIONAL BANK OF NIGERIA
> and retrieve your lost birthright.

13/ Newlyn and Rowan think that Nigerian indigenous banks should be seriously studied because "first, the existing banks provide some evidence, both directly and by implication, of the kind of gaps likely to be revealed in the expatriate banking systems of other territories whenever African commercial enterprise and ambition reach significant proportions; second, they suggest the general nature of the type of banking institutions likely to be well adapted to meeting African needs and promoting African capital accumulation." *Op. cit.*, page 96.

The history of African banking dates from 1929.[14] Two short-lived banks were attempted in the first two years of the period. However, the third attempt, the National Bank of Nigeria, was attended with much success and encouraged other ventures. The result was a banking boom-and-bust cycle of the forties, which has been described as the logical sequel of a lack of a source of ultimate liquidity.[15] Other difficulties also contributed to this unfortunate result.

Generally, the African banks were in a less liquid position than the expatriate banks. In the absence of a source of ultimate liquidity, they were exposed to much financial instability. But they were able to provide medium- and long-term finance and to attract small savings.

The importance of advances in the indigenous banking business is shown by the fact that they are their principal earning assets. For instance, advances for the National Bank in 1951 were 77.0 per cent of total assets (about 87.5 per cent of deposits) and for the African Continental Bank over 60 per cent of deposits. The most common security held by them against these advances have been property mortgages.[16]

Their deposits have been exclusively Nigerian though in recent times they have received increasing amounts of government, quasi-government and business deposits as independence was achieved.[17]

Within the dual Nigerian banking system, there is a high level of cooperation between the foreign and domestic banks. For example, some of the expatriate banks are agents for the indigenous banks overseas, while the reverse position obtains in Nigeria. Also, the new Bank of Lagos is an example of joint enterprise between Nigerians and foreigners.

The Banking Ordinance 1958

Before 1952, commercial banking in Nigeria was unregulated except in so far as the companies ordinance applied. In that year, a Banking Ordinance was promulgated mainly on the recommendations of the Paton Report.[18]

14/ Ibid., pages 97-122.

15/ This subject is dealt with by the writer in an unpublished paper on the West African Currency Board.

16/ Newlyn and Rowan, op. cit., page 113.

17/ For example, the African Continental Bank is banker to the Eastern Region Government while the National Bank is banker to the Western Region Government. The latter was nationalized early this year by the Western Government and is under inquiry. The Banker (London) July 1961 (vol. cxi, No. 425) page 507. However, they continue to do private commercial business.

18/ G. D. Paton, Report on Banking in Nigeria (Lagos: 1948). Banking Ordinance, No. 15 of 1952. For a full discussion, see Newlyn and Rowan, op. cit., pages 230-241; IBRD, op. cit., pages 155-156.

The Ordinance required all banks to be licensed and gave broad powers to the Financial Secretary as the licensing authority. To obtain a license, a bank had to satisfy the Financial Secretary that it possessed the minium capital,[19] an adequate cash reserve against deposits and maintained satisfactory conduct.

The Ordinance, however, tended to restrict rather than to promote development of the banking system and many banks were forced to close their doors. The Financial Secretary, as the supervisory authority, was certainly not a source of ultimate liquidity; he was in no position to help "tide over" a substantially strong bank which experienced a run.

The Banking Ordinance 1958, which was promulgated on the recommendations of Mr. Loynes,[20] repealed that of 1952 and regulates commercial banking activity at present. Under the Ordinance, the Central Bank is the supervisory authority and all banks are required to obtain a license to conduct business. The minimum paid-up capital for African banks is £12,500, and for foreign banks £200,000. A reserve fund is to be established by each bank to receive at least 25 per cent of its net profits so long as the fund is less than its paid-up capital.

Prohibited activities include granting credit on the security of its own shares or unsecured advances in excess of £500 to any of its directors or any business in which it has interest, and the holding of shares in other business to the excess of 25 per cent of the sum of its paid-up capital and reserves, unless such business is approved by the Central Bank as promoting the financial mechanism or economic development of the country.

All banks are required to maintain a minimum liquidity ratio to be set by the central bank. The ratio is computed as a percentage of specified liquid assets[21] against demand and time liabilities. The ratio as of November 1959 was 25 per cent.

19/ The minimum capital was set at £25,000, of which half must be paid up in cash, for African banks, and a paid-up capital of £100,000 for foreign banks.

