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GDP Rebasing: Implications of a Bigger Nigerian Economy

Third World Housing Dilemma: The Sustainable Way Out

INSIDE

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All correspondence to:
The Editor,
Zenith Economic Quarterly,
Research & EIG,
Zenith Bank Plc
7th Floor, Zenith Heights
Plot 87, Ajose Adeogun Street,
Victoria Island, Lagos.
Tel. Nos.: 2781046-49, 2781064-65
Fax: 2703192.
E-mail:marcel.okeke@zenithbank.com,
zeqeditor@zenithbank.com
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www.zenithbank.com

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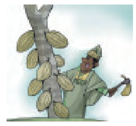


Chimera, Illusion or Reality?

It was Vincent Edward "Vin" Scully, an American sportscaster, best known as the play-by-play announcer for the Los Angeles Dodgers baseball team, who is credited with the now famous saying that "Statistics are used much like a drunk uses a lamppost: for support, not illumination". In other words, statistics, whether of the economic or theoretical genre, are largely subject to the whims and caprices of the policymaker—the manipulator.

Thus, one of the universally accepted indexes (statistics) for measuring the size of an economy—the Gross Domestic Product (GDP)—has also been riddled with criticisms. It is defined as the total market value of all goods and services produced within the borders of a country during a specified period. But the subjectivity as to what goes into the calculation as well as what constitutes the "market value" of the items are yet subjects for disputation. Still, the computation of the GDP is anchored on a base year—the selection of which is again subjective and arbitrary. Yet, the GDP is taken as the most important measure of economic activities in a country and is often used as a barometer of the general health of the economy. Indeed, economies of the world are graded according to their sizes—the GDPs; thus, the United Nations (UN) expects nations to regularly update their GDPs—through rebasing (changing to a more current base year).

In this regard, in a bid to improve the Nigerian statistical system to conform to this UN expectations, and global best practice, the National Bureau of Statistics (NBS) is in the process of rebasing Nigeria's National Accounts Estimates from which the GDP is computed. In line with this effort, our topic: "GDP Rebasing: Implications of a Bigger Nigerian Economy" gives an insight into this project. The exercise is expected to lead to a more realistic and true estimate of the value and size of economic activities in Nigeria. But in point of fact, rebasing does not change the realities of an economy. It will not increase the size of the domestic market in Nigeria, neither will it correct any structural deficiencies nor eliminate any obstacles to the country's development. Yet it will end up creating a perception or an 'illusion' that the Nigerian economy has 'increased' in size. In 'reality', it will lead to the re-classification of the Nigerian economy—very likely to a 'higher' class—with the attendant benefits and costs.

"GDP Rebasing: Implications of a Bigger Nigerian Economy" gives an insight into this project. The exercise is expected to lead to a more realistic and true estimate of the value and size of economic activities in Nigeria.

Our other star article in this package: "Third World Housing Dilemma: The Sustainable Way Out" focuses on low income economies as they grapple with the challenge of inadequate housing for their rapidly growing population. This article looks beyond the traditional "roof over the head", to developing a sustainable housing master plan for the Third World. Hence, the author admonishes that, for the Third World, it is time to ensure adequate funding for the development of sustainable homes and neighborhoods using global and local financial institutions.

In our 'Foreign Insight' segment, our man in London holds that 2013 ended as a relatively bullish year for global markets despite the widespread recession worries. He however wonders whether the trend will be sustained in 2014.

Under 'Discourse', a detailed review of the strategies, figures, strengths and weaknesses of Nigeria's 2014 budget is provided. The author also attempts some scenarios as to how far the plan document would go in meeting the set objectives of the nation's policymakers. A detailed analysis of risk management practices by banks and factors that determine the success or failure of banks in their intermediation role is also carried out in our 'Issues' segment.

As usual, the 'Periscope' section provides an update on issues and trends in various sectors of the economy; identifying and underlining factors that drove the economy in 2013. The 'Facts & Figures' section also provides annotated charts on key indicators of the economy.

Have an exciting reading!

Marcel Okeke

I hereby acknowledge with much thanks the receipt of ZEQ Vol. 9 No.3, July 2013. It is a very useful and critical source of information on Nigerian economy for our students.

Therefore we would appreciate that you keep us on your mailing list for future editions.

Thank you.

Yours faithfully,

Adigun, T. A.
University Librarian, Crawford University

I am directed to acknowledge receipt of your letter dated September 25th, 2012 on the above subject and to commend your effort for deeming it fit to forward the Zenith Economic Quarterly (ZEQ) Journal to the Ministry.

The Journal will afford the Ministry the opportunity to have first-hand information on issues of Agricultural reforms and global economy for strategic policy decision and implementation.

Please accept the assurances of the Honourable Minister's high regards.

Obiageli Ihekwaba
For: Honourable Minister
Federal Ministry of Education

Your letter of October 28, 2013 of the above subject refers.

I wish to acknowledge receipt of the July 2013 Edition of your Quarterly, and thank you for same.

Please accept the expression of the Honourable Minister's esteemed regards.

Benedict Eigbiluese
SA [Admin] to the Hon. Minister
Federal Ministry of Works

I am directed to acknowledge receipt of copies of the Zenith Economic Quarterly News Bulletin of April and July, 2013 respectively under the cover of your letters dated 28th July and 28th October 2013 addressed to Governor Adams Aliyu Oshiomhole and to convey his profound appreciation for the gesture.

Please, accept the renewed assurances of the highest esteem of Mr. Governor.

Yours sincerely,

Principal Private Secretary to the Governor
Office of The Governor
Edo State Government of Nigeria

> ***"...it is indeed packed with critical information on the Nigerian and global economy for strategic policy decision which is relevant to the College Community and library users."***

I wish to acknowledge with thanks Zenith Economic Quarterly Magazine for the periods April (Vol.9 No.2) and July (Vo1.9 No.3) 2013.

The Journals have always been very helpful in providing the much needed information on the economy of Nigeria in particular and the world in general for strategic *policy* decisions.

Accept assurances of my highest regard.

Yours faithfully.

B.E Aigbe
Auditor-General Edo State, Nigeria

I write to acknowledge with thanks the receipt of a copy of July, 2013 edition of your Zenith Economic Quarterly titled: Social Media: The Good, The Bad, The Opportunities, which you donated to the library.

We appreciate your kind gesture. The publication shall no doubt be of immense use to both the staff and students of the university.

Thank you.

Yours faithfully,

Dr. I.I. Ekoja
University Librarian
University of Abuja, Nigeria

We write to appreciate and acknowledge the receipt of the Zenith Economic Quarterly Journal for July, 2013 edition which focuses on the "Social Media: The Good, The Bad, The Opportunities".

It is indeed packed with critical information on the Nigerian and global economy for strategic policy decision which is relevant to the College Community and library users.

It is very interesting and educative.

Thanks.

Yours faithfully,

Mrs Molokwu, E.U
College Librarian
Federal College of Fisheries and Marine Technology,
Lagos.

Nigeria: Economy Yet Scoring Highly

By Marcel Okeke

The Nigerian economy all through 2013 continued to get positive ratings and accolades from numerous reputable institutions and global stakeholders. Indeed, the country was during the last quarter 2013 honoured for meeting the Millennium Development Goal (MDG) of reducing people living in absolute hunger by half well ahead of the 2015 target set by the United Nations. In the 2013 fiscal year, Nigeria was named the 'Number One' destination for investments in Africa by UNCTAD (the UN Conference on Trade and Development), attracting over US$7 billion in Foreign Direct Investment (FDI). Reviews by the African Development Bank, the World Bank, the UN Economic Commission for Africa, the International Monetary Fund, Goldman Sachs, JP Morgan, among others during the year, all returned positive verdicts on the Nigerian economy. The BB- credit rating of the economy (with a positive outlook) by Standard & Poor's (S & P) was also a vote of confidence on the management of the economy. The International Monetary Fund (IMF) also affirmed Nigeria's strong macroeconomic fundamentals and positive outlook going into 2014. The Fund's position is contained in its release at the end of its mission to Nigeria on November 13-26, 2013 to conduct discussions on the 2013 Article IV consultation. According to the IMF, the Nigerian economy performed strongly in 2013. The economy also earned Nigeria the "2013 EMEA Best Sovereign Bond Award" from the City Group Middle East and Africa. The landmark billion euro bond which was issued about mid-last year was oversubscribed four times by investors. And following from all these, a report by Goldman Sachs at the close of 2013 tipped Nigeria as one of the "next global economic giants alongside Mexico, Indonesia, and Turkey." The report "The MINT Countries: Next Economic Giants" identified Mexico, Indonesia, Nigeria and Turkey , collectively called "MINT" as the second generation of emerging market pace-setters.

These positive views about the economy are evident in the state of the key economic indicators at the close of 2013. Indeed, the generally stable macroeconomic environment provided the platform for the strong performance across the various sectors. On aggregate basis, the Nigerian economy when measured by Real Gross

Domestic Product (GDP) grew by 7.67 per cent in the fourth quarter of 2013. It grew by 6.81 per cent, 6.18 per cent, and 6.56 per cent in the third, second and first quarters respectively. Overall GDP growth rate for fiscal year 2013 is estimated at 6.87 per cent, still slightly higher than 6.58 per cent in 2012. The non-oil sector, according to the National Bureau of Statistics (NBS), remained the major growth driver, recording 8.73 per cent in the fourth quarter 2013. The leading drivers within the non-oil sector include agriculture, wholesale and retail trade, and services which contributed 1.64, 2.34 and 2.66 per cent respectively to GDP.

Inflation also trended in the desired direction, remaining in single digits, at 8.0 percent as at end-December 2013. It fell consistently from 9.0 per cent in January to 8.6 per cent in March and 8.4 per cent in June 2013. It was at its lowest level in October when it declined to 7.8 per cent. And according to the Monetary Policy Committee (MPC) of the Central Bank of Nigeria (CBN), on average, inflationary pressure moderated in 2013, remaining within the indicative target range of 6—9 per cent in the second half of the year. Similarly, the exchange rate remained relatively stable within the target band of N155-160/Dollar. Indeed, the average rate of the Naira against the Dollar was at about N155.2/Dollar as at end-December 2013, compared with the level (N155.27/Dollar) in December 2012. Despite the general stability however, the Naira experienced some volatility, especially in the second half of the year. Thus, in August, the national currency fell to its weakest in 20 months due to non-intervention by the authorities and pressure coming from importers. In a bid to curtail the pressure, the CBN introduced a number of measures. These include the suspension of Wholesale Dutch Auction System (WDAS) and its replacement with Retail DAS with effect from October 2, 2013; putting a maximum limit of US$250,000 for authorized dealers in dollars sold to Bureau de Changes (BDCs); and an upward review of the existing spending limit of US$40,000 per annum on naira debt and credit card to US$150,000.

In the area of job creation and poverty reduction for which Nigeria won the MDG award during the period under review, the National Bureau of Statistics estimates that 1.6 million jobs were created across the country. Sectors which experienced strong growth and created jobs include the agriculture, oil & gas, manufacturing, housing & construction, and SMEs. In agriculture, under the Agriculture Transformation Agenda (ATA) of the Federal Government, the provision of inputs in 10 Northern States enabled dry season farming; and engaged over 250,000 farmers and youths even during the dry season. During the period under review, the Federal Government's special intervention programmes such as YouWiN and SURE-P also created job opportunities. Available data show that

YouWiN programme has supported young Nigerian entrepreneurs and created over 18,000 jobs while the SURE-P Community Services Scheme also created about 120,000 job opportunities.

Although the stock of external reserves, one of the performance indices of the economy experienced a decline during the period under review, it still remained substantially high as a buffer to the economy. The CBN report shows that the gross external reserves as at December 31, 2013 stood at US$42.85 billion, representing a decrease of US$ 0.98 billion or 2.23 per cent compared with US$ 43.83 billion at end- December 2012. The excess crude account (ECA) also declined within the period. Earlier in the first quarter 2013, external reserves had climbed to its highest level in more than four years, hitting around US$48.57 billion in May. The drop in both the stock of external reserves and the ECA are attributable to a number of factors. First was the slowdown in portfolio and Direct Foreign Investment (DFI) flows in the fourth quarter 2013, which prompted increased funding of the foreign exchange market by the CBN to stabilize the national currency. Secondly, drop in oil revenue inflow owing to decline in oil output—due to oil theft and pipelines vandalism at various times in 2013 which resulted in the loss of about 300,000-400,000 barrels per day. Thus, this "quantity shock" led to depletion in both accounts—the external reserves and the ECA.

While the ECA and external reserves were getting depleted, the nation's stock of public debt was on the increase all through 2013. Indeed, according to the Debt Management Office (DMO), Nigeria's total public debt stood at N10.04 Trillion (US$64.51 Billion) as at end-December 2013—with the domestic debt standing at N8.67 Trillion (US$55.69 Billion)—representing 86.32 per cent of the total debt. The external debt which is N1.37 Trillion (US$8.82 billion), represents 13.68 per cent. Details of the external debt stock show that multilateral institutions account for 71.13 per cent of the country's debt profile. The International Development Association (IDA), a member of the World Bank Group, accounts for US$5.33 million while another member (International Fund for Agricultural Development –IFAD), is owed US$92.20 million. Also, US$161.10 million is owed the African Development Bank (AfDB), while the African Development Fund (ADF) is owed US$571.40 million. The external debt also includes US$103.20 million which Nigeria owes European

Development Fund (EDF); US$14.50 to Islamic Development Bank (IDB); as well as US$3.30 million to the Arab Bank for Economic Development in Africa (ABEDA). The rest of the external debt (bilateral debt) represents 11.63 per cent of the total.

During the period under review, the Federal Government took definite steps towards the diversification of the economic base of the country. One of such measures was the launch of the National Industrial Revolution Plan (NIRP) which focuses on industrializing Nigeria and diversifying its economy into sectors such as agro-processing, light manufacturing, and petrochemicals. Apparently owing to the new initiatives, a large number of both foreign and domestic investments had begun to come into the economy. Some examples are: US$250m investments by Procter and Gamble in Ogun State; US$40 million in agricultural projects by Dominion Farms in Taraba State; US$1.2 billion in fertilizer and petrochemicals by Indorama; a US$200 million steel plant by Kam Industries; and a US$9 billion investment in a petrochemicals and refinery complex by the Dangote Group.

To further support the manufacturing sector, the Government also negotiated a strong Common External Tariff (CET) agreement with other ECOWAS partners which would enable Nigeria to protect its strategic industries where necessary. The Nigerian Enterprise Development Programme (NEDEP) was also initiated in 2013 to address the needs of small businesses. Some key interventions by NEDEP include supporting small companies with access to affordable finance, access to markets, capacity support, business development services, youth training, and support in formalizing their operations. Also, in 2013, the Federal government lowered business registration costs for small businesses by 50 per cent to help them conserve capital.

The Capital Market

The Nigerian capital market continued its rally with the equities segment providing the lead. The All-Share Index (ASI) increased by 47.2 per cent from 28,078.81 on December 31, 2012 to 41,329.19 on December 31, 2013. Market Capitalization (MC) increased by 47.4 per cent from N8.97 trillion to N13.23 trillion during the same period. Improved corporate earnings, tighter regulatory oversight and enforcement boosted investor confidence, leading to rise in stock prices. The concerted effort of the apex capital market regulator, Securities and Exchange Commission, SEC, the Nigerian Stock Exchange, NSE, Chartered Institute of Stockbrokers, CIS, Association of Stockbroking Houses of Nigeria, ASHON, Issuing Houses, Custodians, Central Securities Clearing System, CSCS, Registrars and other stakeholders in the capital market was pivotal to the restoration of confidence in the market. For instance, the collaboration with the CFA Society of Nigeria, SEC, and the NSE led to the organization of investor clinics for professional and religious bodies, including over 200 workshops for retail investors in various parts of the country in 2013. There were also the Capital Market Committee (CMC) retreats during which various stakeholders in the market met to brainstormed and addressed issues that affect the market.

The NSE's equities market capitalization had reached

an all-time high of about N12.85 trillion in June 2013 and a bearish run triggered later when companies started declaring dividends and bonuses, coupled with announcement by the US Federal Reserves of planned tightening of liquidity, which eroded some of the gains made in the market. The equities market equally saw a boost as an organized Over-the-Counter, OTC, platform, sponsored by the National Association of Securities Dealers (NASD) was launched to enable the transparent and regulated trading of unlisted securities. The NSE also commenced transaction on the new trading engine, X-Gen during 2013. There was also the launch of Alternative Securities Market, ASEM, a specialized board for listing small and mid-sized companies with high growth potential, as part of efforts to achieve the its US$1 trillion marks by 2016. Before the re-launch of the ASEM window, the NSE had appointed 14 companies as Designated Advisers, DAs, for the companies interested in listing on ASEM.

In 2013, the Nigerian domestic bond market got a huge boost following the inclusion of Nigeria's sovereign bonds in Barclay's Emerging Market Bond Index, in addition to its admission into the JP Morgan local currency bond index earlier. These put the local currency bond market within the radar of foreign investors, who year-to-date, have invested an estimated US$5.4 billion in Nigerian bonds. Prior to the admission of FGN Bonds to any international bond index, foreign investors' holding of Nigerian bonds was approximately US$1.2 billion. The state government and corporate segments of the bond market have benefited from a favourable environment, reformed issuance procedures and renewed interest from investors to tap into the bond market. The International Finance Corporation (IFC) in 2013issued its first N12 billion 'Naija Bond' and has approached the SEC for naira-denominated Medium-term Notes (MTN) programme of US$1 billion. The African Development Bank (ADB) has equally filed for the approval of an MTN-programme worth US$1.5 billion, with the SEC.

Year 2013 also saw the successful launching of the Financial Market Dealers Quotation (FMDQ) platform, which is expected to make over-the-counter (OTC) bond trading easier and more efficient. This is intended not only to drive both the primary bond market and the secondary market, but also improve the level of sophistication of the sovereign bond market and accelerate the development of a derivatives market to enhance risk management. In 2013, some new products were introduced in the Nigerian capital market. Specifically, the capital market witnessed the issuance of Nigeria's first

Sukuk bond by Osun State government following the approval of Sukuk rules by the SEC. The Sukuk is a product capable of attracting capital from the Gulf countries and from the Muslim population of Nigeria. The SEC also within the year approved an Exchange Traded Fund (ETF) based on the NSE-30 that will soon join the New Gold as the two ETFs tradable on the floor of the NSE. The Collective Investment Schemes (CIS) industry continues to grow with current net asset value (NAV) of about US$1 billion.

The SEC in 2013 made a number of new rules to boost equity through Securities Lending and Short Selling and Introduction of Market Making. In this regard, the Commission introduced rules guiding securities lending and consequently permitted short selling to herald the introduction of market making, which is already increasing liquidity in the market. Short selling is important not just for its impact on liquidity, but also from a risk management perspective, it helps brokers and other investors to hedge their positions. In the period under review, the SEC also approved new minimum capital requirements for all categories of market operators. The Commission identified technology as an important enabler in the smooth functioning of modern financial market, hence the need to increase the capital base. Under the new capital requirement for market operators, a broker-dealer should have a minimum of N300 million as against N70 million previously. A broker's minimum capital now is N200 million, up from N40 million. The minimum capital increase which must be complied with by all capital market operators has December 31, 2014, as the deadline.

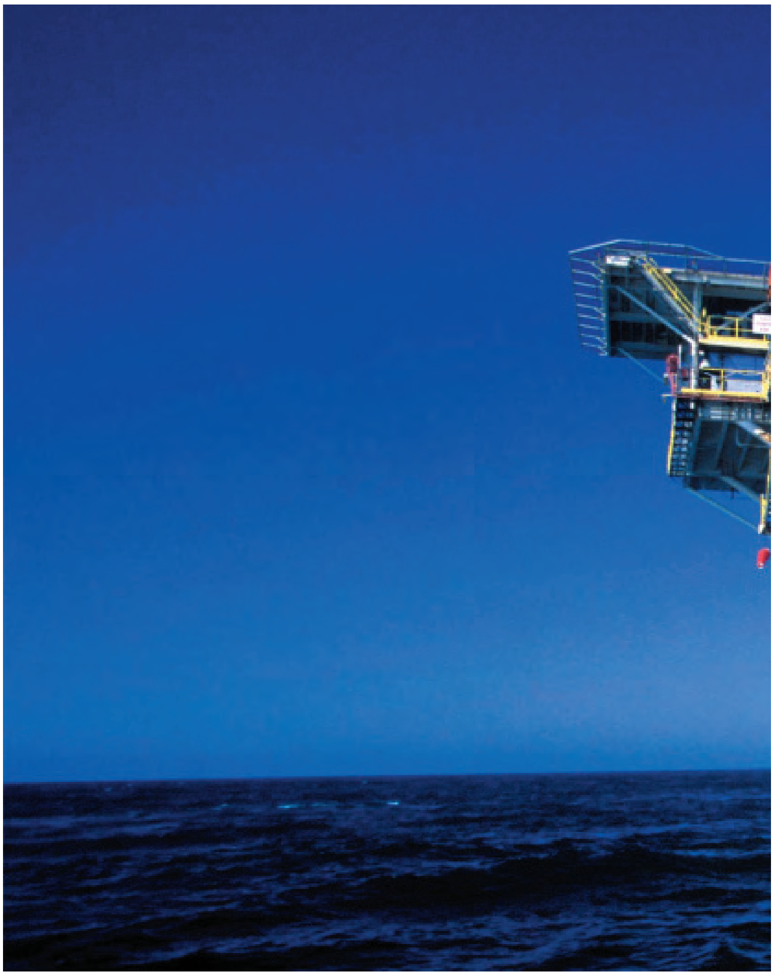
Telecommunications & ICT

The information communication technology (ICT) sector remained a key focus of the Federal government all through 2013, resulting in strategic investments in various areas. Specifically, Government constructed 500km of fibre-optic cable to rural areas, with about 3,000km targeted for deployment in 2013/2014. A total of 266 Public Access Venues were established in 2013: 156 Rural IT Centres, 110 Community Communication Centres (CCC). The Federal Government also facilitated the deployment of mobile communications base stations in some rural areas of country: 59 base stations installed by end-

December 2013, with an additional 1,000 planned for 2014. In addition, the Federal Government also provided wholesale internet bandwidth to Internet Service Providers (ISPs), Cyber cafes, and ICT centres like Community Communication Centres (CCC) in rural communities – connectivity to 12 out of 18 pilot sites already completed. During the year, the Federal Government also deployed a fibre-optic high-speed internet network to connect 27 Federal universities, and provided computing facilities to 74 tertiary institutions and 218 public schools across the country. The Government also established innovation centers to support entrepreneurs in the ICT sector, and launched a Venture Capital fund of US$15 million for ICT businesses.

In order to address the paucity of broadband penetration in Nigeria, government in 2013 introduced some regulatory initiatives. First of all, it released a national broadband plan from 2013-2017, and commenced the initiation of a proper framework for broadband investment and services in the country. In this regard, Government through the Nigerian Communication Commission (NCC) announced the opening of auction for its free 2.3Ghz spectrum, for wholesale service operators to provide last mile broadband services. This had commenced in January 2014. The NCC also began the process of licensing infrastructure companies, InfraCo, to roll out high speed broadband backbone in 2014.