20/ Loynes, op. cit. Also, Nigeria Laws, No. 19 of 1958.

21/ That is notes, coin, balances at the Central Bank, bank balances and money at call in Nigeria and the U.K., Federal Government and U.K. Treasury Bills, and fine bills, both Nigerian and sterling.

Nigeria's banks are organized on the branch system, with headquarters usually in Lagos (the Federal Capital) and with branches throughout the country. At the end of 1949 the number of branches stood at 44; by the end of 1960 it had increased five-fold to over 200. With a population of about 35 million and a banking density of one office per 175,000 population, further expansion is to be expected.

The assets of Nigerian commercial banks have grown from £58 million in 1955 to £120 million in 1960, as may be seen in Table 3. Between 1955 and 1960, their cash declined from 13 per cent to 7 per cent of assets while local loans rose from 33 to 48 per cent. The major recipients of these loans have been in commerce, agriculture and construction, as may be seen from the following estimated distribution of bank loans (in millions of pounds):

Borrower	1959 Dec. 31	1960 June 30	1960 Dec. 31
Government	.3	--	1.1
Public utilities	--	--	.5
Financial institutions	3.4	.7	2.9
Agriculture	9.4	4.7	12.0
Mining	.4	.5	.5
Manufacturing	1.6	2.2	2.4
Construction	3.1	3.4	3.6
General Commerce	13.6	15.3	21.1
Miscellaneous	8.5	8.7	12.4
Total	40.3	35.5	56.5

Loans are highly seasonal and reach their peak in the produce-buying season in November and December.

Local investments, after decreasing from 1955 to 1958, rose sharply in 1960 even though they still comprise only 2 per cent of assets. This expansion reflected the introduction of the Treasury bill. As the bill market grows and the banks gain experience, this portion of their portfolio should expand further. On the other hand, investments abroad were reduced in 1960, a trend which should continue.

On the liability side, time deposits grew between 1955 and 1960 from £11 to £28 million while demand deposits grew only from £32 to £42 million. This trend can be explained by the propensity of the economy to use (1) time and savings deposits as cash balances; and (2) currency rather than bank money.

The three-fold rise in balances due to banks abroad in Table 3 reflects the increased use of overseas funds to expand loans and advances

Table 3

Nigeria: Commercial Bank Assets and Liabilities, 1955-60
(In millions of pounds and per cent)

As of December 31	1955	1956	1957	1958	1959	1960
			In pounds			
Total assets	57.7	67.7	72.9	79.7	100.5	119.6
Cash	7.5	6.8	7.0	6.7	8.5	8.1
Loans and advances	19.1	25.5	34.5	38.3	40.9	57.8
Investments:						
Local	.4	.4	.4	.3	.7	2.7
Abroad	.0	.1	.0	.3	.6	.2
Balances due from other banks:						
In Nigeria	1.6	1.8	2.1	3.5	6.1	4.7
Abroad	20.5	21.8	16.9	15.9	23.7	21.8
Total assets and liabilities	57.7	67.7	72.9	79.7	100.5	119.6
Demand deposits	31.6	35.4	37.3	40.3	40.2	42.0
Time and savings deposits	10.6	10.7	14.6	17.8	25.1	28.1
Balances due to banks:						
In Nigeria	1.8	3.4	2.4	3.9	3.7	2.5
Abroad	5.3	7.2	8.2	5.6	12.7	18.4
			In per cent			
Cash	12.9	10.1	9.6	8.3	8.4	6.8
Loans and advances	33.0	37.7	47.3	48.1	40.7	48.4
Investments:						
Local	.7	.6	.5	.3	.7	2.2
Abroad	.1	.1	.0	.4	.6	.1
Balances due from other banks:						
In Nigeria	2.8	2.7	2.9	4.4	6.1	3.9
Abroad	35.4	32.2	23.1	19.9	23.5	18.2
Total assets and liabilities	100.0	100.0	100.0	100.0	100.0	100.0
Demand deposits	54.8	52.3	51.2	50.5	40.0	35.1
Time and savings deposits	18.3	15.8	20.0	22.3	25.0	23.5
Balances due to banks:						
In Nigeria	3.1	5.0	3.2	4.9	3.6	2.1
Abroad	9.1	10.7	11.2	7.0	12.6	15.4

Notes: Discrepancies are due to rounding. Figures for 1959 and 1960 obtained from Central Bank of Nigeria Annual Report.

Source: Digest of Statistics, Central Bank of Nigeria Annual Report.

(especially the foreign banks) and also the country's growing international trade in which it has been experiencing a deficit in the current account of its balance of payments. Finally, as a result of shifts of funds to Nigeria, the net balance due from abroad, a more useful concept, declined almost steadily from 1955 to 1960.

Liquidity of the banks

In 1953, the World Bank Mission found that Nigerian banks were highly liquid with cash and balances abroad equivalent to 69 per cent of total deposits.[22/] This high figure reflected the low loan ratio. As loans have increased, the liquidity position has been reduced to 43 per cent by the end of 1960, according to the monthly *Digest of Statistics* of the Nigerian Government.

In November 1959, the Central Bank set a 25 per cent minimum liquidity ratio for the commercial banks. Computation of the position of the banks at the end of December 1959 and 1960, found in Table 4, shows that their liquidity ratio declined from 44.14 per cent in 1959 to 40.06 per cent in 1960. Thus, it would appear that the banks have further scope for credit expansion as the economy develops.

Table 4

Consolidated Liquidity Ratios of Commercial Banks 1959-1960
(In millions of pounds)

	As at December 31			
Liquid assets		1959		1960
Cash		8.45		8.08
Balance at the central bank		1.01		1.45
Balances held with banks abroad		23.67		21.77
Call loans and bills discounted:				
Total loans and advances	40.89		57.81	
Less total loans and advances excluding call loans and bills discounted	40.22		56.54	
		.67		1.27
Investment in Nigerian Treas. bills		--		a/ 2.68
Investment in U.K. Treas. bills		.62		a/ .18
Total liquid assets		34.42		35.43
Demand and time deposits		65.29		70.06
Balances held for banks abroad		12.69		18.37
Gross demand and time liabilities		77.98		88.43
Liquidity ratio		44.14		40.06

a/ Investments in Nigeria and the U.K. are mostly in Treasury bills.
Source: Central Bank of Nigeria Annual *Report*, Returns.

22/ IBRD, *op. cit.*, page 153.

Influence on the money supply

It is no longer true, as some observers have stated, that Nigerian commercial banks are merely intermediaries since their loans have grown about as rapidly as their time deposits.23/ On the contrary, between 1959 and 1960, time deposits increased by £10 million, loans by £22 million and the money supply by £20 million, according to the Annual Report of the Central Bank. Thus, the Nigerian banking system now has an important influence on the domestic money supply. As the economy makes greater use of bank money, this influence should grow.

Section III. Money and Capital Markets

The money and capital markets in Nigeria have a real history of only about two years;24/ and the public is not yet used to the instruments handled in these markets. Therefore it is too early to do more than describe the operations of these markets.

The money market

The dominant instrument on the money market has been the Federal Government Treasury bill. Negotiable commercial instruments have been minimal. For example, as at December 1960, outstanding Treasury bills were of the order of about £9 million. Since call loans and bills discounted totaled some £1.2 million, bills alone were certainly much lower.

In April 1960, the first public issue of £4 million Treasury bills took place.25/ Since then, bills have been issued at approximately monthly intervals. Since the Federal Government's estimated revenue in 1960-61 was some £95 million, the amount of bills outstanding has not exceeded £9 million.26/ Bills are issued in denominations of £1,000, £5,000, £10,000, £50,000 and £100,000.

23/ See, for example, Newlyn and Rowan, op. cit., page 165.

24/ In 1941, savings certificates had been introduced under the Nigerian Savings Certificate Ordinance (No. 7 of 1941), the proceeds of which were divided between the U.K. Treasury and the Nigerian Government; in 1946 a £300,000 issue of 3-1/4 per cent Local Registered Stock 1956-61 was offered. An internal bill market was virtually non-existent. There was, in short, no organized money or capital market.

25/ In March, the Central Bank had taken up £2 million worth to reimburse the Federal Government for expenses incurred on behalf of its currency issues.

26/ Under the Treasury Bill Ordinance 1959, total bills may not exceed 10 per cent of the estimated revenue.

Initially, the Bank took up substantial portions of each issue; subsequently these holdings were sold, laying the foundations for the growth of the market "which is now operating smoothly."[27]

The amount taken up by banks and corporations, financial institutions and the general public has been increasing as the Bank's share has declined, as may be seen in Table 5.