As a follow up to the recommendations of the Presidential Broadband Committee which had submitted the Nigerian National Broadband Plan for 2013-2018, a 19-man Broadband Council was inaugurated by the Minister of Communications Technology, Mrs. Omobola Johnson who herself is the Chairperson of the Council. The council is charged with the responsibility of implementing the National Broadband Plan for Nigeria within the period 2013-1018. Membership of the Broadband Council include the Association of Telecoms Companies of Nigeria (ATCON), the Internet Exchange Point of Nigeria (IXPN), and Dr. Ernest Ndukwe and Mr. Jim Ovia, two former co-chairmen of the Presidential Committee on Broadband, which worked on the formulation of the National Broadband Plan 2013-2018. The aim of the five-year plan is to increase broadband penetration five-fold by the end of 2018. The plan outlines a number of ways in which the government intends to achieve this, including: promoting transparency of pricing and reduction of rollout costs by encouraging infrastructure sharing and



interconnections and introducing price caps where necessary or when market forces fail; taking necessary regulatory measures to ensure better performance levels in the delivery of broadband services. Others include facilitating rapid rollout of wireless and wireline infrastructure and providing incentives to encourage a national 3G wireless coverage level of at least 80 per cent of the population by 2018; and the release of more spectrums for broadband services, especially for Long Term Evolution (LTE). It also intends to foster an attractive investment climate through targeted schemes for stimulating demand and providing targeted concessions, tax incentives, grants or support where needed.

The telecom sub-sector remained very active in 2013, with most of the operators engaging in service quality improvement and expansion programmes—especially, acquisitions. The industry was marked by new regulatory developments and market trends, such as increasing mobile saturation in urban areas and the implementation of mobile number portability (MNP), and the fierce competition in the mobile market which also hosts major regional players. Thus, Etisalat Nigeria signed an IT managed services deal with equipment vendor Huawei

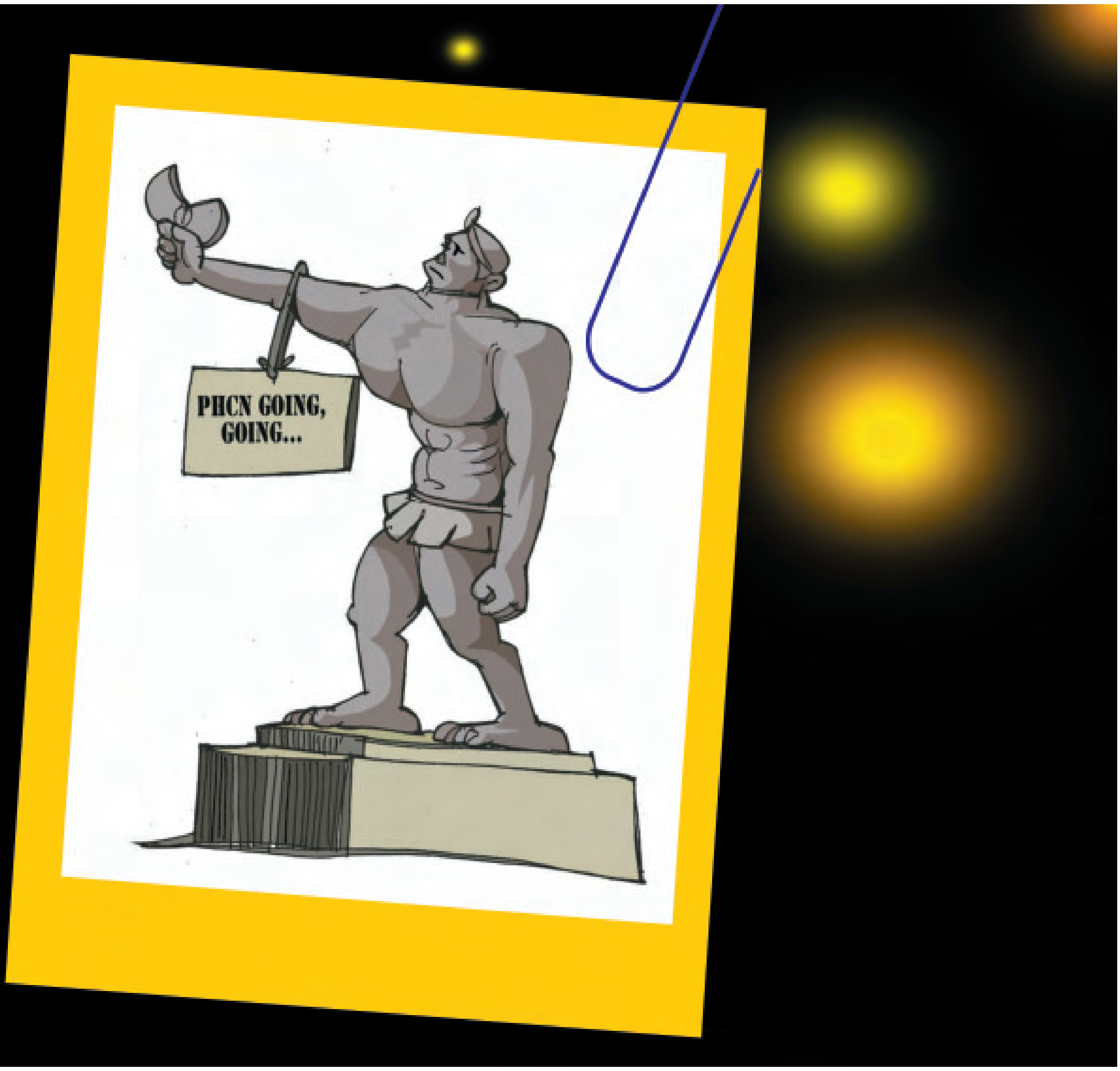
http://www.parker.com/portal/site/PARKER/menuitem.223a4a3cce02eb6315731910237ad1ca/?vgnextoid=2f59c3acbc65e210VgnVCM10000048021dacRCRD&vgnextfmt=EN

Technologies in line with a new corporate vision of creating more value for customers by improving quality and efficiency, embedding innovation, and increasing the speed of service delivery. According to the deal, Etisalat will outsource the operational management of IT services across the technical infrastructure, application management and user support units to Huawei, but will retain the IT services in its business planning, architecture and governance unit. About 75 per cent of Etisalat's current IT staff will be transferred to Huawei. The operator is also considering outsourcing its cell tower management to an independent tower firm.

In December 2013, the Federal Ministry of Communications, the government of Lagos State and telecoms industry stakeholders reached an agreement on right of way and taxation for the deployment of mobile base stations and fibre optic cables in the country's commercial capital. The agreement which lays the foundation for a much more stable and favourable business environment for telecoms operators in Lagos State will hopefully create a precedent for similar deals in other parts of the country. According to Lagos State Commissioner for Science and Technology, Biyi Mabadeje, the state has also agreed to reduce taxes and levies on network roll outs by more than 40 per cent and cut right of way fees from NGN3,000 to NGN500 per linear metre. On their part, telecoms operators assured the use of high quality materials to build base station masts and to a 'dig once' policy. Under this policy, when laying new cables operators will be responsible for installing ducts with enough extra capacity to allow other operators to lay cables along the same route without having to dig up roads again. Operators also consented to submitting annual infrastructure plans to Lagos State, in order to ensure increased coordination going forward.

OIL AND GAS, POWER & ELECTRICITY

The price of crude remained volatile all through 2013 in the international commodities' market, ending the year down by 1.5 per cent relative to January position. Specifically, the OPEC Average Monthly Basket Price of crude oil opened the year at US$109.28 per barrel; it peaked at US$112.75 per barrel in February. It declined thereafter, reaching its lowest level in May when it stood at US$100.05 per barrel, before closing the year at US$107.67 per barrel. Throughout 2013, the OPEC Aver-



age Monthly Basket Price of crude oil was above US$100 per barrel mark. A number of factors contributed in sustaining this situation, including growth in world oil demand, positive economic data from the US and China, political tension in several Middle East and North Africa (MENA) region countries, and prolong maintenance in the North Sea.

In 2013, there were giant strides in the up- and downstream segments of the oil and gas sector. These include the completion of work on the 136km gas pipeline from Oben to Geregu, the 31km pipeline from Itoki to Olorunshogo and the acquisition of 250 square kilometers of 3D-seismic data for the Chad basin. The government also initiated the Ogidigben Gas Industrialization Project which will provide a petrochemicals complex in Delta State.

During 2013, the Federal Government completed one of the most comprehensive and ambitious power sector privatization and liberation programmes globally, when it privatized four power generation companies and 10 power distribution companies—all of them successor-companies to the Power Holding Company of Nigeria (PHCN). The Federal Government also mobilized US$1.5 billion in financing from multilateral sources for investment and upgrade of the transmission network in 2014 and beyond, and commenced construction of the 700MW Zungeru Hydro-Power project. The Nigerian Bulk Electricity Trading Plc (NBET) in the last quarter 2013 was also backed with over N120 billion in financing by the Federal Government to help stimulate greater private investments in the sector.

(* Marcel Okeke is the Editor, Zenith Economic Quarterly)

Regulatory & Supervisory Framework for the Operations of a Mortgage Refinance Company (MRC)

1.0 PREAMBLE

The establishment of a Mortgage Refinance Company (MRC) is primarily aimed at increasing the liquidity within the mortgage sub-sector and availability of mortgage credit in Nigeria, reduce mortgage and related costs, and make residential housing more affordable. The benefits of such mortgage liquidity facilities are well documented and globally acknowledged. As a financial institution, the MRC would be under the regulatory and supervisory purview of the Central Bank of Nigeria (CBN).

This regulatory framework is, therefore, designed to ensure that the MRC operates in a safe and sound manner, on internationally accepted principles, standards and best practice in mortgage liquidity facilities.[1] The regulatory framework is drawn pursuant to the provisions of the Central Bank of Nigeria (CBN) Act 2007, Banks and Other Financial Institutions Act (BOFIA) CAP B3, Laws of the Federation of Nigeria (LFN) 2004, other relevant Laws, and extant CBN Guidelines and Circulars.

The Framework prescribes the basic regulatory requirements for the MRC's principal line of business of refinancing credits to borrowers on the security of residential mortgage assets and other qualified collaterals. It also sets the capital adequacy requirements for the MRC, including its minimum paid-up capital, maximum leverage limit, and the minimum risk-weighted capital requirement. Furthermore, the framework specifies the types of collateral that a borrower can pledge for the MRC's advances, and the discount that the MRC shall apply in determining how much it can lend against any qualified collateral. It also prescribes procedures for the management of the MRC's interest rate risk, its permissible investments and liquidity requirements.

This framework is divided into ten parts, beginning with a preamble, which includes a statement on the major regulatory powers and duties of the CBN with respect to the MRC's operations. The second part discusses mortgage liquidity operations, followed by the licensing requirements for the approval-in-principle and the grant of final licence in Part 3.

The fourth part highlights the MRC's corporate governance requirements, including the specific duties and responsibilities of its Board of Directors and senior management. The remaining six parts of the framework discuss sources of funds, rendition of returns, prudential requirements, on-site examination, reporting and off-site monitoring of the MRC and the administrative sanctions that the CBN may impose for violations of any of the specified regulatory requirements.

1 Specifically, this regulatory review covered the French national mortgage liquidity, Caisse de Refinancement de l'Habitat (CRH), the Tanzania Mortgage Refinance Company, the Egyptian Mortgage Refinance Company, and the United States' national mortgage liquidity facility, the Federal Home Loan Bank System.

1.1 POWERS AND DUTIES OF THE CENTRAL BANK OF NIGERIA WITH RESPECT TO A MORTGAGE REFINANCE COMPANY

The Central Bank of Nigeria (hereinafter referred to as "the Bank") shall have the following powers and duties with respect to the operations of the Mortgage Refinance Company:

(a) To license the MRC.

(b) To determine the MRC's capital adequacy standards and requirements.

(c) To supervise the MRC's business opera tions, which include:

- (i) Prescribing rules and conditions upon which the MRC may extend credits ("loans or advances")to borrowers.
- (ii) Prescribing minimum liquidity requirements and permissible investments.
- (iii) Prescribing eligible mortgage assets or port folio of eligible assets and the appropriate valuation model or methodology.
- (iv) Conducting both on-site and off-site supervision of the MRC operations.
- (v) Reviewing and approving the MRC's Memoran dum and Articles of Association (MEMART), BusinessPlan, Capital Plan, Credit Policy, Asset/Liability Maagement Policy, Financial Management Policy, and Code of Ethics and Business Conduct.
- (vi) Approving the Board and Management teamof the MRC in accordance with the provisions of BOFIA and the Approved Persons Regime.
- (vii) Approving the appointment of the External Auditors.
- (viii) Approving the annual audited accounts of the MRC before its publication and pre sentation at the AGM.
- (IX) Approving change(s) in the MRC's organisational structure before its implementation.

(d) To issue and enforce these regulations, and other such regulations and directives that the Bank may deem necessary, to ensure that the MRC operates in a safe and sound manner and remains healthy.

(e) To undertake such other activities as may be necessary or expedient for giving full ef fect to the provisions of these Regulations.

2.0 MRC OPERATIONS

2.1 DEFINITION OF MRC

A Mortgage Refinance Company (MRC): is a financial institution established to provide short-term liquidity and/or medium- to long-term funding or guarantees to mortgage loan originators.

2.2 OBJECTIVES OF AN MRC

The objectives of the MRC shall be to support mortgage originators such as Primary Mortgage Banks (PMBs) and commercial banks to increase mortgage lending by refinancing their mortgage loan portfolios. It shall act as an intermediary between originators of mortgage loans and capital market investors who typically are looking for long-dated high quality securities.

2.3 PERMISSIBLE ACTIVITIES

The MRC shall engage in the following activities:

a. Refinancing of fully secured mortgage loans.
b. Investment in debt obligations issued or guaranteed by the Federal Government of Nigeria or any of its agencies, which shall not be less than 50 per cent of the MRC's total investments.
c. Issuing guarantee for mortgage loans as part of its off-balance sheet engagements.
d. Issuing bonds and notes to fund its purchase of eligible mortgages.
e. Other activities as may be prescribed by the CBN from time to time.

2.4 NON-PERMISSIBLE ACTIVITIES

The MRC shall NOT engage in the following activities:

a. Granting consumer or commercial loans.
b. Origination of primary mortgage loans.
c. Acceptance of demand, savings and time deposits, or any type of deposits.
d. Financing real estate construction.
e. Undertaking of estate agency or facilities management.
f. Provision of project management services for real estate development.

g. Management of pension funds/schemes.
h. All other businesses NOT expressly permitted by the CBN.

3.0 LICENSING REQUIREMENTS

The procedures and criteria to be used in granting a licence to the MRC shall be the same as specified for banks under the Banks and Other Financial Institutions Act, CAP B3, Laws of the Federation of Nigeria, 2004 (herein after referred to as "BOFIA) and any other regulations issued by the Bank.

3.1 REQUIREMENTS FOR AN APPROVAL-IN-PRINCIPLE:

Any promoter(s) seeking a licence for the operation of the MRC in Nigeria shall apply in writing to the Governor of the Central Bank of Nigeria. The application shall be accompanied with the following documents:

a. A non-refundable application fee of N100,000 [one hundred thousand Naira only] or any other amount that may be determined by the Bank from time to time payable to the Central Bank of Nigeria.
b. A detailed feasibility report containing information that shall include :
    i. The objectives and aims of the proposed MRC (including a vision & mission statement);
    ii. The need for the services of the MRC;
    iii. The branch expansion program [if any] within the first 5 years;
    iv. The proposed training programs for staff and management, as well as succession plan;
    v. A five year financial projections for the operation of the MRC, indicating expected growth and profitability;
    vi. Details of the assumptions which form the basis of the financial projection;
    vii. Details of risk controls and mitigation strategies;
    viii. The organizational structure of the MRC indicating the functions and responsibilities of the top management team;
    ix. The composition of the Board of Directors and the interests represented;
    x. The conclusions based on the assumptions made in the feasibility report.
c. A copy of the draft Memorandum and Articles of Association (MEMART);
d. A list (in tabular form) showing the names of the promoters, amounts subscribed, details of the payment instrument (bank name and cheque number), their business and residential addresses and the names and addresses of their bankers;
e. Curriculum vitae of each member including other directorships held [if any];
f. Evidence of payment of the sum of N5 billion to the CBN via NIBSS, being minimum capital deposit which will be refunded with interest after the proposed institution obtains its final licence; and
g. Draft detailed manual of operations namely:
    A. Credit Policy that describes the credit products that the MRC offers to its borrowers, including the terms and conditions for issuing advances, and sets forth the standards that the MRC will use to manage credit risk in these products. The Credit Policy should, at a minimum be designed to:
        i. Specify the underwriting criteria to be applied in evaluating applications for advances.
        ii. Specify the levels of collateralization, valuation of collateral, and the discounts that are to be applied to collateral values securing advances. These collateral requirements shall comply with the requirements of these regulations.
        iii. Specify the standards and criteria for, and timing of, periodic assessments of the creditworthiness of borrowers, obligors, or other counterparties, and for the establishment of credit limits.
        iv. Specify the fees to be charged for obtaining, or pre-paying, advances, including any schedules or formulae pertaining to such fees.
        v. State the standards and criteria for the pricing of the MRC's products, including differential pricing of advances.
        vi. Include a Master Servicing and Refinancing Agreement that will govern the lending conditions between the MRC and its borrowers.
        vii. Conform to the applicable provisions of the Guide to Bank Charges.

http://www.5pointsbankmortgage.com/graphics/clipart/mortgage/MortgageServicing.jpg

B. Asset/Liability Management Policy (ALM Policy) that highlights the MRC's permissible assets and liabilities, sets the standards for managing its interest rate risk and liquidity risk, and delineates the composition, duties, and operational procedures for the MRC's Asset/Liability Management Committee.

C. Financial Management Policy that highlights the MRC's financial management policies and procedures, and system of internal controls. The Policy should include, at a minimum:
   i. Accounting policies and principles.
   ii. Roles and responsibilities of the senior management officials responsible for financial management.
   iii. Treasury operations, including cash management, vouchers, payroll and procurement.
   iv. Financial record keeping and reporting.
   v. Auditing and periodic testing of internal controls.

D. Code of Ethics and Business Conduct that specifies high standards for honesty, integrity, and impartiality for the MRC's employees, officers, and directors and provides guidance on avoiding conflicts of interest, self-dealing, and other types of impropriety as specified in the BOFIA or by the Bank. Every director and officer of the MRC shall be required to sign the Code of Ethics and Business Conduct.

The application will be subjected to an appraisal which could lead to an approval-in-principle (AIP), if successful. The AIP will state conditions to be complied with for the grant of a final licence.

Following the receipt of an application with complete and satisfactory documentation, the Bank shall communicate the status of the application to the applicant within 90 days of receipt.

No proposed MRC shall incorporate/register its name with the Corporate Affairs Commission (CAC) until an Approval in Principle (AIP) has been obtained from the CBN, in writing, a copy of which shall be presented to the Corporate Affairs Commission for registration;

3.2 GENERAL CONDITIONS FOR GRANTING A FINAL LICENCE

The promoters of the MRC shall submit the following documents to the Bank before such company is considered for the grant of a final licence and thereafter, permitted to commence operations.

(i) Evidence of payment of a non-refundable licensing fee of N200,000[2] [two hundred thousand Naira only], or any other amount that may be determined by the Bank from time to time, payable to the Central Bank of Nigeria.

(ii) A copy of the shareholders' register in which the equity interest of each shareholder is properly reflected [together with the original for sighting].

(iii) A copy of the share certificate issued to each shareholder.

(iv) Certified true copies of Form CAC 2 (Statement of Share capital and Return of Allotment), Form CAC 3 (Notice of Situation/Change of Registered Address) and Form CAC 7 (Particulars of Directors).

(v) An undertaking stating the following:
- That the Board of Directors approved by the CBN has been inaugurated.
- That it shall not engage in capital reduction.
- That the quorum for its Board meetings shall be 2/3 of members.
- That it shall not change the Board composition, external auditor or engage a management staff without the prior written approval of the CBN.
- That its directors would comply with the code of conduct for directors of other financial institutions in Nigeria.

(vi) A certified true copy (CTC) of the Memoran dum and Articles of Association filed with the Corporate Affairs Commission.

(vii) A certified true copy of the certificate of incorporation of the company [together with the original for sighting purposes only].

(viii) A list of the proposed management team, attaching the personally signed and dated curriculum vitae (CV) of each person with photocopies of acceptable means of identification such as driving licence, National identity cards, or international passports.

(ix) The proposed firm of external auditors, attaching a profile of the firm.

(x) An application for a refund of the balance of its capital deposit (where it had received 20per cent of the capital deposit post AIP or full sum where it had not), giving its bank details such as account name, account number, sort code and branch address.

(xi) Evidence of acquisition of a conducive office space and equipping of same, which shall be subject to the CBN's inspection prior to recommendation for final licence.

3.3 CONDITIONS PRECEDENT TO COMMENCEMENT OF OPERATIONS

3.3.1 Where the company has been granted a final licence for MRC operations, it will submit the following documents prior to commencement of business:

(i) A copy of the letters of offer and acceptance of employment by the top management staff and a written confirmation that the management team approved by the CBN has been engaged.

(ii) The opening statement of affairs audited by an approved firm of accountants.

(iii) A letter to the CBN, stating the date of commencement of business.

3.3.2 The CBN may, at any time, vary or review any condition of a licence or impose additional conditions.

3.3.3 Where a licence is granted subject to conditions, the MRC shall comply with those conditions to the satisfaction of the CBN within such period as the CBN may deem appropriate in the circumstance. Any MRC that fails to comply with such conditions shall be guilty of an offence under BOFIA.