Table 5

Nigeria: Summary of Treasury Bill Tenders, 1960

	Total amount offered (1)	Applied for by: Banks, corporations, public (2)	Applied for by: Central Bank (3)	Total amount issued (4)	Rate of issue % per annum (5)	Prevailing London rate[a] (per cent) (6)
	(thousands of pounds)					
April 7	4,000	3,090	910	4,000	4.63	4.65
May 5	2,000	1,652	348	2,000	4.63	4.58
June 9	3,000	1,923	1,007	3,000	4.56	4.88
July 7	4,000	3,760	240	4,000	5.69	5.58
Aug. 4	2,000	4,054	216	2,000	5.00	5.58
Sept. 8	3,000	6,134	300	3,000	5.06	5.53
Oct. 6	4,000	5,982	nil	4,000	5.00	5.36
Nov. 3	2,000	5,429	127	2,000	4.13	4.44

a/ The London rate is the average rate for the month.
Source: Central Bank of Nigeria Report, December 1960.

The bill is now emerging as an investment medium in Nigeria. In particular, commercial bank holdings of, and dealings in, Treasury bills have increased and are at their peak in the seasonal period May to November after which the banks engage in the financing of agriculture and find it necessary to rediscount some of their bills with the Bank in order to restore their cash positions. Recent monthly bill holdings of commercial banks (in millions of pounds) were as follows:

	1960	1961
March	0	4.1
April	2.1	4.8
May	n.a.	6.6
June	4.5	6.7

27/ Central Bank of Nigeria Report, December 1960, page 17.

The rate of issue must be related to rates obtained in the London market. If the internal market is to attract purely local funds and those usually invested abroad, the rate must be sufficiently high and the market should be considered "safe" by the potential investor. In practice, the monthly Nigerian rates have tended to move roughly with rates in London (see Table 5).

The Bank rediscount rate for bills has been maintained "fractionally higher" than the current-issue rate to encourage the growth of the market: such a structure would deter holders from rediscounting their bills immediately after purchase; but it is sufficiently near the issue rate to encourage the public to invest in the instrument.28/

Finally, the growth of the money market will be aided by the recent introduction of an acceptance house which will deal with stock issues, bill finance and industrial finance. Information regarding its activities is not yet available, but it is expected to provide a further source of employment of short-term funds within the country.

The capital market

Information regarding the activities of the recently established Lagos Stock Exchange is not yet available. However, a few significant developments may be noted.

In the first place, the first Federal Government loan handled by the Central Bank was floated in May 1959. It was a Federation of Nigeria Development Loan for relending to the Northern and Eastern Regional Governments. Ten days were allowed for applications and the disposition was as follows:

	Offering	Subscription
5% Fed. of Nigeria Development Stock 1964	£400,000	£650,000
5-1/2 % Fed. of Nigeria Development Stock 1969	£600,000	£850,000
6% Fed. of Nigeria Development Stock 1979	£1,000,000	£1,355,000

All three stocks were oversubscribed. The response came mainly from institutional sources -- Superannuation and Provident Funds (Pension Funds), Sinking Funds and Corporations, Banks (including Post Office) and Marketing Boards. The purely private sector subscribed about £100,000. The Central Bank considered the response to be "as expected" and "most encouraging in circumstances in which the general public is not yet accustomed to this type of investment."29/

28/ Ibid., page 17.
29/ Ibid., March 31, 1960, page 17.

Secondly, public issues of company shares have also taken place. The first issue was made in February 1959 when the Nigerian Cement Company offered 174,398 shares of £1 each at par. No information is yet available on the response but it is understood that a number of dealings in the shares has taken place. In May 1960, the Nigerian Tobacco Company offered £100,000 Ordinary Stock in £1 units. It was over-subscribed and the company decided to increase the allotment to £200,000. Again in August 1960 John Holt Investment Company offered £100,000, 7-1/2 per cent Cumulative Preference Stock in 10s units and £100,000 Ordinary Stock in 5s units. Applications were made for £37,890 Preference Stock and £70,267:10s, Ordinary Stock.

Thirdly, pending the operation of the Lagos Stock Exchange, the Central Bank set up an interesting machinery for dealings in Federation Bonds. A commercial bank notes names of buyers and sellers and forwards them to the Bank where a central register is maintained. The Bank then links a potential buyer and seller and suggests a price at which the deal might take place, the price reflecting "the price of issue plus accrued interest to the date of transfer."30/ Understandably, such a price would not reflect the demand-supply position which would tend to obtain in a more perfect market.

Fourthly, the Central Bank has recently been authorized to raise internally a Federal Government loan of £10 million of the following disposition:31/

£2m. 5% Fed. of Nigeria 2nd Development Stock 1967
£4m. 5-1/2% Fed. of Nigeria 2nd Development Stock 1977
£4m. 6% Fed. of Nigeria 2nd Development Stock 1985

Outlook for these markets

In the capital market, as in the money market, obligations of the Federal Government have been the dominant instruments. No doubt as the market grows and the public gains good experience in the media of long-term investment, the volume of public issues will expand. An important vehicle in this regard is the recently established Investment Company of Nigeria concerned with channelling public funds to industrial development.

Further, in view of the absence of an efficient machinery for ensuring adequate marketability of stocks and lack of experience on the part of the public in the capital market, the public response to the First Development Loan must be considered very favorable. If the success of

30/ Ibid., page 18.
31/ West Africa (a weekly periodical published in London), February 25, 1961, page 219.

the First Development Loan may be taken as an indicator then, in so far as Nigeria is concerned, the significant thing for economic development may well be the absence of institutions to mobilize and foster savings rather than the virtual nonexistence of such savings.

If this view is correct, then the entire financial mechanism needs to be strengthened where necessary or new institutions created. To a large extent, the development of these institutions will have to be a responsibility of the Central Bank. Thus, even though the money and capital markets have achieved some success, they are still in their infancy.

Section IV. The Present Scope for Monetary Policy

The three standard goals of monetary policy are defined as price stability, full employment and balance of payments stability.[32] While these policies are difficult to formulate precisely, they are interrelated. For example, a policy of price stability may conflict with a full employment policy, while the latter would tend to put pressure on the balance of payments; then inflation, full employment and a balance-of-payments deficit tend to coincide, while deflation, underemployment and a balance-of-payments surplus can constitute the obverse side of the coin.

A policy of price stability, which aims at smoothing and sharp movements in the price level, would undoubtedly engender confidence in the domestic economy and thereby contribute to the rapid growth of the financial mechanism, in particular, and economic development in general. But measurement of price stability must be recognized to be difficult in Nigeria and price indices provide an unreliable guide for Central Bank policy.

A full employment policy, as Professor Halm has pointed out, is "not a precision instrument."[33] Again, in Nigeria it would be difficult to define it in any acceptable terms. Assuming, however, that it could be formulated, such a policy would be limited mainly to the purely market sectors -- mining, construction, industrial, commercial and, perhaps, export-agricultural sectors.

After all, fiscal and monetary policy are inseparable adjuncts in formulating an employment policy. The effectiveness of monetary policy is usually predicated on the assumptions that (1) bank money is the major component of the money supply, and (2) bank credit is the major determinant of money income. Given these assumptions, the Central Bank would then use bank reserves to expand credit supplies.

32/ George Halm, Economics of Money and Banking, (Irwin: 1956), pages 246-51.

33/ Ibid.

Such assumptions may be valid for the advanced countries but do not altogether hold for Nigeria at present. For, as we have seen, currency is the major portion of the money supply: even though bank lending has in recent years had a significant influence on the money supply, it is not yet a sufficient factor in expanding demand. Incomes still tend to be determined by the balance of payments.

Further, with the foreign banks in a stronger liquidity position than the indigenous banks and accounting for a greater proportion of bank money, the Central Bank may find its influence on commercial banks through the legal liquidity ratio reduced.[34/] For example, foreign banks usually regard themselves as overseas branches of the home bank; thus, they can call for needed reserves or cash at any time and could thereby nullify bank action. In such a case, the tool of persuasion may be available but one cannot be certain that it will bring significant results.

We are thus left with fiscal policy. Effecting this in an undeveloped securities market, such as exists in Nigeria, must limit severely the effectiveness of Treasury operations. This is not, of course, to deny the usefulness of a full employment policy but merely to point up the limitations that may be expected with monetary and fiscal measures.

Given the fractional reserve system established by the Central Banking Ordinance, the domestic money supply is somewhat more divorced from balance-of-payments fluctuations (and the cost of money supply similarly reduced) than under the Board system. But, as we have seen, the Bank can no longer take the external value of the currency as given: it is now a goal that has to be striven for.