3.4 FINANCIAL REQUIREMENTS

The financial requirements which may be varied as the CBN considers necessary are as follows:

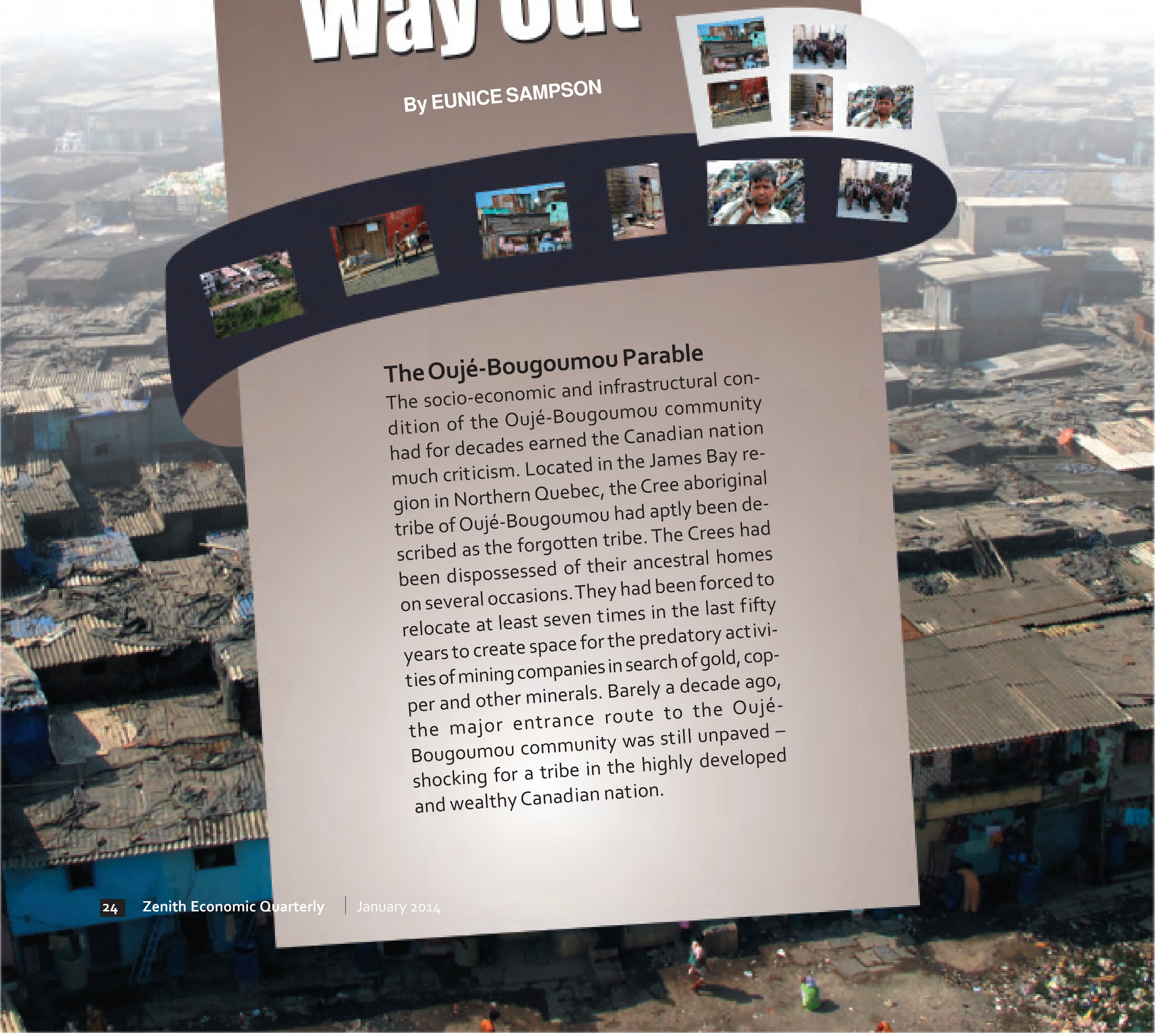
Minimum capital: - N5,000,000,000.00
Non-refundable application fee - N100,000.00
Non-refundable licensing fee - N200,000.00
Change of name fee - N50,000.00

Continued from next edition

[2] *A lower application fee is recommended as the MRC is a private company working for public good. The fee would be considered as part of CBN's contribution towards the initiative for housing sector development.*

Third World Housing Dilemma: The Sustainable Way Out

By EUNICE SAMPSON



The Oujé-Bougoumou Parable

The socio-economic and infrastructural condition of the Oujé-Bougoumou community had for decades earned the Canadian nation much criticism. Located in the James Bay region in Northern Quebec, the Cree aboriginal tribe of Oujé-Bougoumou had aptly been described as the forgotten tribe. The Crees had been dispossessed of their ancestral homes on several occasions. They had been forced to relocate at least seven times in the last fifty years to create space for the predatory activities of mining companies in search of gold, copper and other minerals. Barely a decade ago, the major entrance route to the Oujé-Bougoumou community was still unpaved – shocking for a tribe in the highly developed and wealthy Canadian nation.

But the Oujé-Bougoumou community was to experience a *rebirth* in 1992 when the tribe's decades of grievances finally caught the attention of the Canadian government and concerned global institutions. Douglas Cardinal, the legendary Canadian architect was commissioned to design a master plan for the development of the long abandoned squalor that was the habitat of the Crees. The architect set to work, producing an architectural masterpiece out of the once piteous Oujé-Bougoumou community. In 2002, Douglas Cardinal won the United Nations' Sustainable Design Award for his work in Oujé-Bougoumou, one of the most prestigious honors for an architect and for a sustainable community.

While barely a decade ago the Oujé-Bougoumou community could not have competed favorably with even the worst of Third World ghettos, today its environmental and architectural landscape has become a global model that some of the most developed countries of the world cannot rival. The once pitiable landscape has been rebuilt with all the latest ideas and techniques in sustainable neighborhood in mind. Their status as very late comers to the development race has given the Crees a rare edge – they could start from the very scratch to build neighborhoods that are inspired by the useful lessons learnt from the early birds and forerunners in development. The Oujé-Bougoumou community development scheme is now a symbol of global best practices in sustainable housing development.

The question is, can the Third World replicate the Oujé-Bougoumou story? After decades of struggles with massive housing shortages and

architectural defects, can the low income economies now begin to enjoy a rebirth in their housing and construction sector, similar to the Oujé-Bougoumou experience?

In the new world order, housing stands out as one aspect of human basic needs that requires a massive overhaul, not only in the low income economies but around the world. This is because much of the world's existing houses were built at a time that stakeholders did not know better. But as experts understood the relationship between humans and their social, economic and ecological environment better, their eyes were opened to lapses in building structures and designs that they never knew existed. For countries that can afford it, massive renovations are underway, and in some instances, outright demolitions and reconstructions are being carried out. Even in the most developed economies, not all housing designs meet today's construction standards.

Global Homelessness: Scary Statistics

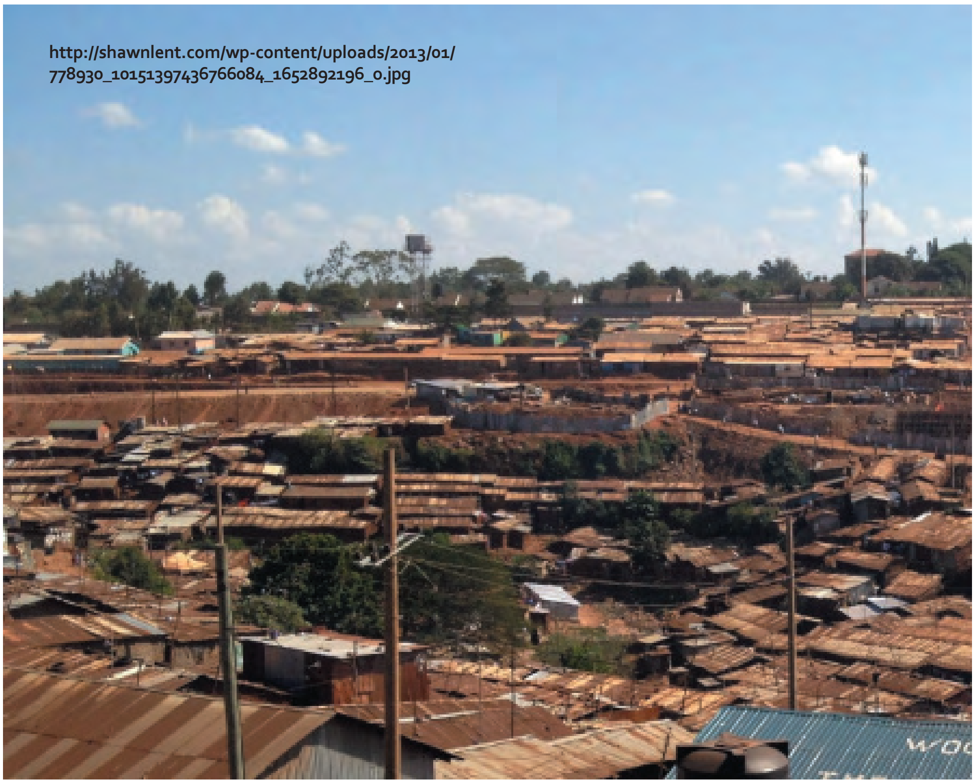
The world today is faced with a double dilemma – available houses are not sufficient to provide roofs over the head of the rapidly growing population, plus, much of the available houses even in some developed economies do not meet today's 'sustainable' standards.

On the issue of inadequacy, the statistics are indeed alarming. The United Nations put the total number of the world's homeless at 100 million. But Share International, a US non-profit rightly postulates that these "numbers would surpass 1,000 million if we include 'all people who lack an adequate home with secure tenure ... and the most basic facilities such as water of adequate quality piped into the home, provision for sanitation and drainage". In other words, several millions around the world may be living in houses; but these houses may not be 'sustainable'.

Several factors are responsible for the world's growing homelessness, including social factors such as mental health, substance abuse, cultural inhibitions and human right violations. This is applicable in virtually all economies of the world. But for the low income economies specifically, the most important reasons for the growing cases of homelessness are poverty, unemployment, financial exclusion, and lack of affordable housing. Land ownership barriers and lack of access to mortgage facilities further compound Third World housing challenges. For example, unlike in the developed economies where an average person with a stable source of income almost automatically qualifies for mortgage facilities, in most low income economies, the word 'mortgage' still sounds 'foreign' to many as it barely exists in their domain. And in a situation where housing units are insufficient; the mortgage system is underdeveloped; rent charges and terms are left at the discretion of the homeowners; and poverty and unemployment are rife, homelessness cannot but be a common syndrome.

Africa with a population of one billion people continues to struggle with the challenge of mounting homelessness and inadequate housing. In Nigeria, the continent's second largest economy and largest in population size, housing units are estimated by the authorities to be short by 17 million units. And the World Bank estimates that the country would require a whopping N59.5 trillion (about $350 billion) to bridge this gap. In the same vein, the Centre for Affordable Housing Finance in Africa puts South Africa's housing deficit at 2.1 million units (or 8 million to 10 million people) despite intensive efforts by government in recent years to deliver affordable housing to its people. Also, according to estimates given by the Habitat for Humanity, about 2,250,000 households in Kenya (750,000 and 1,500,000 households in rural and urban areas respectively) lack access to housing; only eight percent of Kenya's 41.6 million people can afford a mortgage, according to statistics by the World Bank and the Central Bank of Kenya (CBK). In Egypt, North Africa's biggest economy and the continent's third largest, approximately 20 million people, or one-quarter of the country's population live in slums, according to reports by Habitat International Coalition. Egypt's housing deficit is put at up to 1.5 million units.

Though virtually all the nations of the world have signed treaties and conventions proclaiming housing as a *fundamental human right*, yet several economies have not done enough to ensure housing for all. In much of the low income regions of the world for example, up to 60-70 percent of houses are self-built, as against those built by governments and private developers. In the more developed economies, the reverse is the case.



http://shawnlent.com/wp-content/uploads/2013/01/778930_10151397436766084_1652892196_o.jpg

The fact that a good number of Third World houses are self-built makes it difficult to enforce standards and quality, as everyone is left to build what they can afford, with or without the input of certified developers. In the end, quality and standards are compromised and so are the livability and environmental sustainability of the neighborhoods.

What are 'Sustainable' Buildings?

The principles of Sustainable Development emphasize the need for sustainability in every aspect of our lives, including the houses and the environment we live in. The global standard in housing development today is called the 'green' or 'sustainable' building. A green building is one that follows all laid down environmental and construction rules and with limited footprints on the ecological environment.

A report submitted to the California Sustainable Building Task Force in 2002 rightly described 'green' or 'sustainable' buildings as "buildings that are sensitive to the environment, resource and energy consumption, impact on people (quality and healthiness of work environment), financial impact (cost-effectiveness from a full financial cost-return perspective), the world at large (a broader set of issues, such as ground water recharge and global warming, that a government is typically concerned about)." In other words, for a building to be certified as 'green', it must provide basic comfort, convenience, healthiness and security for the inhabitants, save costs in the long run, especially on energy consumption, waste and water management, among others, and also ensure the preservation of the surrounding environment.

Because of the far-reaching activities that go on before, during and after the construction of housing projects, houses could have devastating impact on the natural environment. A badly managed construction process creates problems not only for the ecological environment but also for the inhabitants of the houses and the entire neighborhood. Because of these complications, regulators and environmentalists around the world are now deeply concerned about how to ameliorate the negative impact of housing and construction projects. Advocates of green and sustainable buildings argue that a roof over the head is not sufficient. A good roof over the head must make life safer, healthier, easier, and cost effective for the dwellers and more sustainable for the natural environment.

Achieving Green and Sustainable Buildings

Sustainable housing is the natural step towards achieving a sustainable community, defined by the US Institute for Sustainable Communities (ISCs) as a community "that is economically, environmentally, and socially healthy and resilient", and designed with "the present and future, well beyond the next budget or election cycle" in mind. Sustainable housing and communities "meet current needs while ensuring that adequate resources are equitably available for future generations". http://www.iscvt.org/what_we_do/sustainable_community/.

Achieving a green or sustainable building is not rocket science; neither does it entail an out of this world model or technique. Rather, it is the construction of houses the way we have always done, but with enhanced concerns and provisions for the humans that would live there and the entire neighborhood, including nature. As the United States' Environmental Protection Agency (USEPA) puts it, green buildings entail "the practice of creating structures and using processes that are environmentally responsible and resource-efficient throughout a building's life-cycle from siting to design, construction, operation, maintenance, renovation and deconstruction."

Green buildings are designed with concerns for economy, utility, durability, and comfort at heart. They are designed for water and energy efficiency, and to protect the health and physical wellbeing of the occupants. They are also designed to reduce waste, pollution and environmental degradation. Unlike the conventional building designs, which are prevalent in most low income neighborhoods and even in the neighborhood of some developed economies, green buildings are designed to reduce the overall impact of constructions on human health and the natural environment.

Another aspect of 'greenness' in buildings is the materials that are used in their construction. Developers are encouraged to incorporate sustainable materials in their construction, including reused and recycled content or materials that are made from renewable resources. A green building should also reduce indoor and outdoor pollution, including greenhouse gas, and make provisions for landscaping, gardening and tree planting.

The USEPA lists the seven features that a green building must have to include:

- Energy efficiency and renewable energy
- Water efficiency
- Environmentally friendly building materials and specifications
- Waste reduction
- Toxics reduction
- Indoor air quality
- Smart growth and sustainable development

The USEPA also estimates that buildings account for 39 percent of total energy use; 12 percent of the total water consumption; 68 percent of total electricity consumption; and 38 percent of the carbon dioxide emissions. Therefore, the design and quality of houses and neighborhoods could have devastating footprints on our natural and human environment, explaining why housing occupies a critical space in the efforts to achieve global sustainable development. It is no wonder then that countries are getting more aggressive in the drive to achieve green building standards. According to the U.S. Green Building Council, "generally, green homes are healthier, more comfortable, more durable, and more energy efficient and have a much smaller environmental footprint than conventional homes."

Achieving a sustainable housing environment is not the responsibility of real estate developers alone. It requires a multi-stakeholder collaboration — national and sub national governments, communities, financial institutions, private investors, technical teams (architects, structural, mechanical, electrical engineers, among others) and of course, regula-

Achieving a green or sustainable building is not rocket science; neither does it entail an out of this world model or technique. Rather, it is the construction of houses the way we have always done, but with enhanced concerns and provisions for the humans that would live there and the entire neighborhood, including nature.

http://energysmart.enernoc.com/bid/319663/USGBC-Gives-LEED-v4-the-Green-Light tors and relevant professional institutions.

The 'Triple Bottom-line' Concerns

The 'Triple Bottom-line' of sustainable development emphasizes the social, economic and ecological wellbeing of the environment. This is what green houses are designed and built to achieve. Unfortunately, millions of households and families in low income economies still live in houses with conditions that are deplorable and uninhabitable. These houses are characterized by poor sewage and sanitary conditions, lack of potable water, environmental pollution, proximity to stagnant and mosquitoes breeding water; proximity to industrial wastes, deafening noise and poor ventilation, among others. Good quality housing may not be a multi-billion dollar mansion or castle. But it must have some basic features including cleanliness, good ventilation, good lighting and closeness to nature (such as gardens, trees, etc). Good quality housing must also be safe, secure, accessible, loosely populated, and with proximity to healthcare facilities, schools, recreational parks, walkways and an efficiently run, convenient and affordable public transportation system.

From the 'triple bottom-line' perspectives, the USEPA identifies the expectations of green and sustainable housing to include:

Environmental

- Enhance and protect biodiversity and ecosystems
- Improve air and water quality
- Reduce waste streams
- Conserve and restore natural resources

Economic

- Reduce operating costs
- Create, expand, and shape markets for green product and services
- Improve occupant productivity
- Optimize life-cycle economic performance

Social

- Enhance occupant comfort and health
- Heighten aesthetic qualities
- Minimize strain on local infrastructure
- Improve overall quality of life

A sustainable community would make provisions for the welfare and convenience of the aged, the physically challenged, children, pregnant women, among others. It would have in place facilities and infrastructure that meet the needs of these different segments. It would also have an efficient parking arrangement and safe and convenient sidewalks for walkers and bikers. A sustainable community should also provide easy access to elementary and preschools for the convenience of parents and their wards, and recreational facilities, especially playgrounds for children. It should have family and community gardens, and tree for beautification and carbon emissions management. A sustainable housing project should be built on renewable sources of energy including solar, wind, hydro, among others to reduce carbon emissions and ensure environmental sustainability. There should also be easy access to potable water with structures in place to compel water efficiency and purity. A sustainable housing project should set carbon emission standards for the neighborhood. This it could do by putting in place an affordable and convenient public transportation system, encouraging a shared transportation arrangement for private vehicle owners and enforcing the allowable carbon emission limits for vehicles.

Oujé-Bougoumou Before

A sustainably built neighborhood should be well ventilated and pollution free. For the temperate regions, a centrally controlled heating system that provides some level of warmth even in open air areas is a growing practice. It should be designed to ensure the preservation of the natural life in the neighborhood and protect the community's bio-diversity, including the flora and fauna. Very importantly, a sustainable housing scheme should make provisions for easy access to quality public and private healthcare facilities including child health, maternal care and care for the aged. It should also have in place emergency care facilities and a good referral policy for specialized healthcare facilities when the need arises.

These specifications might sound

Oujé-Bougoumou After

utopian to some, but several well planned out communities around the world have already attained these standards.

Compelling Compliance

In developed economies and in several developing ones, governments, real estate investors, developers, tenants, and other stakeholders are getting increasingly aware of the new environmental standards that housing construction must meet. Several indexes and indicators have been developed to check, measure and certify the sustainability of today's housing and construction projects. And stakeholders now weigh the value for their money using these sustainability indexes. It is no longer business as usual.

The Global Real Estate Sustainability Benchmark (GRESB) has been adopted by several property and real estate developers around the world and they are required to report to stakeholders and the general public on their performance in applying these benchmarks.

At the sovereign level, some countries have voluntarily developed methodologies for measuring and certifying the 'greenness' of building and construction projects. The United Kingdom for instance, in 1990 launched the British Research Establishment Environmental Assessment Method (BREEAM) to set and monitor standards in sustainable building design, construction and management. About 250,000 buildings have been certified by BREEAM since 1990, with over a million registered for assessment.

In 2000, the UK introduced the EcoHome initiative to evaluate the sustainability of housing projects in the country. "EcoHome is an assessment method that balances environmental performance with the need for a high quality of life and a safe and healthy internal environment. Buildings are rated on a scale of "Pass with 36 points", "Good with 48 points", "Very Good with 58 points" or "Excellent with 70 points". All funded construction projects in the UK are now required to achieve a minimum of 'Very Good' rating. These ratings are carried out using seven main indicators – energy, water, pollution, materials, transport, ecology and land use, health and well-being". EcoHome has helped developers to improve the environmental performance of their housing delivery with regard to reduced environmental footprints and lowered running costs for residents. https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/7810/1501290.pdf.

Both at the national, sub-national and communal levels, the United

States has also developed several initiatives for regulating the compliance of new and existing buildings to sustainable standards. The US Green Building Council (USGBC) was established in 1993 for this purpose. In 1994, the USGBC commenced the Leadership in Environmental and Energy Design (LEED) Green Building Rating System, to verify and rate all classes of buildings using laid down sustainability benchmarks. Under the initiative, construction projects are certified as Silver, Gold or Platinum, depending on their level of compliance with laid down 'greenness' standards.

Canada also launched the Building Environmental Performance Assessment Criteria (BEPAC) in 1994, with the mandate to rate and certify the compliance of housing projects with sustainability criteria; while Hong Kong's Building Environmental Assessment Method (HK-BEAM) was also recently unveiled, among other similar initiatives around the world.

As governments tighten their regulatory grip, private sector operators in all industries and sectors including real estate and housing would be compelled to embrace sustainable business practices. Pressures are currently being mounted on the World Federation of Exchanges (WFE) to mandate its over 45,000 member quoted companies to adopt sustainability reporting standards. And it is a question of time before such calls from key global investors are heeded.

However, the concept of sustainable housing is already receiving widespread acceptance with several communities around the world getting more compliant. In the last decade or more, sustainable neighborhood champions have even emerged. Experts rank the top ten green cities in the world to include Reykjavik, Iceland at the top spot; followed by San Francisco in the United States; Malmö, Sweden; Vancouver, Canada; Portland, Ore (United States); Curitiba, Brazil; Copenhagen, Denmark; Stockholm, Sweden; Hamburg, Germany; and Bogotá, Colombia, in the 10th position. http://www.greenoptimistic.com/2013/06/04/top-10-greenest-cities/. These cities have pioneered green neighborhoods, prioritizing respect for the wellbeing of the natural environment, energy efficiency, reduction in greenhouse gas emissions, recycling and reuse of materials, effective waste management, tree planting and maintenance, efficient public transportation system, convenient bikeways and walkways, good and easily accessible recreational facilities, and walkable distances to elementary and preschools, among others.

http://www.iceland.is/iceland-abroad/ca/study-in-iceland/

http://livinginecuador.files.wordpress.com/2011/03/cuenca-life-001.jpg

The Cost Phobia

One of the factors militating against widespread sustainable building practices is the fear of incurring higher construction costs. But the outcomes of recent surveys show that this is not necessarily the case. A sustainable building project is not essentially more expensive than a conventional one, at least in the long run.

A report presented to the California Sustainable Building Task Force in 2003 ("The Costs and Financial Benefits of Green Buildings"; Greg Kats, et al) concluded that "sustainable building is a cost-effective investment, and its findings should encourage communities across the country to 'build green.'" Citing the successful construction of its LEED-complaint Education Headquarters Building, the first LEED Gold state owned office building in the United States, the government of California reports that it saved taxpayers $500,000 a year in energy costs alone. According to the report, "an initial upfront investment of up to $100,000 to incorporate green building features into a $5 million project would result in a savings of at least $1 million over the life of the building, assumed conservatively to be 20 years". The report listed the financial benefits of green buildings to include lower energy, waste disposal, and water costs, lower environmental and emissions costs, lower operations and maintenance costs, and savings from increased productivity and health. http://www.usgbc.org/Docs/News/News477.pdf.

Another study showed that it would cost somewhere between 1 and 3% extra to achieve a rating of 'very good' for a house on sustainability compliance.

While green buildings would cost more than conventional buildings in the short term, the "green premium" is however far lower than is commonly assumed. And as more developers adopt the initiative and more skills are built in green building construction and management, the cost would keep declining.

Aside from costs, other concerns for developers in low income economies may include uncertainties about the methodologies involved, including technical requirements, dearth of specialized labor and skills, availability of required facilities, among others.