What is the significance of balance of payments considerations on policy? The Bank can mitigate the deflationary consequences of balance-of-payments deficits via an expansionary policy, depending on the size of the Bank's reserves, the marginal propensity to spend of the domestic economy and the marginal propensity to import: "if the Bank's reserves were high and if the marginal propensities to spend an import were low, the Bank would be able to pursue an expansionary monetary policy to a greater extent and for a longer period than would be the case if reserves were already near the prescribed minimum and if the marginal propensities were high."[35/]

The Bank's reserves, as we have seen, are to be lowered with caution to the prescribed minimum. Even if the reserves are always more than adequate, the marginal propensities in Nigeria are thought to be

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34/ See the excellent article by H. M. A. Onitiri in Proceedings of the Nigerian Institute of Social and Economic Research (Ibadan, December 1958), page 84.

35/ *Ibid.*, page 83.

high.[36] Obviously in so far as this is correct, the Bank's contribution will be similarly limited.

Offsetting the inflationary consequences of balance-of-payments surpluses can be effected through open market operations, influence on commercial banks' reserve position and the issuing of non-negotiable "stabilization certificates" (which will be redeemed at the pleasure of the Bank) to earners of sterling balances.[37] These instruments will be of little avail at present for, as previously suggested, Nigeria is confronted with a young securities market and a banking system which is not a determinant of money incomes and one where Bank action can be nullified.

However, a policy of balance-of-payments stability is of the utmost importance to the developing Nigerian economy: it would allow the domestic economy to marshal its resources for economic development less hampered by external fluctuations and also inspire external confidence in the currency and in the economy. Therefore, balance-of-payments stability should be regarded as an important consideration by the Nigerian authorities.

To conclude, the scope for Central Bank action in Nigeria at present is limited. The Bank has recognized this position in these words:[38]

> "In present circumstances there is only very limited scope for the employment of monetary measures dealing with expansionary tendencies or balance of payments difficulties, should this be necessary. It will clearly take time before capital and money markets, which are still in very early stages, have sufficient breadth and activity to make effective the employment of the instruments normally used by central banks to influence credit conditions, but it may well be that this will develop at a faster rate than has been anticipated."

Section V. Associated Problems of Central Banking

The scope for monetary policy, as we have seen, is limited in Nigeria primarily by the lack of a sufficiently broadly-based financial

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36/ Between 1950/51 and 1956/57 Gross National Income for Nigeria rose by £219 million; the corresponding rise in imports for consumption by itself was £110 million, giving a crude marginal propensity to import of about 0.5. This high figure in part reflects the increased rate of government spending on development activity in the past few years.

37/ Onitiri, *op. cit.*, page 84.

38/ *Central Bank of Nigeria Annual Report*, (December 1960) page 19.

structure. For this reason, the Central Bank has understandably been continuously interested in the increased use of currency and bank money by the population and the establishment or expansion of specialized financial institutions to gather and utilize effectively the country's domestic savings to promote economic development. To this end, the Bank has assumed more responsibility for improving the country's financial structure than has been the case of central banks in more developed countries. This emphasis upon institutional development is likely to continue to occupy the efforts of the monetary authorities until a more effective credit mechanism has been achieved. This judgment suggests that the Bank should devote much time in the near future to these four problems:

(a) The development of indigenous banking;
(b) The development of a local securities market;
(c) The development of agricultural credit; and
(d) The centralization of foreign assets.

Development of indigenous banks

Note must be taken of the fact that, as previously stated, indigenous banks are in a less liquid position than foreign banks; however, unlike foreign banks, they engage in medium- and long-term finance and have been successful in the attraction of small savings. In addition, property mortgages are the most common security held by them against advances. The development of indigenous banks therefore centers around the need to ensure their liquidity and thus to encourage their unique role.

Liquidity can be assured by the prescription of a minimum reserve requirement, as Loynes has suggested.[39/] But it would be a mistake to think that this is the only or best way in which liquidity can be achieved. Reserve requirements are no substitute for good business conditions, marketability and distribution of assets with regard to their liquidity and shiftability and a source of ultimate liquidity.

It is surprising that while Loynes recognizes that property mortgages are the most common security held by these banks and, further, that to "forbid any such lending by law ... would create special problems in Nigerian conditions,[40/] he urges against it. Newlyn and Rowan take the opposite view. They maintain that the use of property mortgages as security should be encouraged, that the Bank (apart from standing ready to make advances against Government securities) should be empowered to

39/ Loynes, op. cit., page 28.
40/ Ibid., page 31.

make advances to the commercial banks against the security of property mortgages. For:41/

> "it would make such mortgages shiftable and thus reduce the expatriate banks' dislike of this type of asset. This would in turn assist in lowering mortgage rates and thus make it simpler to sell locally issued government securities ...,"

and

> "it would go a long way to ensuring the liquidity of African banks since mortgages are the most common security held by them against advances."

Such rediscounting would be looked upon as "unorthodox" but it happens to apply to the peculiar Nigerian situation. What is being urged is that such rediscounting would assist the growth of the banking system and enable otherwise ineligible borrowers to make their contribution to economic development.

But the problem has become complicated by the Loynes recommendation that there should not be "a relaxation of the standards set in the draft statutes for the type of security against which the central bank ultimately lends to the other banks."42/ If he feared that lending by the Bank on mortgage security could lead to inflation perhaps this might be taken care of by a regulation that mortgage and similar securities form a specified (variable) percentage of commercial banks' assets.

The contention that the Bank should aid the development of indigenous banks is not because they have a poor liquidity position43/ but because they have succeeded in (1) meeting the demands of Africans for short-, medium- and long-term finance; (2) encouraging small savings; and (3) providing many ancilliary services for African businessmen. Therefore, it is suggested that the emergence of a class of strong African entrepreneurs depends on indigenous banking development.

41/ Newlyn and Rowan, op. cit., pages 276-7.
42/ Loynes, op. cit., page 7.
43/ With the deposit of official (especially Regional Government) and quasi-official funds in some of these banks -- e.g., the African Continental Bank and the National Bank of Nigeria -- it may appear as if their liquidity position has improved. This may not really be the case. In the first place, these funds are liable to be transferred at any time by the governments. In the second place, under present arrangements, the governments concerned may decide to elect the Central Bank as a depository for their funds. In short, this "source of liquidity" may prove to be unreliable.

In addition, the entire banking system should be made more homogeneous. The expatriate banks should expand their local loans, particularly to the African population, and indigenous banks should attain stronger liquidity positions even though they are expanding their activities.

Development of a local securities market

Lack of information regarding the progress of the newly-established Lagos Stock Exchange makes it difficult to discuss this topic. But Loynes has recommended that "any support given by the Bank to new marketable issues should be marginal" and that it "should not be under any obligation always to buy government securities on offer in the market ...."44/

However, it could be argued that such a policy, by depriving locally issued securities of the necessary marketability, would hamper the development of a securities market. Since the Bank would advise the Government on the type of securities to be issued, it might (following Loynes' suggestion) offer self-negating advice. It could happen that the Bank might decide to refuse to buy government securities from a seller, and thereby precipitate a loss of confidence in the market. If the Bank was obligated to buy such securities and fully support the market, the attraction of the local market for investors would be enhanced; otherwise even if the local market offered higher interest rates than the external (London) market, the latter might still be preferred. In time, as the market proves that it is able to stand on its feet, the Bank would reduce its support to a marginal extent. The IBRD mission similarly stated:45/

> "In order to give publicly issued local securities the necessary marketability and to make them suitable for the trust accounts managed by the Bank, the Bank must be prepared to purchase them at all times."

On the other hand, it could be argued that such a restriction on the Bank would tend to make it a passive instrument. This conclusion finds support in the experience of the Federal Reserve System of the United States in 1942-51, before the Treasury-Federal Reserve Accord. Because of the resultant inflationary credit expansion, central bank support of securities markets did not promote genuine confidence in these markets or in holding bonds as an investment.

44/ Loynes, op. cit., pages 20-21.
45/ IBRD, op. cit., page 99.

A third position might argue that the Bank and Treasury might work closely together on each issue. Since the Treasury, an arm of the Government, is in reality more powerful than the Bank, it should have the pressure to secure in advance a promise from the Bank to take up the balance of securities unsold on the market for each individual issue and to give that issue the fullest support. If the terms of the offering were agreeable to the Bank, then some of the dangers of this policy might be reduced. Coordination of Treasury and Bank policy on a case-by-case basis would be less dangerous than a "blanket" Bank commitment to support the market. At the same time, private security buyers would be given the confidence and encouragement and the Bank would be free to determine its position on each issue. In this way, perhaps, a genuine development of the market could be achieved.

Development of agricultural credit

The Bank can, and should, encourage the Marketing Boards and other associated institutions to develop the use of the trade bill which, in turn, it would rediscount for commercial banks. But the role of the trade bill, as we have seen, is minimal and will remain so for some time.