But sustainable housing is worth every extra investment and effort that goes into it. Aside from its ecological and social benefits, sustainable housing comes with huge economic gains for the homeowners, developers, investors and other stakeholders. Not only does it increase the value of the properties, it ensures that such properties stand the test of time. For the larger economy, it boosts activities in the real sector, builds capacity and skills while also creating volumes of jobs. Speaking on aspects of the San Francisco's green infrastructure project, California's Lieutenant Governor and former Mayor of San Francisco Gavin Newsom affirmed that "for every billion dollars spent, the coal sector created 890 jobs while investments in retrofitting existing buildings created 7,000 jobs." http://www.globalgreencities.com/wpcontent/uploads/

Potential Productivity Gains from Improvements in Indoor Environments

Source of Productivity Gain	Potential Annual Health Benefits	Potential U.S. Annual Savings or Productivity Gain (2002 dollars)
1) Reduced respiratory illness	16 to 37 million avoided cases of common cold or influenza	$7 - $16 billion
2) Reduced allergies and asthma	8% to 25% decrease in symptoms within 53 million allergy sufferers and 16 million asthmatics	$1 - $5 billion
3) Reduced sick building syndrome symptoms	20% to 50% reduction in SBS health symptoms experienced frequently at work by ~15 million workers	$10 - $35 billion
4) Sub-total		*$18 - $56 billion*
5) Improved worker performance from changes in thermal environment and lighting	Not applicable	$25 - $180 billion
6) Total		*$43 - $235 billion*

Adapted from: William Fisk, "Health and Productivity Gains from Better Indoor Environments"

Secondary source: "The Costs and Financial Benefits of Green Buildings"; A Report to California's Sustainable Building Task Force; Greg Kats, et al; October 2003; from http://www.usgbc.org/Docs/News/News477.pdf

Green Buildings Costs Premium: Summary of Findings (per ft2)

Category	20-year NPV
Energy Value	$5.79
Emissions Value	$1.18
Water Value	$0.51
Waste Value (construction only) - 1 year	$0.03
Commissioning O&M Value	$8.47
Productivity and Health Value (Certified and Silver)	$36.89
Productivity and Health Value (Gold and Platinum)	$55.33
Less Green Cost Premium	($4.00)
Total 20-year NPV (Certified and Silver)	**$48.87**
Total 20-year NPV (Gold and Platinum)	**$67.31**

Source: Capital E Analysis

Secondary source: "The Costs and Financial Benefits of Green Buildings"; A Report to California's Sustainable Building Task Force; Greg Kats, et al; October 2003; from http://www.usgbc.org/Docs/News/News477.pdf

GlobalGreenCitiesKeyFindingsWeb.pdf.

UK Code for Sustainable Homes: Mandatory Issues

Issue Code	Description	Code Level 1	2	3	4	5	6	
Mat 1	*Environmental impact*[1]	At least three key elements to achieve a Green Guide rating of A+ to D						Uncredited mandatory issues
	Mandatory Credits	-	-	-	-	-	-	
Sur 1	*Surface water run-off*	Ensure peak rate of run-off into watercourses will not increase as a result of development						
	Mandatory Credits	-	-	-	-	-	-	
Was 1	*Waste storage*	Allocate space for waste storage in line with British Standard 5906						
	Mandatory Credits	-	-	-	-	-	-	
Was 2	*Construction waste management*	Develop and implement a site waste management plan to monitor and report on waste generated on site						
	Mandatory Credits	-	-	-	-	-	-	
Ene 1	*% improvement on TER*	10%	18%	25%	44%	100%	ZCH	Mandatory issues
	Mandatory Credits	1	3	5	8	14	15	
Hea 4	*Mandatory to comply with all principles of Lifetime Homes*	No	No	No	No	No	Yes	
	Mandatory Credits	-	-	-	-	-	4	
Wat 1	*Maximum internal water use (litres/person/day)*	120	120	105	105	80	80	
	Mandatory Credits	1	1	3	3	5	5	

Taking the Plunge

Cities that are already fully built will have challenges transiting to the new sustainable neighborhoods. This is because of the huge financial costs and other setbacks associated with outright demolition of existing structures and rebuilding of new ones. For countries in this category, the most viable option would be renovations and retrofitting of existing facilities to at least bring them as close as possible to sustainable standards.

The huge housing gap waiting to be filled in several low income economies therefore comes as a blessing in disguise. It creates for them a good opportunity to go back to the drawing board and redesign their housing master plans in compliance with today's sustainable building standards. Beyond building houses and erecting roofs over the heads of the rapidly growing Third World population is the need to achieve a sustainable housing blueprint that would meet the needs of today and the future.

As latecomers to the development of widespread housing schemes, they are at least in a privileged position to learn from the mistakes of the early birds and develop new housing patterns that are at par with modern standards. Here, the parable of the Oujé-Bougoumou community comes to mind again. Low income economies could leverage their seeming setbacks in the provision of adequate housing to become flag bearers in the construction of ultramodern, sustainable housing projects. Just as several of them, including Nigeria, Kenya and Bangladesh leveraged their late arrivals to become champions in the adoption of the latest technologies in telecommunications, mobile money, among others.

But the time to start leveraging this advantage is now, to avoid a continuation of the old, unsustainable trends in housing construction. To effect the needed change, governments must develop a sustainable housing roadmap and put indicators and checks in place to guide construction of new houses going forward. There should also be in place effective regulation, incentives for compliance and punitive measures for defiance.

Governments must also take up the responsibility of developing the desired sustainable houses and communities, rather than the current practice of leaving housing development at the unguided discretion of individual builders. Mass building schemes must be taken up by governments and certified private developers. Also, financial inclusion strategies should be pursued and the mortgage system developed and made accessible to enable more people leverage ownership of homes that have been built sustainably.

For the Third World, it is time to ensure adequate funding for the development of sustainable homes and neighborhoods using global and local financial institutions, capital markets, institutional investors and proceeds from available sovereign wealth funds. Several low income economies may have missed the housing development revolutions of the past; but they definitely cannot afford to miss this new one.

(* Eunice Sampson is the Deputy Editor, Zenith Economic Quarterly)

Risk management in the Nigerian banking system: 2

CHALLENGES & PROSPECTS

By Chuks Nwaze

In the first edition of this serial, we introduced the concept of risk management and why it is indispensable in contemporary banking. In this edition, we shall continue to explore the subject by reviewing the relevant literature on the core aspects of the risk management function, which is credit risk, otherwise called loans, and by so doing benefit from the experience and practices in other jurisdictions around the world. In other words, we are going to intellectually ventilate on the previously identified variables viz: borrowers' character, collateral, economic conditions and corporate governance and how they impact on performance of loans. These parameters will be discussed mostly from the prism of existing body of knowledge from conceptual, theoretical and empirical perspectives.

Before discussing the conceptual parameters of credit risk mentioned above, it is necessary to remind ourselves of what a bank is and what it does as well as the regulatory environment that controls the operation of banks in Nigeria. This study will also consider the need for credit in the economy.

FUNCTIONAL CONCEPT OF BANKING

A bank is most commonly defined in terms of its functions. According to Paget (1966), a bank or banker is a corporation or person (or group of persons) who accept monies on current accounts, pay cheques drawn upon such accounts on demand and collect cheques for customers; that if such minimum services are afforded to all and sundry without restriction of any kind, the business is banking business, whether or not other busi-

However, in the Nigerian Banking Act of 1969 the term bank was interpreted as meaning "any person who carries on banking business." The Act (as amended by section (i) (k) Banking (Amendment) Decree No. 3 1970), stated that banking business " means the business of receiving monies from outside sources as deposits irrespective of the payment of interest and the granting of money loans and acceptance of credit or the purchase of bills and cheques or the purchase and sale of securities for account of others or the incurring of obligation to acquire claims in respect of loans prior to their maturity or the assumption of guarantees and other warranties for others or the effecting of transfers and clearings and such other transactions as the commissioners may on the recommendation of the Central Bank, by order published in the Federal Gazette designate as banking business".

From the above, it can be summarized that an institution is a bank if it has a license to be so called and performs some basic functions which must include providing deposit facilities for the general public, permitting money to be withdrawn or transferred from one account to another and lending the surplus of deposited money to customers who wish to borrow (Cox, 1981). It is this last basic function which has to do with the lending process and all the challenges associated with it that constitute essentially the subject matter of this study.

STATUTORY REGULATION AND RISK MANAGEMENT

The Banking industry worldwide is highly regulated and Nigerian Banks are no exceptions to this extensive prudential regulation. Gardnex (1978) asserted that in virtually all developed market economies the banking industry is more heavily regulated than any other commercial or industrial sector. The situation is not different in developing economies, including Nigeria. Interestingly, the extent of regulation has not waned over the years; rather, it is increasing with amazing intensity. Apart from the need for deliberate intervention to prevent and correct the failure of individual units in the industry, the case for regulation also stems from the desire to protect depositors, address the indigenous community's savings

http://murrayglobal.files.wordpress.com/2010/07/lagos-skyline-harbor.jpg

and investment requirements as well as accelerate national economic development initiatives. Regulation of the industry also arises from the uniqueness of the banking business itself which traditionally occupies a vital position in the economy. According to Johnson and Johnson (1987), the centrality of banking in the economic development singles it out for a much heavier regulation than any other industry.

We can safely infer, therefore, that banking activities are sternly regulated to ensure "a fair-playing-ground" especially now that there is heated competition in the industry. Without a sound and well articulated operating framework like the prudential guidelines, some institutions would wonder beyond their sphere of jurisdiction and burn their fingers. This would no doubt expose the innocent depositors to risks or losses through no fault of theirs. The contagious effect in the financial system is another reason for keeping the activities of banks within safe and acceptable levels. The failure of one

bank, if unguarded, would spread onto others and the confidence upon which the entire banking business is based could be eroded.

This study will briefly discuss the two statutory regulatory institutions whose specific mandate and activities have a direct bearing on performance of loans which is the subject of this study viz.: the Central Bank of Nigeria (CBN) and the Nigeria Deposit Insurance Corporation (NDIC). It is these two institutions that conduct regular on-site and off-site examinations to ascertain the quality of loans being granted and by implication the health of the banks.

THE CENTRAL BANK OF NIGERIA (CBN)

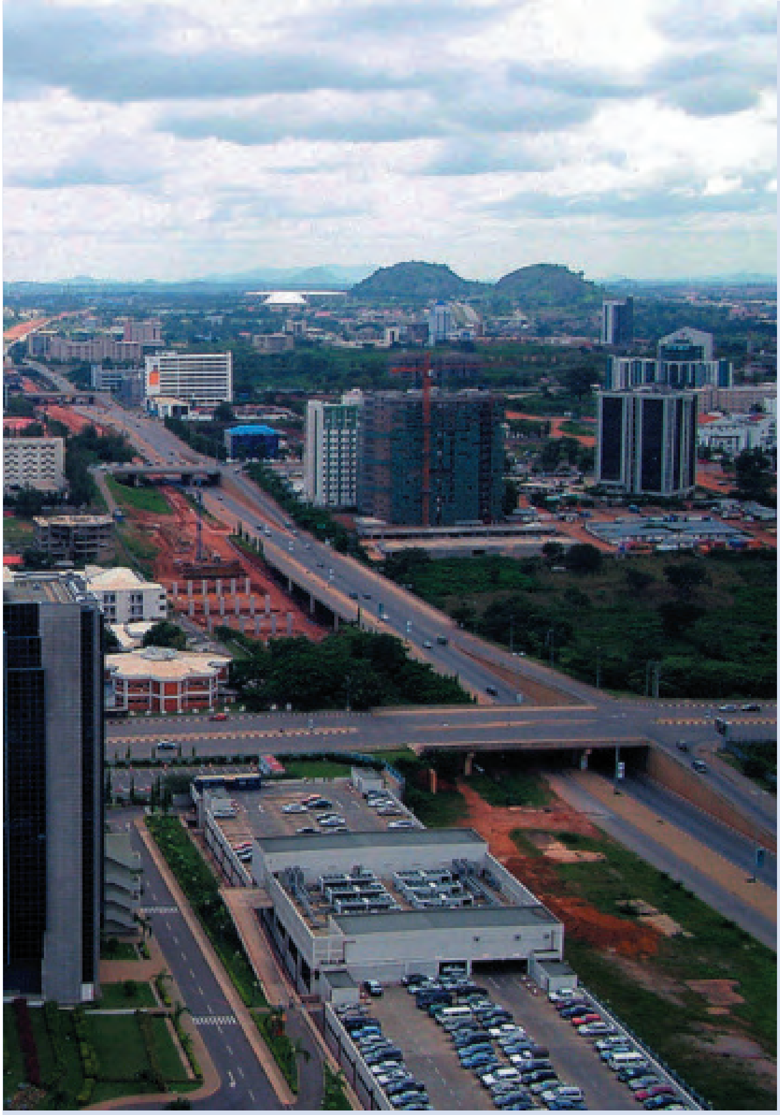
In addition to other fundamental functions that have to do with control of currency, monetary policy and being banker to the government, etc, the Central Bank of Nigeria (CBN) which started on 1st July 1959 is the apex regulatory authority of the Nigerian financial system. It is the body statutorily charged with the responsibility to regulate and supervise the banking industry. According to Onado (1986), this responsibility can be classified as structural regulation, prudential regulation, and "fair play" or level playing field regulation.

The structural regulation controls such things as requirements for entry and exit into and out of the industry as well as rules for growth and diversification. The prudential regulations proper are concerned with the structure of the balance sheet to ensure that liquidity and solvency requirements are complied with while the 'fair play' or level- playing field regulations, as already explained above, are aimed at ensuring the diffusion of information on the money market to ensure that each bank is put on equal footing and minimize unfair advantages from accruing to some banks at the expense or detriment of others.

There are, however, no clear-cut lines between the three boundaries. For instance, while some of the structural regulations are also prudential in nature and vice versa, the regulations bordering on a level-playing field and unfair competition also have to do with structural and prudential guidelines for the orderly conduct of banking business for protection of depositors and other stakeholders.

NIGERIAN DEPOSIT INSURANCE CORPORATION (NDIC)

Although the NDIC complements the regulatory and supervisory roles of the CBN, it is, however, autonomous of the CBN and reports to the Federal Ministry of Finance. The NDIC, which commenced operations in 1989, is statutorily charged with the responsibility of providing deposit insurance and other related or ancillary services for banks in order to promote confidence in the industry. In order to effectively prosecute their mandate, the NDIC is empowered to regularly assess and monitor the level of operational and credit risk of banking



institutions by examining the books and affairs of insured banks.

Licensed banks are mandated to pay 15/16 per cent of their total deposit liabilities to the NDIC as insurance premium while a depositor's claim in the event of bank failure is limited to a maximum of N50,000 (recently increased to N200,000) per depositor. It is necessary to establish the nexus between the mandate of the NDIC and this study by explaining the fact that non-performing loans can fuel banking crisis and subsequently result in the collapse of banks. Demirgue-Kunt et al (1989), cited in Berger and De Young (1997) are of the view that failing banks have huge proportions of bad loans prior to failure and that asset quality is a statistically significant predictor of insolvency (Aballey, 2009).

CREDIT RISK

Specifically, in the banking context, risk asset refers to an asset owned by a bank or financial institution whose value may fluctuate due to changes in interest rate, credit quality, repayment risk, etc. In practical terms, this refers to loans granted to borrowers at specific terms and conditions. It is a risk asset because these terms and conditions can be breached and repayment can be in default. The extent of inherent risk will determine the extent of possible default.

In the view of Nwankwo (2000), credit constitutes the largest single income-earning asset in the portfolio of most banks. This explains why banks spend enormous resources to estimate, monitor and manage their credit quality. Sadly, however, these assets (they are known as 'risk assets' because of the inherent risk) often become delinquent, non-performing or completely bad which ultimately affect the health and sometimes even the continued existence of banks. As we have explained earlier, this state of affairs has to do with the fact that, until very recently, banks have paid only scanty attention to the concept of risk management.

To lend credence to this assertion, Adedoyin and Sobodun (1991) are of the opinion that lending is undoubtedly the heart of the banking business. Therefore, its administration requires considerable skill and dexterity on the part of the bank management. While a bank is irrevocably committed to paying interest on deposits it mobilized from different sources, the ability to articulate 'loanable' avenues where deposit funds could be placed to generate reasonable income, maintain liquidity and ensure safety requires a high degree of pragmatic policy formulation and application (Olokoyo, 2011).

The concept and interpretation of the word "credit" is as varied as there are fields where it is applied. Credit is not only the power to borrow money and the ability to command capital but also the present right to a future payment. While contending that credit is based on confidence, a loan or extension of credit is an advance of cash or a credit to an account which can be withdrawn in cash or used for the payment of bills or liquidation of promises to pay against the belief of the lender that the funds so borrowed or so advanced will be repaid at a future date. The notion that credit is based on confidence was further buttressed by Orji (1989) when he noted that credit is borne out of confidence in a debtor's ability to honour repayment obligation at some future time. He went further to classify the groups involved in credit as the lender who extends or who is ready to part with money and the borrower to whom the credit is granted.

In the context of this research, therefore, credit can be succinctly defined as the art of allowing a person or entity the use of an asset not owned by him under some mutually agreed terms and conditions. Following from the scope of this study, the person or the entity who allows the use of his asset is the bank (the lender) while the party that uses the asset is the borrower, the asset used being fund. The borrower includes individuals, business firms, governments and their agencies etc.

Credit can also be seen as the borrower's demand for facilities ahead of his ability to pay for them, the nature, terms and conditions being determined by the prevailing circumstances upon which it is consummated at a particular point in time. The financial intermediation function of banks is based, therefore, on credit creation and eventual disbursement of the funds created on specific terms and conditions.

CREDIT RISK AND ECONOMIC DEVELOPMENT

Banks through credit reconcile the diverse needs of the surplus and deficit sectors of the economy. The surplus sector or the creditors avail themselves the opportunity of investing their otherwise idle funds in productive ventures via the borrowers who on the other hand would be cash strapped were the funds not realized by the creditors. This evidently is of immense benefit to the economy as a whole as it brings about positive distribution of scarce funds. This importance is highlighted by Cross and Hampel (1980) who described credit as the "life blood" of an economy. Hampel, Coleman and Simpson (1986) further stressed that the manner in which these funds are distributed in the economy can have enormous effect on national economic development initiatives.

Government also achieves its macroeconomic objectives from sectoral allocation guidelines and ceilings which act as the framework within which banks are to operate from time to time. Examples abound in the banking industry guidelines of today; the manufacturing and agricultural sub-sectors are usually most favoured in the allocation of credit ceilings by the CBN from time to time.

Besides the foregoing importance of credit in the national economic outlook, credit is an important monetary tool of the government. Various economic policies of the government are anticipated and brought to bear on national economic programmes through bank credit.

As a result of this, therefore, sectors of priority economic interest are often favoured more than other sectors in banks' credit portfolio which undoubtedly brings about macro economic benefits to the citizenry. For example, by granting more credit to the manufacturing sector, the problem of unemployment would be ameliorated as more jobs would be created as new manufacturing plants come on stream and old ones improve on capacity utilization through additional capital investment. Also, more goods and services will be produced which will not only bring down inflation but also increase gross national product (GDP). Other multiplier effects will also result from extending credit for agricultural purposes.

The need for credit and the specific type of the facility actually re-

quired depend to a large extent on the nature of the borrower, the maturity or tenor of the loan, the purpose of the loan and the security offered. The commonest in our own jurisdiction is the classification by purpose and maturity. Basically, there are two types of borrowers, viz.: the corporate and the individual borrowers. Corporate borrowers represent business firms who borrow to finance seasonal/short term working capital as well as long-term investment. Individual borrowers, however, are persons borrowing for their respective individual needs, which range from personal domestic obligations to non-domestic financial commitments or responsibilities.

In developing countries, however, the level of individual borrowing is relatively low compared to corporate borrowers because of the dearth of financial information on consumer lending and the attendant high level of risk involved. However, both corporate and individual borrowers fall within the operational confines of commercial and merchant banks. While Hempel et al (1986) recognized the following categories of credit: Internal loans, Agricultural, Real Estate, Government Guaranteed, Lease Financing and Oil and Gas, Nwankwo (2000) mentioned production and general commerce loans which are mainly business loans for financing seasonal working capital, long-term working capital needs and fixed assets. Other purposes include financing changes in payment patterns, bridging facilities, unexpected one-off expenses as well as replacement of fund lost due to unprofitable operations.

Credits extended for public utilities, transportation, and communications, etc are examples of loans for social services. Others refer to loans made to various levels of governments, professional bodies as well as other miscellaneous loans for sundry purposes. Bank guarantees in international trade obligations, discounting of international payments, in the view of Hempel el al (1986) also typify international loans.

PARAMETERS OF CREDIT RISK: APPRAISAL AND INVESTIGATION

The concept of credit appraisal has to do with an assessment of the various risks that can impact on the repayment of a loan. The ultimate question for which the lender must be prepared to answer is: 'will I get my money back?' Depending on the purpose of a loan and the quantum, the appraisal process may be simple or elaborate. For small personal loans, credit scoring based on income, lifestyle and existing liabilities may suffice. But for project financing, the process involves technical, commercial, marketing, financial, managerial appraisals as well as implementation schedule and ability. Credit appraisal revolves around character, collateral capability and capacity. For individuals, it takes into account various factor like income of the applicant, number of dependants, monthly expenditure, repayment capacity, employment history, number of years of service and other factors which affect credit rating of the borrowers.

Credit appraisal is premised on the basic ingredients of lending which constitute the variables for this work, viz.: borrower's character, collateral, economic conditions and corporate governance. It is the crystal ball with which the lender makes his decision as to whether to accede to a loan request or not. It is a loss-minimizing function in the creation of risk assets. Through it, the bank attempts to determine the ability of the borrower to repay legitimate loans extended to him. Credit analysis (or appraisal) is the process of assessing the risk of lending to a business or individual against the benefits that would accrue from the loan. The benefits could be direct, such as interest earnings and possibly deposit balances required as a condition of the loan. It could also be indirect, such as initiation or maintenance of a relationship with the borrower which may provide the bank with increased deposits and assess to a variety of other bank services which are mutually beneficial to both parties.

Assessment of the risks inherent in credit can be either qualitative or quantitative. The qualitative aspect, which is the focus of this study, is concerned with issues such as gathering and appraising of information bordering on the borrower's record of financial responsibility, determining his actual need, identifying the risk posed by both current and future economic and political environments and finally the borrower's commitment regarding the repayment of the loan. The other aspect of credit analysis - quantitative analysis- involves issues such as the analysis of the borrower's historical financial data and future projections to ascertain his capacity to honour his financial obligations as and when due.

The first step in conducting a successful credit analysis for a loan proposal is a thorough environmental appraisal. This enables the loan officer to study, understand and appreciate the strengths and weaknesses as well as objectives and mission of the bank as contained in its corporate plan and loan policy. Environmental appreciation provides the framework and enables the loan officer to study and master the capital and money markets as well as the social, economic and political realities. The next step is credit investigation, which is aimed at assessing the borrower's capacity and willingness to service the loan when it is granted. In sum, this specific enquiry is targeted at ascertaining the borrower's credit worthiness.

Ezirim (2005) stressed that bank lending decisions generally are fraught with a great deal of risks which calls for a great deal of caution and tact in this aspect of banking operations. The success of every lending activity to a great extent therefore, hinges on the part of the credit analysts to carry out good credit analysis, presentation, structuring and reporting. Traditionally, banks resort to six factors in carrying out credit investigation. These factors are popularly known as the C's and 'M' of credit investigation. The C's are: character, condition, capacity, collateral and capital while the M is management (corporate governance). However, a closer observation will reveal the fact that these parameters can be categorized into four viz: borrowers' character, economic conditions, collateral and corporate governance. The rationale for this is the fact that capital and capacity are part of the human or corporate character (Osayameh, 1987).

BORROWERS' CHARACTER

The concept of borrowers' character in relation to financial institutions and extension of credit risk refers to whether the borrower is trustworthy and if he will willingly repay his debt as agreed. Character or credit reputation refers not only to how the borrower handles his financial obli-

gations, especially during periods of adversity, but also whether he actually has the capacity, in terms of income, assets or other financial resources to fulfill his financial commitments as and when due.

Unfortunately, character or human psychological factor does not lend itself to easy assessment. In fact, it is the most difficult of all the factors in credit investigation. In this context, character can be described as attributes of honesty, integrity, industry and morality. It connotes to the extra mile a borrower has to go in repaying a debt or to honour the obligations under a loan contract. It also refers to the individual or corporate integrity of borrowers and their commitment to abide by the contract they willingly entered into. The character of a borrower is ascertained, as it were, through face-to-face interviews as well as an examination of his past record and character references. This is where the loan officer's judgment becomes of paramount importance. According to Dennis (1981), successful commercial lending requires judgment more than it requires technical skills.

Another important concept which is part of the borrowers' character has to do with the borrower's strength (capacity) to meet the loan obligations. The salient issues here also include the borrower's cash flows during the loan period. If 'earnings' constitute the source of loan repayment, then it must be sufficient to cover the loan and other operating expenses. Banks as a matter of prudence insist on 'earnings' being the primary source of payment since it is derived from the cash flows of the borrower's business. However, according to Hempel, Coleman and Simpson (1986) sources of repayment other than cash flows from operations should be viewed with caution. In the same vein, the concept of capital is also vital. Capital in this context refers to the borrowers' legal capacity to pay back the loan. Weston (1977) said capital is "measured by the general financial position of the firm as indicated by financial ratio analysis with special emphasis on the tangible net worth of the enterprise".

COLLATERAL

Collateral (otherwise called 'security') is anything of value offered or pledged by the borrower for the creditor to fall back on in the event of any default in meeting the agreed loan obligations. It serves to bring the borrower's commitment to bear on the obligations of the credit. Collateral is the asset which the borrower pledges to convince the lender that he is fully committed to meeting his commitments on schedule.

Banks generally do not accord this aspect of credit investigation much prominence in credit decision-making for two reasons. The first is that the image of the bank is often affected negatively, or at best, at the mercy of the general public when a bank takes possession of the pledged asset in the event of default. The second reason is that the value of the pledged asset at the time of disposal is often much below the value of the disbursed loan plus the accrued interest. Besides, the cost and time it takes to recover full title or dispose the asset is usually prohibitive. Hence, in practice, collaterals only serve to get the borrower's unflinching commitment to honour his loan obligation. As Nwankwo (1991) puts it, banks take adequate collateral securities as a manifestation of the customer's confidence in his own project and as something upon which the banker can resort to.

In the light of the above, theoretically, loans can be secured or unsecured. In practice, however, all loans are secured one way or another as most of the apparently unsecured loans are often based on personal reputation which is assumed to be of value and as such covered by the definition of security. While security should not be the basis for granting a facility, there is no doubt, whatsoever, that it plays a fundamental role not only in forcing the debtor to comply with the terms of the facility but also to indemnify the creditor in the event of the unexpected. It is highly advisable, therefore, that all loans should be collateralized.

ECONOMIC CONDITIONS

Another important variable which is part of this study is economic and environmental conditions. These conditions include: interest rates, GDP, inflation, unemployment, government policy, etc. The loan officer in order to make successful loan decisions is required to cast both macro and micro looks at the loan proposal. The prevailing and future environmental and economic realities (conditions) should also be taken cognizance of while investigating credit proposals. This aspect is necessary so that the purpose for which the loan is being sought is not isolated from the environmental and economic situation of the country. Besides, neither the lender nor the borrower can be realistically insulated from the current or potential developments in the economy, politics and society as a whole.

CORPORATE GOVERNANCE

The last, but surely not the least, in the list of variables under consideration is the concept of managerial effectiveness, otherwise known as corporate governance in contemporary literature. There is no doubt, whatsoever, that the quality of corporate governance is very critical in carrying the whole loan arrangement from inception to repayment. From the point of view of the borrower, corporate governance can be reduced to (1) the evaluation of management success on the venture for which fund has been borrowed and (2) the estimate of management's determination to honour its obligations to the lender. If the borrower has a clear and unequivocal determination to repay, then any circumstances that can lead to inadequacy of resources will probably not lead to serious collection problems.

In this study, however, our discussion on corporate governance will focus on the lending institution (the bank). This is because it is the lending institution that bears the brunt of non-performing facilities. It is also the lending institution that must ensure that the borrower makes wise decisions not only in relation to the credit application but also the implementation of the project for which the facility was obtained. This aspect has to do with credit monitoring.

CORPORATE GOVERNANCE AND CREDIT INFORMATION

The ability of the lending institution to obtain relevant information for decision-making with respect to credit appraisals is an important component in the evaluation of corporate governance effectiveness. Osayameh (1986) recognizes two main sources of credit information as internal and external sources. The applicant or the management of the company in need of the credit facility constitutes the internal source of credit information. The information is obtained via the applicant's credit proposal, face-to-face interviews and on-site inspection of the intended project. Hempel et al (1986) also notes that lenders can quickly gather a wealth of supporting information by using well placed questions during the loan interview.

The external sources of credit information as noted by Osayameh include banks, trade sources, major customers and competitors. The

bank where the borrower has maintained an account for a reasonable length of time could also constitute a veritable source of information. This information, however, is difficult to obtain because of the traditional oath of secrecy inherent in banking business which is also an aspect of the practitioners' professional etiquette. Notwithstanding, this, however, banks often have mutual understanding and usually assist one another in this regard. Trade sources as external sources of credit information are of little relevance and use in developing countries. This is contrary to what obtains in countries like the US and U.K where information from trade sources is well developed and used. Where trade information is

http://www.agrion.org/wire/agrion.php?langue=ny&nom=Sustainability_Reporting_Half_Day_Conference

available, however, a lender can easily avail himself the opportunity of evaluating a borrower simply by making enquiries in appropriate sources including news media, financial press, published reports, research centres, internet, etc.

The borrower's customers as well as his competitors are also possible sources of credit information. However, information from these sources must be interpreted with caution because of the inherent prejudices. In fact, Osayameh (1986) writes that while competitors' opinion is valuable, keen judgment with extreme caution is required in evaluating information from competitors. Surely, no person wants his competitor to excel if it is within his power to pull him down in any conceivable manner. After all, 'in war all is fair'

CREDIT INFORMATION AND RISK FACTORS

The success of a project depends not merely upon the capabilities of the applicant, it depends also on how hard he works or strives for the success of the project and for the fulfillment of his obligations to the financier, how compatible his objectives are with those of the financiers, and how a frank, co-operative and honest relationship can be created between borrower and lender. After all, loan obligations are future commitments which the borrower is expected to meet based on the lender's present evaluation and judgment. It is important, however, to emphasize the fact that although the lender's assessment is often based on the borrowers past track record, which is historical in nature, at the end of the day, loan repayments are made from future cash flows, not historical figures. This view is supported by Haneef et al (2012) who stated that Banks place undue emphasis on historical financials instead of a forward-looking approach..

Sadly, several lending institutions have not come to terms with the stark reality that it is in the character of prospective borrowers with fraudulent intent to simulate, misrepresent, window-dress or even falsify both turnover and other satisfactory indices of historical performance, ab-initio, to satisfy their bankers as a basis for loan application. They are aware that this is what their bankers will be looking at. There is no doubt, whatsoever, that a little more creativity on the part of lending institutions in this respect will do them a lot more good. Historical performance indices as a basis for credit appraisal should, therefore, be handled with utmost care.

From the foregoing, it is obvious that the whole exercise of successful credit analysis is predicated on the availability of a sound and unbiased data. The entire essence of credit investigation is to acquire enough information to determine the loan applicants' willingness, honesty and capacity to service the proposed facility.

(* Chuks Nwaze is the Managing Consultant/CEO, Control & Surveillance Associates Ltd)

GDP Rebasing:
Implications of a Bigger Nigerian Economy

By **Sunday Enebeli-Uzor**

In a bid to improve the quality of the Nigerian statistical system to conform with the latest System of National Accounts (SNA) of the United Nations, and global best practice, the National Bureau of Statistics (NBS) is currently in the process of rebasing Nigeria's National Accounts Estimates from which the Gross Domestic Product (GDP) is computed. The entire process is referred to as GDP rebasing for easy grasp. GDP rebasing involves replacing the base year used in the computation of GDP with a new or more recent one to reflect structural changes in the economy; base year being the year against which the performance of an index is measured. The base year is critical because it determines the year in which prices are held constant, and it is expected to be a normal year devoid of dramatic economic changes. Presently, 1990 is the base year for computing Nigeria's GDP. The rebasing exercise will see the base year change from 1990 to 2010, in the process taking into account new sectors of the economy that have sprung up over the last twenty four years, and also structural changes that have occurred in the economy during the period.

The GDP rebasing process when completed is expected to give a more realistic and true estimate of the value and size of economic activities in Nigeria. Expectations are high that there will be an increase in the size of Nigeria's economy as measured by Gross Domestic Product (GDP) after the rebasing exercise. This will put to rest the widely held perception that Nigeria's GDP is presently underestimated due to its humongous informal sector that has not been captured in current official statistics. The rebased GDP will provide reliable information needed for evidence-based planning, policy formulation, and informed debate about the Nigerian economy. It will also enable researchers and policymakers to investigate the causal mechanisms at work within the economy. The GDP rebasing exercise has expectedly generated interests especially on its desirability and the implications of a bigger Nigerian economy.

Gross Domestic Product (GDP) is the most frequently quoted indicator of economic performance of a country. It is the most important measure of economic activities in the country and is often used as a barometer of the general health of the economy. Gross Domestic Product is the total market value of all the goods and services produced within the borders of a country during a specified period. GDP is derived from a country's System of National Accounts (SNA) – an internationally agreed standard set of recommendations on how to compile measures of economic activity in accordance with strict accounting conventions based on economic principles. The accounting framework of the SNA allows economic data to be compiled and presented in a format that is designed for purposes of economic analysis, decision-taking and policymaking. The accounts provide a comprehensive and detailed record of the complex economic activities taking place within an economy and of the interaction between the different economic agents, and groups of agents that takes place in the economy.

Why Rebase GDP?

Why rebase Nigeria's Gross Domestic Product (GDP) appears to be the collective enquiry in the public discourse since the National Bureau of Statistics (NBS) announced the commencement of the rebasing exercise. According to the United Nations Statistics Division (UNSD), rebasing a country's GDP is imperative because of continually changing economic environment. These changes manifests as structural variations in production patterns over time, continuous developments and innovations, and obsoleteness of many products. There are also structural changes in consumption patterns and acquisition of capital goods, and changes in the openness of the economy to the rest of the world. These imply that relative price changes over time and price structure becomes less representative of the base year structure as time progresses. Over time, this culminates in misstating of GDP which becomes less accurate, and unreliable for economic analyses and evidence-based policy making.

Consequently, the UNSD expects countries to rebase their System of National Accounts (SNA) either periodically (preferably every five years) or annually. Higher income countries usually revise their base year every five years while majority of low-income to middle-income countries do so more sporadically, because they lack the requisite technical resources to overhaul their SNA at regular intervals. In rebasing GDP, data from national household surveys are incorporated to expound neglected or under-reported sectors that contribute to economic activity and in the process there is usually an upward revision of GDP estimate. For instance, in 2009, South Africa rebased its GDP, changing the base year from 2000 to 2005. The exercise led to an increase of 2.1 percent in South Africa's GDP. In 2010, Ghana rebased its GDP, moving the base year from 1993 to 2006 and there was an increase of 60.3 percent in its GDP. Malaysia rebased its GDP from 2000 to 2005 and reported a 3.2 percent uptick in nominal GDP estimate. In Turkey, the GDP rebasing exercise led to 30 percent increase in 2008.

There is no doubt that the Nigerian economy has metamorphosed and undergone structural changes in the last twenty-four years and for some reasons, the country's GDP has not been rebased to reflect the new realities. As policymakers and the world await Nigeria's new GDP estimate, there are expectations of a substantial increase of the country's Gross Domestic Product after the rebasing exercise. Conservatively, the exercise is expected to boost Nigeria's GDP by at least 40 percent. The most optimistic scenario suggests that the country's GDP could be up by 65 percent to 70 percent in nominal terms after the rebasing. This will see Nigeria's GDP jump to over $400billion, surpassing South Africa's $370billion and effectively placing Nigeria as the largest economy in Africa. Also, Nigeria's GDP per capita could increase to over $2,600 from around $1,700, which will culminate in reclassifying Nigeria as an upper-middle income economy.

The anticipated upsurge in Nigeria's GDP is likely to be driven by almost all the sectors of the economy as they are all expected to expand in absolute numbers. It is also likely that there will be structural shifts in the economy as some hitherto major sectors could lose their dominance in contributions to GDP while others will become the prominent contributors to GDP. For instance, the impact of the dramatic growth in the telecommunication sector is expected to have significant impact on the rebased GDP. Investment in the sector since its liberalisation is well over $25billion. The sector has also generated employment opportunities with over 8,000 Nigerians in direct employment, and over three million indirect employments. The banking sector is also expected to contribute to the upsurge in GDP following the sector's consolidation exercise of 2004-2006. The contribution of the country's bourgeoning entertainment industry (Nollywood) may have been downplayed over the years and this is expected to be corrected in the rebasing exercise. Also, the impact of Information Communications Technology (ICT) on the Nigerian economy may have been systematically undercounted in current official statistics.

Benefits and Implications of GDP Rebasing

There is limited evidence of immediate real impact of GDP rebasing on the economy at least from the experiences of other countries. The new measurement is not expected to change any of the realities of the Nigerian economy. It will not increase the size of the domestic market and it will not correct any structural deficiencies or eliminate any obstacles to the country's development. However, the exercise will give a reflection of the accurate value added of the production of goods and services in all sectors of the economy. The new System of National Accounts (SNA) from where the Gross Domestic Product will be computed is expected to highlight the country's under-realised economic potential. This is likely to trigger an upsurge in foreign direct investments because investors would be attracted to take advantage of the size of the Nigerian economy. Nigeria will also become unavoidably visible on the radar for anyone looking at investment opportunities in Africa by virtue of the size of the economy.

The exercise is also expected to lead to significant shifts in the perception of Nigeria's economic potential. Improved GDP figure will also improve the country's overall rating in the comity of nations. Rebased GDP estimates would imply that some of the country's macro ratios would change. For instance, Nigeria's relatively low public debt to GDP ratio, which is currently in the high teens, is expected to shrink further after the rebasing, making Nigeria one of the least leveraged countries

in the world. There will also be improvement in the budget deficit to GDP ratio. Consequently, Nigeria's public debt, budget and current account ratios are likely to be among the best in Africa and in the emerging markets at the end of the GDP rebasing exercise. The country's sovereign credit ratings are likely to also improve.

The downside to the GDP rebasing exercise is that Nigeria is likely to become ineligible for aids and grants as the country will probably be reclassified as an upper-middle income economy. Nigeria is currently classified as a lower

middle-income economy and as such qualifies for some aids and grants from international development partners. During the last Spring meeting of the World Bank/International Monetary Fund (IMF) in Washington, Nigeria's status was reclassified from poor country by Gross National Income (GNI) per capita to lower-middle income country by GNI per capita, consequently giving Nigeria a 'blend' status. The blend status, which is for a period of six to seven years applies to countries with Gross National Income (GNI) per capita of about $1,170.

The decision to reclassify Nigeria was taken after a review of the country's economic indicators revealed that there was a reduction in poverty rate per capita in the country which dipped to 62.6 percent from 64.2 percent as well as improvement in revenue accretion. Lower-middle income countries are those whose per capita are $1,036 to $4,085 based on estimates of Gross National Income. Nigeria's GNI per capita is estimated to have reached about $1,200. Gross National Income (GNI) is the total domestic and foreign output claimed by residents of a country, consisting of Gross Domestic Product (GDP) plus factor incomes earned by foreign residents, minus income earned in the domestic economy by nonresidents. With a rebased GDP estimate that pushes Nigeria from lower-middle income by GNI per capita into the category of middle-income economies, Nigeria will forfeit its eligibility for, or access to, aids and grants from some international development partners. Currently, Nigeria is eligible to borrow from the International Bank for Reconstruction and Development (IBRD) with 25 years repayment plan, grace period of five years, and interest rate of about 1.3 percent to 1.5 percent.

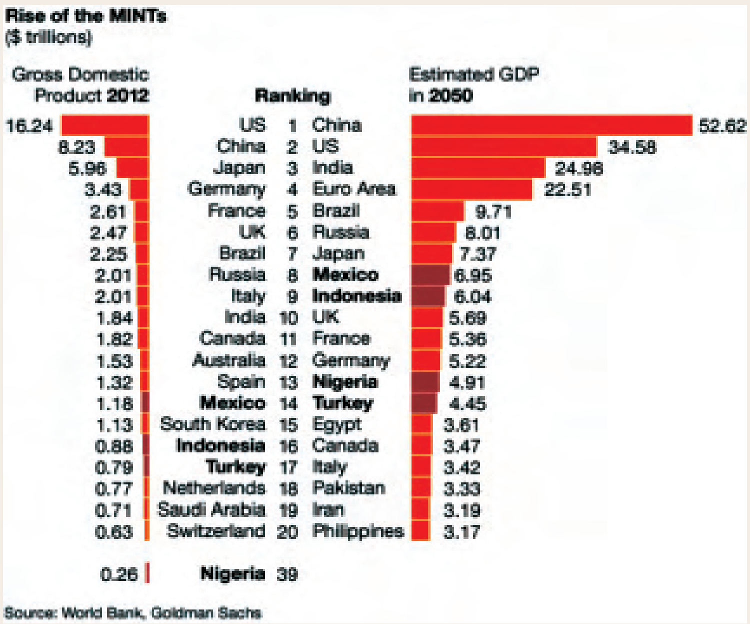
Geopolitical and Continental Economic Power Shift?

The GDP rebasing exercise – a mere statistical endeavour, is likely to fundamentally alter the geopolitical and continental economic balance in Africa as Nigeria is likely to knock South Africa off its decades-long perch as the continent's largest economy. Lagos is also being tipped to replace Johannesburg as Africa's economic hub. The coveted crown of being the leading economy on the African continent carries a lot of significance beyond the "bragging rights" of "being on top" because GDP is a powerful tool in global politics, economic relevance, and diplomacy. This is so because the most important global governance institutions, from the G8 to the G20, are all based essentially on GDP credentials. So far, South Africa is the only African country represented in the G20 simply based on the size of its economy. Should Nigeria displace South Africa as the continent's largest economy, South Africa's place as the continents sole representative in the G20, and its claim to be included in the BRICS (Brazil, Russia, India, China, South Africa) group of powerful emerging economies will be challenged.

As the world wait to see how the geopolitical configuration and governance structures of the continent will emerge post-rebasing of Nigeria's GDP, the fundamentals of the economies of Africa's two leading economies remain unchanged. Nigeria is heavily reliant on natural resource exploration – oil & gas, while South Africa is dependent on solid minerals mining. However, it is pertinent to note that the South African economy is more diversified and sophisticated than the Nigerian economy because South Africa has somewhat successfully leveraged its mineral resources to diversify its economy comparatively. South Africa also has world class infrastructure, superior services industries and is above Nigeria in the ease of doing business ranking. The country's financial markets rank among the world's most advanced. These positives notwithstanding, the South African market appears to be saturated and the economy has been growing at a slow rate – often described as underwhelming. Conversely, Nigeria is a massive market with an estimated population of over 170 million and a growing middle class. Most sectors of the Nigerian economy are just emerging, especially tertiary activities. Already, Nigeria is currently the preferred destination of Foreign Direct Investment (FDI) in Africa according to the United Nations Conference on Trade and Development (UNTAD). According to UNCTAD's World Investment Report 2013, FDI inflows to Nigeria stood at $7.0billion in 2012, while South Africa recorded $4.5billion FDI inflow in the same period.

Nigeria Rising

Whilst Nigeria's rebased GDP estimate is still being awaited, the country has already been tipped as one of the next global economic giants alongside Mexico, Indonesia, and Turkey according to a report by Jim O'Neill. O'Neill, former Chief Economist and Head of Asset Management at Goldman Sachs, is credited with coining the now famous acronym BRIC (Brazil, Russia, India & China) in his 2001 Goldman Sachs report "The World needs better Economic BRICs". In a new report "The MINT Countries: Next Economic Giants?", the renowned economist identified Mexico, Indonesia, Nigeria and Turkey, collectively called "MINT" as the second generation of emerging market pace-setters. The report states that if the "MINT" countries would be able to design appropriate policies, some of them would match the Chinese-style double-digit growth rates that occurred between 2003 and 2008. According to the report, the "MINT" countries share some common features. They all have big and growing populations with plentiful supplies of young workers. This is expected to help them grow fast when ageing and shrinking populations will lead inexorably to slower growth rates in many developed countries (and China) over the coming decades.



The "MINT" countries are expected to develop their own economic-political club just as the "BRIC" countries did. Nigeria could leverage this economic-political grouping to enlarge its trade frontier and economic cooperation. According to the report, with Nigeria's GDP estimated at $0.26 trillion as at 2012 and currently ranked 39, by 2050, if the right policies are put in place, the country could rank 13 with $4.91 trillion GDP. Nigeria's rebased GDP estimate will have profound impact on O'Neill's report because the fundamental premise of the projection will change.

Post GDP rebasing, Nigeria will leapfrog its 39th position to around the 22nd position in current GDP ranking and by 2050, the country could rank amongst the top 10 economies in the world, measured by GDP. Although the report identified some impediments to Nigeria's growth potential, especially poor power infrastructure, it however noted that the country has the potential to grow between 10 and 12 percent if the power outage suffered in the country is sorted out.

Structure of the Nigerian Economy

Nigeria is a resource-rich country, with about 34 different minerals, including gold, iron ore, coal and limestone. The country is also endowed with about 37.1 billion barrels of proven oil reserves, 187 trillion cubic feet of proven natural gas reserves, and produces about 2.3 million barrels of oil per day. Nigeria also has over 70 million hectares of cultivatable arable land – 60 percent of it is idle. The structure of the Nigerian economy is oriented towards two primary production activities: agriculture and mining (including crude oil & gas). According to the National Bureau of Statistics (NBS), primary production accounts for about 65 percent of the real gross output and over 80 percent of government revenues. Also, primary production activities account for over 90 percent of foreign exchange earnings and 75 percent of employment. In contrast, secondary activities comprising manufacturing and building and construction, which traditionally have greater potential for broadening the productive base of the economy and generating sustainable foreign exchange earnings and government revenues account for a mere 4.14 percent and 2.0 percent of gross output respectively. Services or tertiary activities which depend on wealth generated by the productive sectors for their operations comprise about 30 percent of gross output.