Much agricultural credit is at present medium-term financed on mortgage security through commercial banks and cooperative institutions.[46/] As before, this can be developed further by making these securities eligible for Bank rediscounting. In addition, since agriculture, and therefore agricultural credit, is of great importance to the economy, the Bank could be empowered to set up an Agricultural (or Farm) Bank to deal specifically with this type of credit and to coordinate the activities of Marketing Boards, Cooperative Societies and allied institutions in this field.

Whatever mode of operation is adopted, it seems impossible to escape the conclusion that the Bank should consider seriously the question of rediscounting mortgage security if this type of credit is to really develop.

Further, owing to the nature of agriculture, agricultural credit cannot usually compete on equal terms with other borrowing. This has been recognized in many other countries. The result has been a liberal policy towards agricultural loans and relatively favorable interest rates for agricultural credit. At present the Central Bank has no such powers. It would therefore seem desirable that the Bank (or its agent, the proposed Agricultural Bank) should be authorized to set special interest rates for such credit or otherwise be in a position to influence them.

46/ Newlyn and Rowan, op. cit., pages 113, 129, 133.

Centralization of foreign assets

The fact that the Central Bank holds only about one-third of Nigeria's sterling assets has raised the question of whether it would be desirable to concentrate these foreign balances in the Central Bank. The principal holders of sterling assets at the end of 1959 (in millions of British pounds) were:

Official:	Federal	30.6
	Regional	39.9
	Local	3.5
	Regional Development Corporations	5.3
	Marketing Boards	34.0
	Other semi-official holders	11.7
	Total	125.0
Other:	Central Bank	82.5
	Post Office Savings Bank	3.0
	Net balances of banks due from abroad	11.6
	Total	97.1
Total official and banking sterling assets		222.1

The centralization of all foreign assets with the Bank is in reality part of the balance-of-payments stability objective. It is a pecularity of the Nigerian (and indeed, West African) situation that a large volume of external transactions by-pass the banking system. This is only to be expected in a situation where Government and quasi-Government agencies -- Marketing Boards and corporations -- (and, of course, banks) do business directly with London. The question arises, therefore, whether the Bank would be more effective in the matter of stabilization if it were merely "kept informed" about the external assets of these bodies, as Loynes suggests, or if they were lodged with it.47/

There are, of course, many objections to such concentration: over-saddling the Bank with "idle" or "unmanageable" assets, the possibility of inflationary pressures developing and political control over the activities of private enterprise. Even if one were to assume that these objections have a real basis, they would still be outweighed by the advantages to be gained from concentration. First, Bank action can be thwarted by opposite movements of these assets if it cannot control them. Second, concentration would enable the Bank, in consultation with the Federal Government, to distinguish more clearly between reserves to be earmarked for backing, stabilization and relief of balance-of-payments difficulties, on the one hand, and truly excess funds, on the other.

47/ Loynes, *op. cit.*, page 6.

There is the example of the "powers taken by the Central Bank of Ceylon to reduce the holding of overseas assets by the commercial banks to their need for working balances."48/ The IBRD mission presented a similar argument:49/

> "Foreign assets of government and semi-government bodies should be centralized, as is the case in nearly every country in the world. By far the greater part of Nigerian government and semi-government reserves is now held abroad. This makes it particularly important that they be centralized in the state bank. The consolidation of these sterling assets would have the advantage of permitting Nigeria to safeguard the external value of its currency with a smaller level of foreign reserves than is necessary when foreign assets are held individually by separate agencies. It would therefore permit maximum use of the country's accumulated capital for development."

In arguing for centralization, H. M. A. Onitiri, of the University College, Ibadan, has pointed out that the Bank is well placed to invest and manage them;50/ it can, given concentration, separate assets for currency backing and for stabilization purposes; and, finally, that concentration would ensure maximum economy in the use of foreign exchange reserves. In his view, in order to achieve centralization with minimum difficulty, the Bank should be empowered to pay interest on assets lodged with it by official and quasi-official agencies; otherwise these bodies will have no incentive to transfer their assets to the Bank since at present they earn interest on them.

As Nigeria's earnings abroad continue to grow the question of concentration will be further complicated. Even if the Nigerian authorities do not decide to concentrate foreign assets in the hands of the Bank, they are bound to continue to be confronted with this problem in the future.

48/ Newlyn and Rowan, *op. cit.*, page 275.
49/ IBRD, *op. cit.*, page 97.
50/ Onitiri, *op. cit.*, page 86-89.