The current structure of the Nigerian economy skewed towards primary production and extraction does not support inclusive growth and employment generation. The sectors driving growth in the economy have weak sectoral linkages with other sectors of the economy and are not high job-creating sectors. For instance, the oil and gas industry is capital intensive (not labour intensive) and generates very little employment – estimated at 4 percent. The lacklustre performance of the manufacturing sector over the years for instance, reflects a constellation of several growth-inhibiting constraints principal amongst which is dilapidated infrastructure, and the effect of the infamous Dutch disease. Whereas the manufacturing sector is the main engine of growth and catch up for developed and developing economies respectively, it has remained comatose in Nigeria for too long. Manufacturing has the highest multiplier effects of all the sectors in an economy because of its forward and backward linkages with other sectors of the economy. It is the major source of productivity gains and foreign direct investment, a major investment inducer, a prime creator of jobs and employer of labour. It is also the driver of research and innovation.

http://www.independent.com.mt/mobile/2013-04-12/news/mediterranean-oil-and-gas-makes-progress-in-malta-1378516994/

Beyond the Euphoria, Diversification is Key

Beyond the euphoria and the "bragging rights" that "being on top" will confer on Nigeria after the GDP rebasing exercise, concerted effort is required to diversify the Nigerian economy from disarticulated and narrow primary production activities to secondary production activities especially manufacturing. Productivity, economic-inclusiveness and wealth-creation is much higher in the manufacturing sector than in agriculture and mineral mining which aptly explains the disjuncture between Nigeria's robust economic growth of the last decade – averaging about 7.5 percent and employment generation. Comparative with agriculture and mining, the manufacturing sector offers special opportunities for capital accumulation. Capital accumulation can be more easily realised in spatially concentrated manufacturing than in spatially dispersed agriculture which currently dominates the Nigerian economy. Also, manufacturing offers special opportunities for economies of scale, which are less available in agriculture. Linkage and spillover effects are stronger for manufacturing than for agriculture or mineral mining.

To really be the continent's leading economy, the Nigerian economy must also be transformed to become competitive as it is presently one of the least competitive in Africa. The near monolithic nature of exports exposes the economy to the vagaries of crude oil price fluctuations in the international commodities market. This was evident during the recent global economic crises when crude oil prices plummeted from over $140 per barrel to less than $40 per barrel, resulting in massive reduction in government revenue and depletion of external reserves. In diversifying and transforming the economy, government should restrict its role to that of an enabler, facilitator and regulator while the private sector becomes the executor, manager of businesses and real driver of economic activities. The challenge however has been that the private sector is weak and diffuse with poor response record to government incentives. Government must also make effort to obliterate all perverse incentives that enable rent-seeking in the economy.

http://agronigeria.com.ng/2013/05/21/nigeria-new-agric-initiative-targets-700000-commercial-farmers/

Cheeringly, the present administration has demonstrated the will and determination to transform and diversify the economy and steer it towards the path of sustainable development by initiating several reforms to fix dilapidated infrastructure, and simultaneously jump-start several sectors of the economy. For instance, government has successfully undertaken one of the most ambitious overhauls of the power sector following the privatisation of the country's power infrastructure. It is believed that in no distant time from now, there will be improvement in power supply and this will spur the growth of Small and Medium Enterprises (SMEs) that have had to grapple with the enormous cost of private power generation over the years. Also, the new National Automotive Industry Development Plan (NAIDP) which seeks to resuscitate the moribund automotive industry has kindled flickers of hope for the critical automotive industry as several automotive manufacturers are now willing to commence vehicle assembling in the country. The agricultural sector which has been largely informal and dominated by the use of simple technologies is also undergoing structural transformation to reposition the entire agric value chain as a viable business for wealth creation. Several other sectors of the economy are currently ongoing reforms. It is expected that the result of the GDP rebasing exercise will provide realistic and reliable estimate of the value and size of economic activities in the country, and could be leveraged to reposition and diversify the Nigerian economy.

(* Sunday Enebeli-Uzor is an Analyst, Zenith Economic Quarterly)

The Global Economy – Escape velocity for some?

General Monash, one of the unsung military commanders of the First World War, promoted the idea of "collective individualism" – the concept where diverse and sometime disparate groups of individuals are brought together around common interests.

In the case of Sir John, the common interest was defeating the enemy.

In the modern world, there is a pressing need for the differing global economies to move away from the current 'Individualist' approach, where a single or limited number of entities hoard economic intelligence, information and answers. What is required is a 'Collectivist' approach, where economic information and solutions are shared freely and willingly.

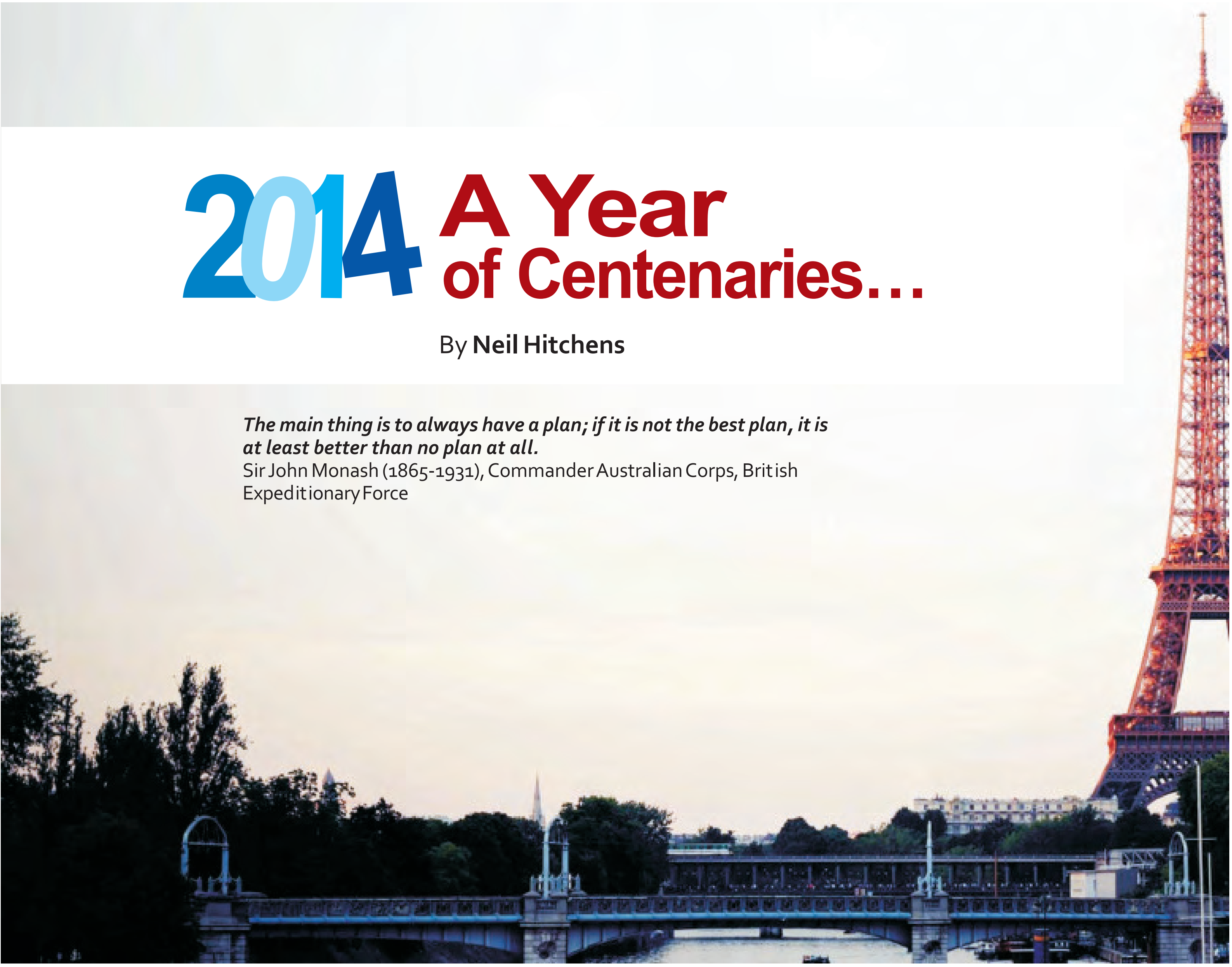
This inability of countries to share best practice does, in many respects, explain the diverging and growing differences in economic growth forecasts for 2014 and beyond. Where all countries were, economically at least, in similar starting positions in 2008, why are some now doing considerably better than others and what is being done by the winners to help the losers?

In short – not a lot.

2014 A Year of Centenaries…

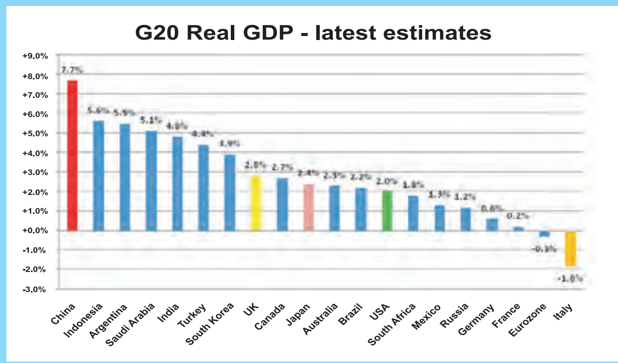
By **Neil Hitchens**

The main thing is to always have a plan; if it is not the best plan, it is at least better than no plan at all.
Sir John Monash (1865-1931), Commander Australian Corps, British Expeditionary Force



Even though solutions are available, they are either not being shared, or if they are, the advice is being ignored in favour of home grown solutions.

As a result, GDP forecasts for 2014 and 2015 now show worrying signs of extreme near-term divergence and countries that should have been at, or close to,the much hoped for economic escape velocity are stuck in continued low growth situations. Perversely, a few countries have learnt lessons from some of the faster growing economies and have adjusted economic policy to enable them to return quickly to their previous levels



Source: Bloomberg

Photo: http://www.gdefon.com/download/Paris_Eiffel-Tower_France_city_sky/348981/1920x1200

of growth.

While overall economic activity is expected to improve further during 2014-15 there have recently been some worrying downward revisions to growth forecasts in some of the economies, who only last quarter, were predicted to resume their strong upward trends.

Japan, previously predicted to have GDP of +3.8% in 2014, has had growth revised down to +2.4%. Germany has slipped from +0.9% to +0.6%. France has been cut back from +0.4% to +0.2%, which statistically speaking is close to returning to recession.

Certainly in the case of France there is much more to be concerned about, given the size of its economy within the Eurozone. While, from a British standpoint, there is some element of Schadenfreude about the woes of France, it is not as if this situation is some overnight phenomenon.

However, France is looking increasingly like the 'Sick Man of Europe' – very similar to how the Britain itself was viewed some 40 years ago.

When President Hollande was elected his sales pitch was to present France with a social contract rather than capitalism red in tooth and claw. His plans to reinvigorate the Eurozone's second largest economy were widely dissected and initially at least were given a tacit thumbs up.

During 2013, many commentators reviewed their initial enthusiasm as the figures began to show that the French economy was not working. While the threat of a Euro collapse has disappeared for the moment, the pressure for internal reforms continues.

France does, we will admit, have many strengths, but its weaknesses have been cruelly exposed by the Euro crisis. French competitiveness has been shown to be a sham in comparison to Germany. Germans have cut costs and improved efficiency; French industry has not.

The grip of the French state has moved counter-cyclically to be 57% of GDP, the highest proportion in the entire Eurozone. The French budget has not been balanced since 1981 - a third of a century. Public debt in that time has risen from 19% to over 90% of GDP today.

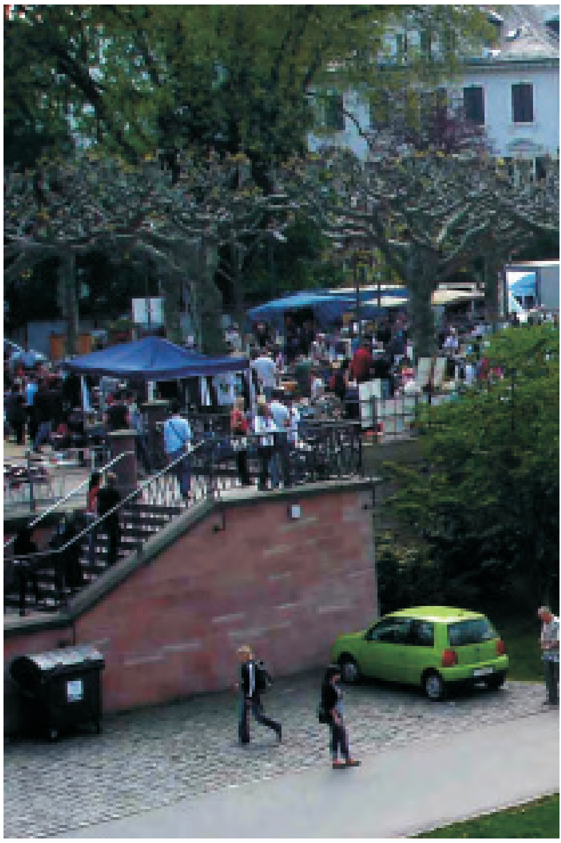
As we have commented on previously, the business climate in France worsens. Enterprise is stifled by a combination of overly rigid labour and market regulations combined with eye-wateringly high tax rates and heavy social charges on payrolls. No wonder there are fewer entrepreneurs per head in France than can be found in all similarly sized economies.

The economy is stagnant and unemployment is higher than it should be. The external current-account deficit has swung from a small surplus 15 years ago into one of the Eurozone's biggest deficits.

It is delusional to think anything other than France's companies are uncompetitive and the country's bloated government is livings beyond its means.

The solution, "mes amis", is simple. Hollande has offered French business a deal, whereby public spending is to be cut by € 50 billion / US$ 68 billion and the use of state resources reduced. Social costs to businesses would in turn be reduced by € 30 billion / US$ 41 billion. In return 'all' French businesses had to do was expand their workforces, offer better wages and provide better training.

However, why should French companies believe someone who has already pushed through a string of leftish measures including a 75% top income tax rate, has reversed the previous attempt to raise the pension age above 60 and has steadfastly re-



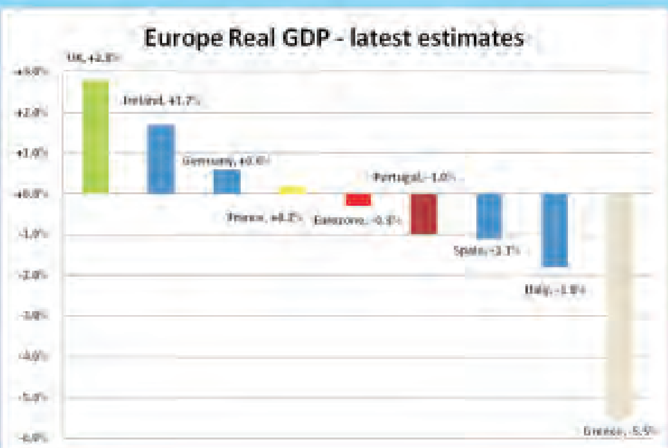
fused to make even simple structural changes?

It is highly possible that the next quarterly GDP number could be revised downwards to give a flat/zero reading and not beyond the realms of possibility that there could be a negative number.

No wonder at the end of December we learnt that inward investment in France fell by 77% in 2013. That is not a situation that augurs well for 2014.

Elsewhere in Europe, the picture could not be more different.

Away from the statist, almost command economy model of France, those countries that truly understand what was required are now reaping the benefits of taking fairly unpleasant steps early on in the financial crisis and are seeing sudden [and



Source: **Bloomberg**

http://www.terrafirmatourist.com/wp-content/uploads/2011/09/Outdoor-Dining-on-the-river.jpg

slightly unexpected] economic rebounds.

First up was the news at the end of 2013 that Ireland had managed to exit its period of ECB administration and that its short-term borrowings had been repaid and it was now able to re-enter the global bond issuing universe again with its reputation restored and its borrowing ability undiminished.

The Irish recovery was due to the fact that the economy was both a small and nimble one but also that some hard decisions were appropriately 'sold' to the general Irish public. True, austerity will not disappear overnight until morale improves, but going forward there will be disciplined budgets, which should hit the required 3% deficit or under of GDP, as well as a slow reduction in the overall debt-to-GDP ratio.

The Irish banks will continue to be a drag on the Irish economy for some time, despite the creation of the NAMA (National Asset Management Agency) which is where all the bad property debts go to corporately 'die'.

There is also a growing realisation in Ireland that the Germans are not necessarily their best friends, but the British could well be. Apart from the historic upcoming State visit to Britain by the Irish President in 2014, the realisation that the British stepped in to assist the Irish economy when they most needed it is becoming clearer. While there is not a hope in the near term of the Irish leaving the Euro and retuning to what was the 'Sterling Zone' where there was a common currency between the two countries until just over 30 years ago, the economic ties remain close.

UK and US – showing the way ahead...again.

Within Europe, the stellar economic performance is coming from an unexpected source – The UK.

Only last quarter GDP was forecast to be at best +1.5%. By the end of 2013 this figure had almost doubled to +2.8% and it is entirely feasible that we could see a +3.0% print at some stage in 2014.

While we will be the first to admit that overall the recovery is slightly fragile, you do have to start somewhere in any sustained growth reactivation. There are now real grounds for optimism that the UK economy is finally ready for recovery.

The services sector continues to lead but retail sales picked up over Q3 of 2013 and continued into Q4. We are now seeing growth coming from manufacturing and the construction sector too is recovering, albeit from a very low base starting point.

Growth should continue to strengthen as we move into 2014 but the economic risk remains that an external exogenous shock could possibly dampen the growth picture. Also the high levels of household debt will probably act as a drag to some extent on the overall prospects until well after the next General Election due in May 2015. But the effect of this debt level will be one which trims growth by no more than around 0.1% - 0.2%, not exactly something to upset too many economists, especially as once we move above the previous overall high water mark in the UK economy, the trickle down effects of growth will both enable debt to be repaid faster as well as ensure overall wage growth returns to trend.

The Bank of England, in many respects, probably cannot believe their luck that things are sorting themselves out quicker than expected. Governor Carney said when he took up his position that interest rates would need to be re-examined when unemployment fell back to 7% from the then 8%+ level 'probably in 2016 or 2017'.

Almost as if to spite him the jobless rate from that day on has fallen faster and more consistently than expected with the latest reading as at the end of November 2013 showing a rate of only 7.1% with the odds that the magic 7.0% level could well be reached in the reading for end December 2013 or January 2014.

As if to exacerbate the positive problems, markets have now sharply revised their forecasts for the first rate rise and, oddly, seem to agree with the position we took three months ago, that rates could well rise either at the end of2014 or certainly in the first half of 2015 – right when the General Election is to happen.

Before anyone start panicking, we know already that from the current 0.5% level interest rates are only likely to move in 0.25% steps for some time. The market will soon get used to interest rates returning towards their historic norms.

To put things into perspective the average Bank of England base rate for the past 100 years (December 1913 to December 2013) was 5.593% - this figure is skewed by the rates of the late 1970's and early 1980's – where interest rates varied went as high as 12% - 16%.

There are now real grounds for optimism that the UK economy is finally ready for recovery.

The Decade averages are as follows:

• 1920's - 4.854%	1930's - 2.476%	1940's - 2.000%
• 1950's - 3.938%	1960's - 5.915%	1970's - 9.530%
• 1980's - 11.805%	1990's - 7.831%	2000's - 4.639%
• **2009 to date 0.50%**		

http://www.plbusinessgroup.com/?p=191#prettyPhoto[gallery191]/0/

I would suspect that the interest rate will first move up to an initial 0.75% level by end 2014. After the May 2015 General Election (the current UK economic 'Great Unknown') there is likely to be an immediate move inJune 2015 to 1.00%. Subsequently, as I believe the UK economy is likely to continue on its growth path unless there are some particular inappropriate economic policies implemented by whoever wins in 2015 (which even now is a 'Known Unknown', rates will move possibly as follows;

Current	0.50%	End Q4 2014	0.75%	June 2015 - 1.00%
Q3 2015	1.25%	Q4 2015	1.50%	Q2 2016 - 1.75%
Q3 2016	2.00%	Q4 2016	2.25%	Q1 2017 - 2.25%

Rates will probably top out in mid-2018 at around 3.50% - 4.00%.

Bond markets will react to this and longer term maturities will see prices fall from current levels as the longer term interest rates increase.

The current Bloomberg GBP Investment Grade Bond Index yields an average 3.68% (Yield to Worst) and has an average maturity of 13.27 years. This is a situation that cannot and will not be sustainable.

The index average yield is very close to the UK 30 year Gilt – 3.665% as at December 31st 2013. For the average yield to move to 5.50 % within two years (a 50% rise in yield) would not be unexpected. Yields at the longer end would rise proportionately more – as such until we can see a little more clearly the near term trend of both the economy and the UK Base rate, it makes sense at the moment to remain defensive.

Yields in the 5 – 8 year area of around 5% – 6% in the Sterling Corporate universe do not look too unattractive.

Shock Horror in the US! Fed doing what they said they would do......

Markets have been perplexed and perturbed by the recent stance of the Fed.

Having chickened out of announcing the start of the long awaited taper programme a few months ago, as we had posited, at the December 18th meeting the first stage of the stimulus programme was officially kicked into touch.

The Federal Reserve announced, as expected, that it would be reducing its monthly US$ 85 billion bond buying programme by US$ 10 billion. The reduction would continue at each subsequent Fed meeting which would mean that by the end of 2014 the stimulus programme would be reduced to zero.

All well and good – and yet markets initial were confused and unhappy.As we have written previously this is merely the end of the beginning. I do not recall anywhere the Fed minutes saying that the tapering off of the stimulus would be immediately followed by a reversal of the bond buying programme where new Treasury Bonds would be issued in order to soak up the excess cash build-up in the financial system

I am certain that the new Fed Chair – Janet Yellen – has not even begun to work out in explicit detail when, where and how this final step of reversal will be structured. I would hazard a guess that this is a question for 2016 or beyond......

The idea behind QE is that you don't need a printing press to add money to an ailing economy.

In the past the Fed's usual method of fighting recessions was to lower the overnight interest rate – the rate banks charge each other for overnight loans, which in turn allows banks to offer cheaper loans to businesses.

But with an interest rate at almost zero since the financial crisis five years ago, more was clearly needed. The Fed began buying bonds in hopes of driving down long-term rates that are usually outside its control. Not a new idea, but it had never been tried on such a massive scale.

Since September 2012, the Fed has been buying $85 billion a month of Treasuries and mortgage-backed securities. Unlike earlier notions, the Fed's purchase plan was described as open-ended, with officials saying it would continue until the labour market "improved substantially."

The idea was that reducing the purchases gradually — that is, tapering them off — would make clear that the central bank would continue to offer support for the economy, just at lower levels. But its problem soon became how to convince markets that a taper was different from an exit.

Almost since the first such purchases, critics have been warned that this would spur inflation.

Wrong.....so far.

Prices fell in October 2013, putting the 12-month inflation rate at 1%, half of the 2% the Fed regards as healthy. Others suggested the increases in the stock and housing markets as unhealthy.

Others again inferred how effective QE has been. Some economists see only a modest effect, coming mostly through lower mortgage rates.

Yellen has said that the pain for savers from low interest rates was more than offset by the help the policy has given to the labour market and the economy as a whole. At the same time, she acknowledged that QE "cannot continue forever" – which is now happening.

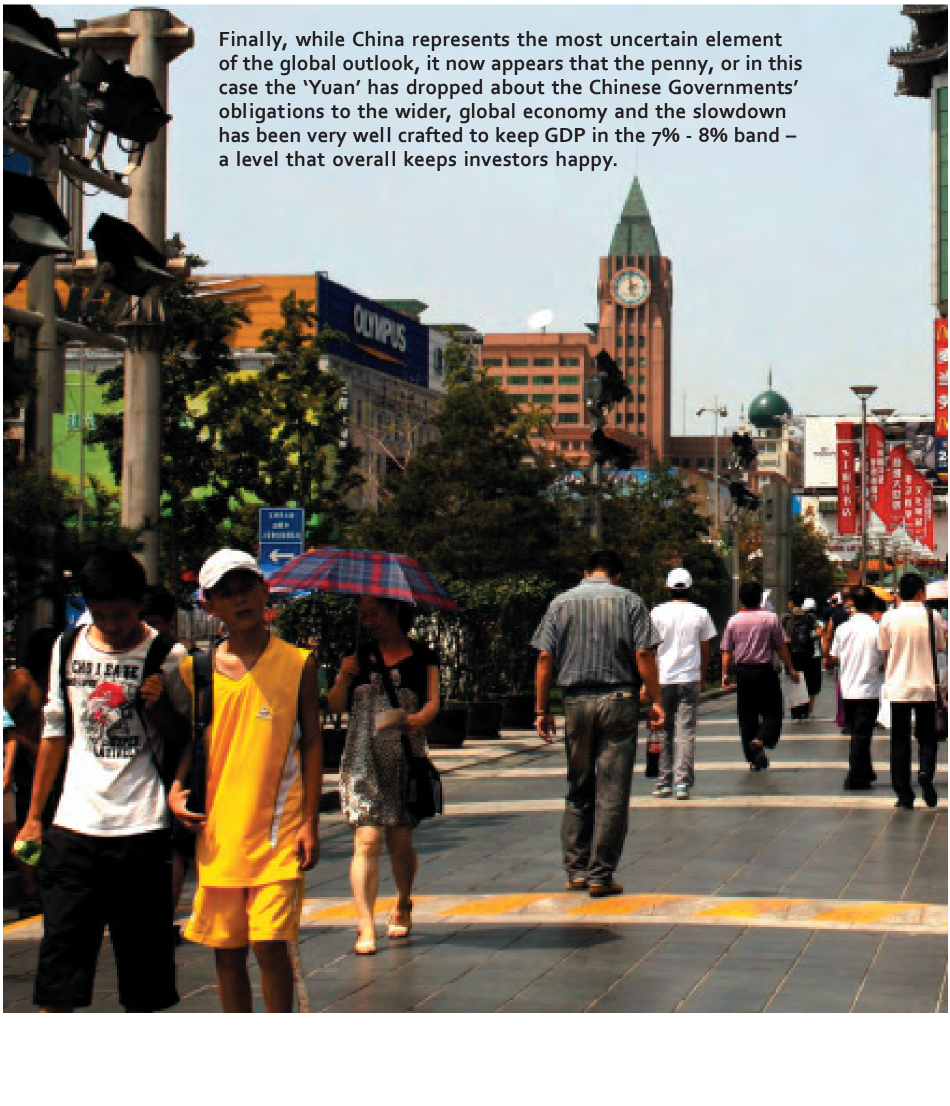
Having reached the end of the beginning, it will only be a matter of time before we start the beginning of the end for QE.

That though will be a problem for the next US President – whoever he, or she, may be.........

The US gains but Emerging Markets suffer delayed pain.

2013 was, as the parlance goes a "challenging" year for investors, in Emerging Markets (EM). EM participants faced problems from a variety of directions. At the beginning of the year the weakness in the major markets proved problematic. Midway through the year, as we noted at the time, the weak leadership by the Fed over the timing and nature of the end of Quantitative Easing unsettled in-

http://www.layoverguide.com/wp-content/uploads/2010/05/Wangfujing-street-in-Beijing-China.jpg



Finally, while China represents the most uncertain element of the global outlook, it now appears that the penny, or in this case the 'Yuan' has dropped about the Chinese Governments' obligations to the wider, global economy and the slowdown has been very well crafted to keep GDP in the 7% - 8% band – a level that overall keeps investors happy.

vestors. Finally – the spectre at this particular feast – China and its erratic economic releases.

In short this produced a scenario where A) Bond markets significantly underperformed equity. B) Developed equity markets outperformed Emerging and C) US equity markets outperformed all other major markets and D) US Small cap stocks outperformed the rest of the US Equity markets. Not quite a unique set of circumstances, but nonetheless quite a rare event. We will discuss our views on equity markets later.

2014 is most likely to be somewhat different – to be honest it couldn't get any worse – and in all certainly will be better than 2013.

However we temper this assertion by adding an additional word – 'eventually'. Certainly the fallout from the first step of the Feds QE taper in December was just working its way through the currency, bond and equity markets of the Emerging Market universe. As investors started to pull their money out of the higher yielding but significantly more volatile and dangerous Emerging Markets, the fault lines were already beginning to appear at the end of the year.

In 2014 the slowdown in growth in EM is unlikely to be repeated – as the recovery in the more developed markets becomes more entrenched and more widespread, even if marred by occasional data setbacks there is a corresponding trickle-down effect into all smaller markets.

Also, as the Fed has eliminated the uncertainty about the timing of the ending of QE, financial conditions are likely to become more stable. This degree of policy visibility, totally absent throughout most of 2013 had a major contribution to market volatility. The recovery may well be uneven, especially if the Fed decides, perversely, to increase the speed of the taper if economic data manages to surprise on the upside – always a distant possibility but something that has been overlooked by many market observers.

Finally, while China represents the most uncertain element of the global outlook, it now appears that the penny, or in this case the 'Yuan' has dropped about the Chinese Governments' obligations to the wider, global economy and the slowdown has been very well crafted to keep GDP in the 7% - 8% band – a level that overall keeps investors happy.

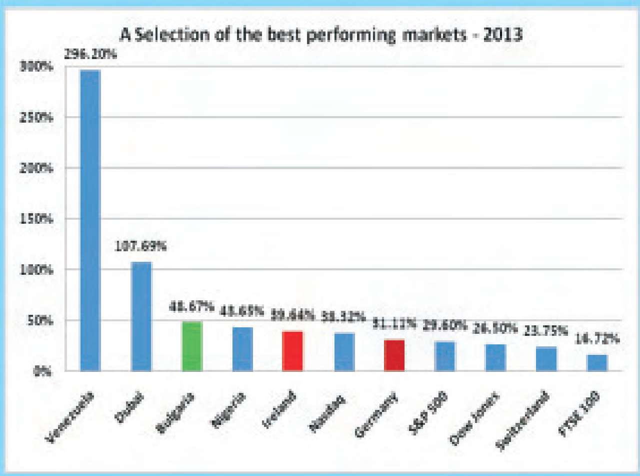
While many Emerging market participants expect the Fed tapering to be fairly smooth and overall benign, many risks remain.

Despite the recovering global economic outlook, economic divergence between Emerging and Developed countries will continue in 2014. Emerging growth will be positive but the pace of recovery will be slower than the average Developed markets number.

Inflation, though, in the EM sector is running 'hot' while disinflation and deflation reign in the Developed world. This divergent path will in 2014, be compounded by a busy political calendar in the 'Feeble Five' (Brazil, India, Indonesia, South Africa, Turkey), additionally exacerbated by a febrile political atmosphere in some.

We would, though, urge caution at best for market participation.

Careful country differentiation is



Source: Bloomberg

the order of the day. Political risks, paired with economic challenges that have not been addressed during the past 9-12 months, make both Turkey and Brazil underweight positions. On the other hand India seems to have disused its near-term problems; however this may well be a temporary state of affairs.

Korea, while probably one of the more hopeful situations does remains hampered by the increasingly bizarre behaviour of its Communist neighbour. Certainly the recent sinister internecine warfare among the ruling Kim family does unsettle – while outright war is probably unlikely (we hope) the possibility of a few initial skirmishes evolving into something grater cannot be ruled out especially if the North Korean economy is imploding as badly as some have stated.

Russia remain an enigma – despite still retaining many elements of it command economy, the recent weakening of the oil price may well cause problems in 2014 given the Putin governments dependency on oil revenues to bolster the country's finances. In the short term the Winter Olympics in Sochi is likely to be the unwelcome magnet for terrorism and while we hope for an uninterrupted Olympics, it is probably unlikely.

Equity Markets – 2013 performances unlikely to be repeatedin 2014.

While it may be difficult to repeat the excellent returns seen in 2013 for major indices, there is still hope for those who missed the rally.

Then again, as we had grown nervous about the strength of the underlying rally in the last weeks of the

http://www.skyscrapercity.com/showthread.php?t=265458 year, taking some money off the table at that point was not necessarily such as bad move – as we continue to emphasise, while you should never take all bets off, it does make sense from time to time to bank profits and wait for a market pull-back. Such a pullback in the first quarter of 2014 is almost inevitable as investors digest the next three Fed meetings in January, February and March and their combined, potential to withdraw US$ 30 billion in tapering from overall market liquidity.

The major indices did put on some solid gains during the year and, as in 2012, the best performing index was Venezuela. However as we noted then, its inclusion in any measure of comparable indices is rather like adding the Cuban or North Korean stock markets – a bit like "Bigfoot", while they may exist they are only for the true believer.

Overall though the business cycle is now around the mid-point of its 10-15 year cycle and confidence grows while uncertainty wanes. Inflation has yet to make its usual appearance which has given specialist areas such as inflation linked bonds a terrible recent existence. The macro background is one which should guarantee a solid base and decent near-term upturn, though, as we continue to stress, 2014 is unlikely to match 2013 for overall index returns. What is lacking is a solid recovery in total earnings growth – sectors such as mines and metals had a terrible 2013 and are unlikely to sparkle in 2014. Equities, while they no longer carry the cheaper ratings we saw 2 or 3 years ago are now more fairly valued although they do remain extremely cheap compared to the somewhat overstuffed bond markets. Bonds, as we have mentioned already, should be viewed with extreme caution especially for maturities of ten years or more, during 2014, until we get a better idea of the near term direction of US and UK interest rates.

Indeed, one thing that emerges from the year end research that has crossed our desks in London is the almost universal bullish consensus. For a true contrarian such as me this sets off various alarms. – Hence our initial caution about the first quarter of 2014. Certainly the near-term uncertainties in Emerging markets will drip feed into Developed until the 2nd quarter.

However, in many asset allocation models the US continues to remain underweight. Here I think the modellers are wrong. Certainly there can be no global equity bull market without the participation of the US investor and so long as the US is perceived as the dominant and healthiest economy in 2014 then the money is unlikely to move far from the Dow Jones or S&P 500 indices.

While the UK is likely to be the best performing European market and will be running neck and neck with the US during 2014, the stronger Sterling currently being seen as investors anticipate early interest rate rises is impacting earnings.

Additionally the quirk of the FTSE 100 in having an extremely dominant mining sector continues to drag down its overall performance. A good measure of this is to compare the performance of the FTSE 100 against the FSTE 250 – the measure of the next 250 largest UK quoted companies by capitalisation.

FTSE 100 in 2013 +16.72%
FTSE 250 in 2013 +31.34%

Russia remain an enigma – despite still retaining many elements of it command economy recent past the recent weakening of the oil price may well cause problems in 2014 given the Putin governments dependency on oil revenues to bolster the country's finances.

Indeed – if you split down the components of these two indices combined as shown, the ensuing index the FTSE 350 (FTSE 100+FTSE250) has a 2013 return of +18.71%, which is significant.

If you further breakdown the differences in the top and bottom 5 individual stocks the difference is startling and shows the divergences that individual and sectorial performances can be found even in what at first glance looks like a good, solid overall index behaviour.

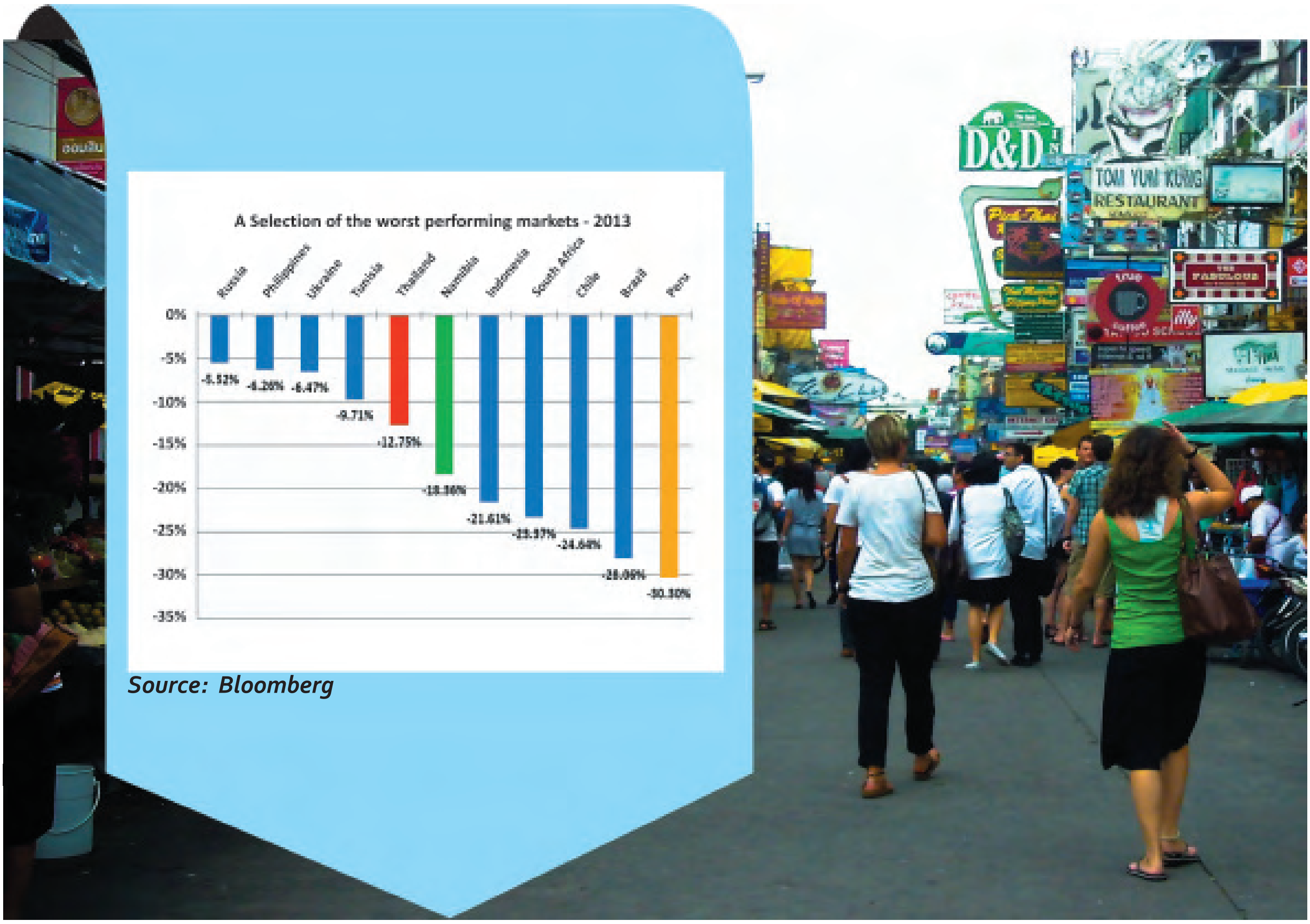
FTSE 350	**Top 5 stocks for 2013**	**Bottom 5 stocks for 2013**
	Ocado Group +409.64%	Kazakhmys plc -71.90%
	Thomas Cook +301.82%	Fresnillo -59.01%
	Xaar plc +300.72%	African Barrick -57.83%
	Supergroup plc +152.23%	Evraz -56.78%
	Bank of Georgia +132.52%	Imagination Tech -55.01%

Unless you are absolutely certain of your individual stock picking abilities, it is always more sensible to invest when the near term looks uncertain in as widely diverse an index as possible.

So for the UK we would be looking at a near or slightly above index weighting and for the US index weighting should be the absolute minimum.

However within the European and Asian markets the choices for 2014 are more difficult.

Certainly Japan has had a good year but only one that overall in US Dollar terms was comparable to the US indices. Again, as we have mentioned before, actuarial forces are at work in Japan. With a continuous zero interest rate policy and the beginnings of government stimulus, the Japanese stock market still lingers well below the highs of some 25 years ago. The Nikkei did close 2013 at 16,291.31 but that was only just below the closing levels in 2007 – in other words for the past six years the index has moved by zero. Indeed the index was previously at this level in Q3 2000 – so net/net there has been no net move for 13 years.....indeed look back at the chart and the Nikkei is still



Source: Bloomberg

http://marianlyman.files.wordpress.com/2010/10/bangkok-street.jpg some 58% below its peak in 1989. Still, I would like to posit, some way to go. Even if the Nikkei has a barn-storming year the counter effect of a weakening Yen is likely to impact un-hedged returns and the Nikkei could well end 2014 flat in US Dollar Terms. A weighting below index standard could be mooted.

In Europe the picture is one of a continuing two speed Eurozone. The countries in the North will outperform those in the South with France as a 'Don't Know'.While the threat of a Euro break up has evaporated for now, the underlying tensions are likely to resurface, probably toward the end of 2014 as countries such as Italy finally realise that they are living on borrowed time and the bailout tensions will resurface.

With a Eurozone GDP in 2014 unlikely to be much more than 0.5% overall it will be touch and go for France especially to see if the economic miracle might arrive in 2014. I suspect it will be a fruitless wait.

2014 for Emerging markets is likely to be tough. Certainly the near term prospect for Turkey, South Africa and many South American economies are cloudy at best. While we retain our common sense over any emerging market equity exposure, the risks in areas such as Argentina remain large. On the surface the figures indicate good solid GDP at around+5.5%. However inflation at nearly 11% combined with producer prices rising at +15% should ring some well-worn alarm bells. Industrial production is collapsing and the current account deficit is ballooning with exports -13.5% from a year ago. Having tried unsuccessfully to peg the Peso at parity to the Dollar, once the break came a decade ago there has been only one way traffic with the exchange rate since. During 2013 there was a near 50% devaluation(4.92 Pesos to the US$ to 6.52). Exchange controls don't work as the general population continue to find ways round any restrictions via online solutions. The stock market is rising in local terms but purely because there is very little else to put your money.

As a further endorsement of the market thoughts on Argentina the US$ Denominated International Bonds are, where rated (and few are), at a deathly DDD – default imminent rating. With yields in excess of 25% and little prospect of any repayment, any exposure to this country is unwise at best.

So what are the prospects for 2014? Time for a few possibilities........

Bonds are unlikely to produce significant overall returns in 2014.

The S&P 500 will end the year at around 2,000 a 10% move from the end-2013 price of 1,848.36. The Dow Jones will end the year around 18,200 – again a 10% rise for the year.

Gold will rise from $1,205 to end 2014 at $1,600

Crude oil will fall over the year as Iran comes in from the cold. Brent will fall from $110.53 to $85; West Texas Intermediate will fall from $98.42 to end 2014 at $75.

France may return to recession. The Republic may be in crisis and President Hollande may resign.

UK interest rates will rise sooner than the market predicts.

The Dollar will strengthen against the Japanese Yen moving from end 2013 rate of 105 to 115.and against the Euro the Dollar could move from 1.3789 to 1.25. Sterling will strengthen against the Euro from 0.8323 to 0.7250.

Certainly somewhere in there some of this could well be true – however whatever your stance whether it be cynic or follower, the best of luck for 2014!

(* Neil Hitchens is a Senior Relationship Manager, Zenith UK)

National Budgeting & Inclusive Development: A Review of 2014 Budget

By **IK Muo**

Unlike other budgets, public sector budgeting goes beyond planning, control, recording and managing of revenue/expenditure. The aim of public budgeting is broadened to involve the allocation of resources among competing public demands and wants in order to attain social goals and objectives. Budget allocations give an indication of the desires of the people as the allocation of resources amongst agencies, projects and activities are supposed to indicate national preferences. It is an instrument for fulfilling the social contract between the Government and the people and the former's constitutional obligation to the citizens; it is also designed to make the Government accountable and responsible and even to limit the powers and activities of the executive arm of the Government. It is an opportunity for the Government to make statements about its overriding philosophy and direction for the period in question. In effect, public sector budgeting has economic [expenditure/ revenue], political, and constitutional undertones and implications (Muo, 2004).

Onyekpere (2014) reminds us that determining the national priorities in the budget is, for the most part, not a matter of law because with the exception of statutory expenses, these priorities reflect political preferences. They reflect the values and worldviews of the framers of the budget, raising questions on the extent of participation of citizens in determining the priorities. The preferences indicated by the budget also raise questions on the accountability of the leadership to the led in terms of using the budget to fulfill the promises made in fundamental national development policies such as the Fundamental Objectives and Directive Principles of State Policy; Vision 20:2020 and its implementation plans; the Millennium Development Goals and ratified international standards such as the International Covenant on Economic, Social and Cultural Rights (Onyekpere,2014)

The broad objective of this paper is to review the 2014 Federal Government of Nigeria budget which is aimed at inclusive growth, job creation, reduction of the cost of governance as well as the consolidation of the administration's transformation agenda.

Global and Domestic Background to the 2014 Budget

Nigeria is a part of the global community and global developments and prospects are germane to budget projections and performance. The World Bank forecasts a global growth of 3.2% for 2014 (higher than the 3% in 2013); 4.7% for Africa and 7% for Nigeria. Though *The Economist* (2014) quotes some experts as projecting that African growth would drop because of lack of factories, the above scenario is an indication that much of the global growth for 2014 would be hinged on developing countries. Chinese growth last year was the least in the recent past and the trend is likely to be maintained this year and thus, the impact of Chinese demand on the price of commodities may not be dramatic. Europe is still generally in crises where for instance, Greece economy has shrunk by 23% and Germany has grown by only 0.7% in the last six years (Stiglitz, 2014) and the US has experienced better growth and more green shoots of recovery will be evident in 2014. But the new Chairman of the Fed, Janet Yellen (sworn in on February 3, 2014 as the first female Chair in the FED's 100 year history), will continue with the tapering already commenced by Ben Bernanke (QE already reduced from $85bn to $65bn monthly). This will thus impact on global liquidity, bonds may not attract favourable rates as investors are more careful and there may be possible reverse forex flows. This may adversely affect the exchange rate and the robust developments in the local capital market.

Domestically, there are challenges to monetary and fiscal policy management as well as disturbing political dynamics with budgetary implications. The 93rd Monetary Policy Committee (MPC) meeting expressed concerns about four recent developments with short-medium term impact. These are:

1. Depletion of fiscal buffers following the continuing decline in oil revenue, rundown of reserves and depletion of excess crude oil savings;
2. Falling portfolio and FDI inflows;
3. Widening gap between the official and the BDC exchange rates; and
4. Creeping increase in core inflation.(CBN, 2014)

Consequently, it raised the CRR on public sector deposits to 75% (hitherto, 50%) which led to the sterilization of about N700bn deposits from the banking sector. Thus, the tight monetary policy regime continues, with Nigeria having one of the highest MPR in the world. A report by Meristream indicates that among the Next 11, BRICS, EUROZONE, North America, and others, Nigeria has the highest MPR. Compared on the basis of interbank rate, Nigeria also has the highest in the world at 13.83% while that of China is 4.4%, Egypt, 8.8%, Europe, .54%, South Africa, 5.46%, UK,1.01%, US,.84%. (see BusinessDay, January 22, 2013).This scenario of tight liquidity and higher interest rates does not, apriori, have the potential to grow the economy.

Those concerns would also adversely affect confidence in the economy especially as the CBN governor's tenure ends this year. Of course, the concerns raised by the MPC are evident. Federally collectible revenue fell by N117.9 bn (10.7%) from N597.75 bn in Novem-

ber 2013 to N479.95Bn in December and this was mostly due to serious disruption in crude oil production and lifting operations, sustained vandalism of pipelines and force majeure in Bonny Terminal. Allocation to the three tiers of Government also fell from N675.65bn to N581.49bn within the same period. On February 5 2014, the Naira traded at 162.8/$ at the interbank market, its lowest in five months, representing 1.5% depreciation in 2014 and this was mostly due to repatriation of profits. The CBN also reports that FDI has fallen by 41.4% from $1.46bn in Q2 2013 to $.86bn in Q3 2013. Portfolio investments have also fallen from $6.52bn to $3.1bn(52.3% decline) in the same period while external reserves fell by $1.8bn in the past eight weeks from $44.5bn on December 3, 2013 to $42.695bn on February 3, 2014. The Excess Crude Account (ECA) has dwindled from $11.5bn in December 2012 to $2.5bn on January 17, 2014. The ECA at $2.5Bn is less than1% GDP while fiscal savings/GDP ratio among other major oil countries average 65%.

The budgetary political dynamics is also not very good as a new tempo of opposition politics has now become an issue in addition to the usual legislative-executive face-off. The National Assembly appears to be combative towards the executive over budget matters and at times, even receiving the budget from the executive becomes contentious. These 'quarrels' always revolve around the oil price benchmark (the NASS always itching for a higher benchmark), the performance of the budget (with the NASS always insisting that it is lower than what the executive reported though the criteria are uncertain), padding of the budget (in which the NASS increases the budgeted figures, mostly starting with its own allocations), the so-called constituency projects and at times over comments made by the members of the executive which the NASS considers offensive. The 2014 budget was presented on December 9, 2013 (2013:10/10/12) because the NASS was unwilling to receive the budget (citing disagreements over performance, MTEF and oil price benchmark) while the details were given on January 20, 2014. The Senate was able to go through a second reading on February 4, 2014 while the lower house had not started the debate on it as at February 10, 2014. Both the 2013 budgetary process and that of 2014 have indeed been turned into a circus show (Muo, 2014). Things however got more complicated when the opposition All Progressives Congress (a product of political mergers), 'acquired' some legislators from the ruling Peoples' Democratic Party and hence claims to wield a majority in the National Assembly. It then directed its members to block all executive bills, with the budget given a special mention!

Details of the 2014 Budget

Before going through the highlights, it is pertinent to compare basic indicators of the budget with the previous 5 budgets and this is done in Table 1. This indicates that the earliest budget to be presented in the last six years was the 2013 budget (October,10 2012) and the most delayed passage was that of budget 2011 (May 25, 2012).

The highlights of the 2014 budget

Table 1:FGN Budgetary Basics, 2009-2014

SN	Variable	2009	2010	2011	2012	2013	2014
1	Date Presented	2/12/08	24/12/09	15/12/10	13/12/11	10/10/12	19/12/13
2	Total (N, Trn.)	3.049	4.608	4.471	4.749	4.987	4.910
3	Capital [N,Trn	796bn	1.37trn	1.56trn	1.32	1.621trn	1.1 [23%]
4	Recurrent[N, Trn	1.649	2.077	2.46	2.47	2.386	2.43 [73%]
5	Oil Price benchmark (USD)	45	67	75	70	79	77.5
6	Oil Qty benchmark [mbpd]	2.292	2.35	2.3	2.48	2.53	2.388
7	Exchange rate benchmark	110	150	150	155	160	160
8	Date passed	17/12/08	24/12/09	25/5/11	20/12/11	10/12/12	Pending

Source: several

Table 2:Highlights of 2014 Budget

SN	Variable	Measure	Remarks
1	Benchmark oil Price	$77.5pb	$79 in 2013
2	Budgeted oil Production	2.338mbpd	
3	Average exchange rate	N160	Same as 2013
4	Real Growth rate	6.75%	
5	Gross federally collectible Revenue	N 10.88rn	
6	Total Deductions[oil production cost, subsidy, gas development.	N2.15	Same as 2013
7	Subsidy payments	N971.1bn	Same as 2013
8	Gross federally collectible non-oil revenue	N3.29trn	
9	FGN budget revenue	N3.73trn	
10	Aggregate expenditure (net Sure-P)	N4.642trn	
11	Aggregate expenditure (+Sure P)	N4.910trn	
12	Statutory Transfers	N399.7	
13	INEC Expenditure	N45bn	N32bn in 2013
14	National Assembly	N150bn	Same as 2013
15	Debt Service	N712bn	N591.8 in 2013
16	Recurrent(non-debt)	N2.43trn(72.71%)	N2.8trn in 2013
17	Personnel cost	N1.723trn	N1.718trn in 2013
18	Capital expenditure	N1.1trn	From 31.9% to 27.27% due to higher pension & wage bill
19	Sure-P	N268.37bn	
20	Fiscal deficit	N911.96bn	1.9% of GDP
21	Net borrowing	N571bn	N577bn in 2013

Source: Budget Office of The Federation, Federal Ministry of Finance proposal are in table 2. The overall objectives of the budget are inclusive growth, job creation and consolidation of the transformation agenda. The budget also hopes to achieve fiscal stability especially bearing in mind that this is an election period. Capital expenditure is proposed at N1.1trn (27.3%), while recurrent is 72.7%; personnel cost is N1.72trn (allegedly due to higher wage and pension bill), debt payment of N712bn, fiscal deficit of N911.9 (1.9%), and N150bn to the National Assembly. The total figure of N4.6trn is 9% less than that of last year, which was N4.9trn.

Broad Fiscal & Macroeconomic Projections

The key fiscal projections are the estimate for oil production- 2.338mbpd; shrinking of the budget by between 4-7% (depending on the figures taken); fiscal deficit of 1.9% and marginally shrinking the public debt to N571bn (N577bn in 2013). All these factors are interrelated because the oil production determines the overall revenue flow for the year and also the extent to which the government borrows and or maintains the proposed deficit position. The key issue is whether we can achieve the 2.338mbpd as proposed. There were challenges in the oil sector which affected the production, lifting and accruable revenue throughout 2013. At its July 2013 meeting, the MPC complained that the growth rate of the oil sector during the second quarter of 2013 was -0.68% and was worried about the continued decline in the contribution of the oil sector to overall GDP and that the underlying factors responsible for this state of affairs were sustained oil theft which has led to a decline in output volumes in the face of an uncertain international oil market and price signals, weak infrastructure, and downside risks due to the discovery of shale oil and the emergence of other African oil exporters competing for Nigeria's traditional oil market.

Indeed, average daily crude production for Q2 2013 was 2.011mbpd as against 2.29mbpd Q1 and 2.38mpbd in Q2 2012. The situation was worse in the last quarter of 2013 when the average daily crude production was 1.6mbpd though it was 1.9mbpd in December but it was generally a downward trend between May and November. In effect, oil production averaged less than 2mbpd throughout 2013, as against 2.47mbpd budgeted. This trend was attributable to pipeline vandalisation and oil theft. This has actually been described as economic insurgency especially when the barges, storages and tank farms used for these operations are 'out there'. It also puts to question, the role of the Joint Task Force, NIMASA and the ex-militant multi-billionaire security consultants in managing the situation and securing our 5000km pipelines. It is thus doubtful if we can attain the oil pro-

Table 3:2013 Crude Oil Production

	Period	Average Production
1	Q4'12	2.38mbpd
2	Q1'13	2.29mbpd
3	Q2'13	2.011mbpd
4	Q3'13	2.26mbpd
5	December	1.9mbpd
6	Q4'13	1.6mbpd
7	2013	2mbpd

Source: NNPC

duction target when not much appears to have been done about the apparently syndicated and audacious international illegal oil bunkering which is now estimated to be up to 20% of our outputs. This view is supported by Standard & Poor's which, on January15, 2014, declared that Nigeria would not likely meet its 2014 oil target because of anticipated tensions in the Delta in the run-up to 2015 when criminality and money politics merges with commercial interests in the scramble for Nigeria's high quality crude.

If the above scenario is added to weak governance policies and practices in the NNPC, then it appears that we may have been overambitious with our oil production estimates. In fact, the 2013 Resource Governance Index of the Revenue Watch Institute which measures the quality of governance in the oil, gas and mining sector of 58 countries across the globe has placed Nigeria 40th in the overall global ranking. That is not an enviable position. So if quantity is dwindling because we cannot check oil theft undertaken with visible barges, tank farms and ships, and if we cannot properly account for what we have earned (as indicated by the worrisome and ongoing altercation between the NNPC and the CBN and on which the CBN governor has submitted a 50 page document), then we are in for a year of fiscal shock. And that is probably why the accretion to reserves is reducing while prices are much higher than benchmarked, evidencing systematic leakages in the system

If we fail to get it right with our oil, then, our other computations are likely to be in disarray. For 2013, tiers of government received allocations based on what was budgeted, rather than actual receipts. And because oil production was below budgeted levels for most part of the year, there was the need to always seek for ways to augment. That was why the ECA collapsed from $10bn in Dec 2012 to $3.598 on November14, 2013 and to $2.5bn on January 17, 2014. The external reserve is also on a downward slope. The fiscal buffer is thus weak. Furthermore, evidence has shown a tendency for fiscal expansionism in election years and we are already in the throes of election as it rose very significantly via a supplementary budget in 2010, in the run-up to the 2011 elections. This will thus affect the projected deficit, borrowing limit and even the plan to shrink the budget size. It is also noteworthy that the provision for debt service is N712bn (65% of capital expenditure) and that

was after we had written off all debts in the first Okonjo-Iwealla era. The amount spent on debt servicing has maintained an upwards trend in the recent past, accounting forN495bn in 2011, N559bn in 2012, and N591bn in 2013 and then N712bn in 2014.

The Capital/Recurrent Mix

One of the most worrisome aspects of the 2014 budget proposal is the meager share of capital expenditure at 27.29%, down from 31.9% in 2013 and an upswing of recurrent expenditure to 72.7 and which is attributed to high pension and wage bills. The mar-

Table 4: Key Allocations to MDAs

SN	MDA	Total Allocation (Nbn	Recurrent(Nbn
1	NASS	150bn	
2	Education	493.4	443.9
3	Defense	340.3	306
4	Police	292.3	285.5
5	Health	262.7	216.4
6	Interior	151	144
7	Works	128	20.1
8	Niger Delta	111.1	64bn
9	Security Adviser	110.7	44
10	Youth Development	80.0	75
11	Judiciary	68	-
12	SGF	63.2	46.2
13	Power	62.5	3.4
14	Petroleum	61.9	55.7
15	Agric	66.6	35.1

Source: Budget Office of the Federation, Federal Minister of Finance ginal gains made in the recent past is lost in one fell swoop as the Federal recurrent budget has moved from 74.4% in 2011 down to 71.4% in 2012 and 67.47% in 2013 but now back to 74% in 2014. This is far below the global benchmark of 70/30 capital-recurrent ratio and also below the National average. This is because the budget proposal of the 36 states for 2014 stand at N6.596trn out of which N3.856 (58%) is for recurrent while N2.734 (41.5%) is for capital expenditure. Akwa-Ibom state is committing 82% of its budget to capital expenditure in 2014 while for Kano, it is 75%. But a research by BGL Group (2014) reveals that the internally generated revenue of the states is barely10% of their budgeted figures and that most states are regular clients in the bond market with 14 of them indebted to the tune of N552bn and likely to borrow more for the shortfalls of 2014, given dismal IGR records.

The ministry of finance blames the high recurrent expenditure pattern on high wage bill and in particular, agreement with unions in 2009. It is surprising how agreements signed with unions in 2009 have just started impacting on our recurrent expenditure to the extent of doubling personnel costs from N875bn to N1.72trn. One thing is obvious; the cost of governance is still too high.

2014 Budget & Inclusive Development

Inclusive growth refers to a high level and broad pattern of economic growth which increases opportunities and income across board and affects all stakeholders, across all sectors leading to rapid poverty reduction. The pace and pattern of growth and development are thus essential for inclusiveness. For this to occur, financial inclusiveness is essential- ensuring that all people of working age have access to a diversity of quality, appropriate financial products at affordable prices, with convenience and dignity. This is essential for poverty reduction, attainment of MDGs and social inclusion. Nigeria has the highest financial exclusivity in Africa though CBN has placed inclusiveness in the front burner and there are some improvements in that regard.

The UNDP argues that many people are excluded from development because of their gender, ethnicity, age, sexual orientation, disability or poverty and that the impact is staggering. Exclusiveness has deepened and continues to deepen inequality across the world where the richest 10% of people own 85 percent of all assets, while the poorest 50% own a mere 1%. Development becomes inclusive and reduces poverty if and when all segments of society contribute in the creation of opportunities, sharing the benefits of development and participating in decision-making. It also integrates the standards and principles of human rights: participation, non-discrimination and accountability. Nations desirous of pursuing inclusive development should enthrone the following policies and priorities:

- Creation of productive and gainful employment
- Effective and efficient social safety nets to protect those who cannot work or who earn too little.
- Enhancing public services by building schools and hospitals, training teachers and doctors, and pro-

Table 5:Allocation for Seed, Seedling & Seed+ by the Ministry of Agriculture

	Code	Item	Amount
1	FMARD002003615	Seed	1.3bn
2	FMARD002003790	Seeds	234.4m
3	FMARD002003793	Seed Dressing	46.9m
4	FMARD002003881	Improved Seeds	448m
5	FMARD002004024	Improved seeds	66m
6	FMARD002004042	Improved seeds	175m
7	FMARD002004065	Improved Seeds	198m
8	FMARD002004083	Tomato seeds	52.5m
9	FMARD002004084	Okra seeds-fresh produce	50m
10	FMARD002004085	Vegetable(Ugwh)-fresh produce	44m
11	FMARD002004087	Onions	40m
12	FMARD002004090	Citrus seedlings	55m
13	FMARD002004105	Improved seedlings	525m
14	FMARD002004119	Seed and seedlings	288.7m
15	FMARD002004186	Improved seedlings	13.5m
16	FMARD002004215	Improved seeds and seedlings(planting materials	20m
17	FMARD002004569	Improved seeds & seedlings(establishment of demonstration plot	92.5m
18	FMARD002002714	Improved seedling(planting materials)	35.2m
19	FMARD002003613	Community seed garden	75m
20	FMARD002003656	Seedlings	217.8m

Source: Budget office of the Federation, Federal Ministry of Finance viding access to water, sanitation and transportation, all of which requires public spending.

• Well-designed fiscal policies - the way a government collects and spends public resources - which plays a major role in stimulating growth and reducing poverty.

Sachs (2004) is of the view that the best way to understand inclusive development is to contrast it with perverse growth [mis development] which is characterized by:

• Excluding a large chunk of the people from the consumer market

• Concentration of income and wealth in few hands

• A strongly segmented labour market in which a large segment of the labour force are confined to eke livelihood from informal activities without any social protection

• Total exclusion or feeble participation of a large segment of the population from the political process, people who are uneducated or poorly educated, unorganized and so engrossed in the struggle for subsistence, with women being the hardest hit.

He then explains inclusive development as involving:

• Exercise of civic, civil and political rights.

• Adopting democracy as a core value because it guarantees transparency and accountability for the effective working of the development process.

• Equitable opportunities for access to welfare programmes and public services-health, education, and housing

• Education is essential since it facilitates awareness building, employability, sense of autonomy, self confidence, self reliance understanding human rights, and adaptability

• Inclusive globalistion because the current pattern of globalisation reproduce between central and peripheral states, perverse concentrating and excluding growth that occurs within nations. Inclusive globalization requires fair trade, aid without strings and transforming science and technology into a public good

So, how far the 2014 budget will go in accomplishing its targets of inclusive development and job creation is hard to see, considering the huge allocation to consumption rather than production. However, it is noteworthy that there have been some post-budget developments. The Government has announced a 'comprehensive social protection scheme' to take off in February 2014 as announced during the break down of the budget and discussions are ongoing with the World Bank in that regard. The Sure-P is ongoing and the third stream of the YOU-WIN project is in the offing. The government has also launched the Nigerian Mortgage Refinancing Company with $300m World Bank loan. This is expected to provide mortgage funding that will last up to 20 years at a single digit interest. The Federal government has also joined hands with the Trade Union Congress in an FG/TUC-100000 housing unit project expected to yield 10,000 jobs. Effective implementation of these policies/programmes will boost inclusive development. The FG is also relentlessly pursuing the MDG agenda, under which 5,532 projects were executed in 113 LGAs between 2011 and 2012 (Aiemen, 2014).

Budgeting for Inclusive Development

Beyond the 2014 budget however, what do we do to ensure a budgeting paradigm that promotes inclusive development? The first step is to clean up our budgeting philosophy process and practices. We should also enhance our revenue base so as to properly fund the budget, focus on sectors that have greater impact across board, enact policies that domesticate growth and development and ensure good governance, especially as it relates to corruption. The budget should be prepared with more care and with the welfare of the majority given the utmost priority.

With a ministry of finance, a full-fledged budget office and a coordinating minister of the economy, the budget should be ready early enough-say September- for proper deliberations, politicking, and early passage. Funds should be released according to schedule and we have to reconsider the practice of augmentation: a budget is an estimate and funds should be released based on actual. This makes it imperative on us to estimate more carefully, especially oil quantity and price benchmark and spend wisely. It must be admitted that some of these issues are more political than economic!

The recent trend of growth without employment and worsening poverty shows that income disparity is worsening and that more wealth is being concentrated at the top. The budget and its implementation process could be leveraged to change this worrisome trend.

We also have to focus attention on sectors that can impact massively on the economy; agriculture, commerce, and power. MSMEs are responsible for about 80% employment in Nigeria. But Bank loan to MSMEs has fallen from 7.5% in 2008 to less than 1% presently while the power situation remains precarious despite all investments and efforts. These circumstances hamper entrepreneurship. It is also estimated that N6.5trn flows from domestic trade annually. Efforts should thus be made to encourage and streamline commerce in the country and boost the MSME sector. Those who wish to go into manufacturing should be encouraged to drive down the high unemployment level. After all, Britain when it used to be called Great Britain, was a 'nation of shop keepers'. We also cannot develop inclusively if the current level of financial exclusivity is not reduced.

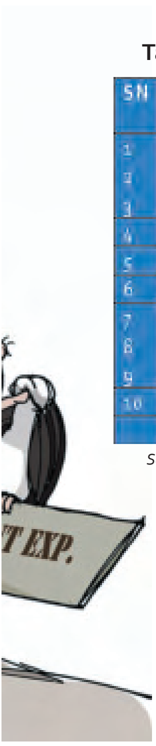
Specific steps to increase our revenue base and domesticate growth include widening the tax bracket beyond public/civil servants and corporate entities who pay most of the tax in Nigeria, tackling the issue of our refineries once and for all which settles the matter of subsidies and boosts domestic economy and seriously fighting the economic insurgency in the oil sector through which between $6bn-$12bn is lost every year, by reactivating the miscellaneous offences act which imposes life imprisonment on such offences. We should also adopt the 20/80 rule and concentrate on the syndicated, organized international gangs and not on poor villagers scooping fuel with 20-liter cans!

The buy-Nigeria policy should be introduced by ensuring that the local content law applicable in the oil industry is totally applied to drinks, entertainment, stationeries, consumables, vehicles and even contracts especially at the government level. When all government expenditures are localized, it creates a situation where all government activities lead back to job creation. Indeed, I align with the advice of Okoye (2014) that all MDAs should submit quarterly reports on how their activities create jobs or support job creation-even if it is through their recurrent expenditures (72% of total budget). The automotive policy, is thus a step in the right direction though some gray areas should be smoothened. 300000 old and 100000 new cars worth N550bn were genuinely imported into Nigeria in 2012; This excludes all those imported through 'Alternative Routes ', which are in multiples of the genuine imports. If

Table 6: Some Epicurean States

SN	State	Recurrent	Capital	Total(N ,bn)
1	Anambra	71.5	28.5	140
2	Bayelsa	54.5%	45.5%	299
3	Taraba	52.5%	47.5%	80bn
4	Oyo	51%	49%	189
5	Adamawa	59%	41%	98
6	Kogi	53%	47%	150
7	Benue	61%	39%	105
8	Nassarawa	53%	47%	114
9	Niger	76%	24.%	94
10	Kwara	61.5%	38.5%	94.4

Source: Various State2014 Budget Proposals




http://globalvillageextra.com/wp-content/uploads/2013/11/national-assembly.jpg

those orders were placed with Nigerian manufacturers-Innoson and PAN, the multiplier effects would have been awesome. The scandalous rate of waivers, exemptions and concessions which cost Nigeria N1.5trn in the past three years and on non-essentials and finished goods that enrich the well-connected and create economic value in other countries, should cease. In 2011, 5 oil companies received waivers valued at N182bn, constituting an economic drain.

The issue of Treasury Single Account (TSA) has been severally discussed. This is the time to insist on it because of its numerous advantages. The adoption of treasury single account structure minimises leakages, reduces bank fees and transaction, optimises costs of liquidity management, facilitate efficient payment system and improve control. We should also simplify the budgetary process so that as many people as possible should understand and track the budget. Of course, the era of people sitting in an air-conditioned office in Abuja and deciding the best project for my home-town is over. The citizens should also participate in deciding what they want and this increases the ownership of the budget and its outcomes.

To reduce our recurrent expenditure, which the ministry of finance blames on excessive wage and pension bills, we must merge some of the agencies as recommended by the Orosonye Committee. And while it is the legislature that would pass the necessary bills, the executive can and should initiate the bills to amend or abrogate the original bills setting up those duplicated and moribund organizations. But the ministries also require serious restructuring, first by executive fiat to reduce it to 36 and then by legislative fiat so that the number of ministries is determined by need and not by number of states. Allowances and benefits should be reduced but it should start from the top because they consume an unfair proportion of our commonwealth and because of the announcement effect. We must spend prudently and spare some thoughts for the nation rather than trying to capture the largest possible sum for our own subheads.

We can also learn from South Korea and her ***Disciplined Market Strategy.*** Working with the conviction that the most urgent priority of 2014 is the creation of quality jobs, South Korea has devised a creative economic strategy to achieve its objective of raising employment rate from 64%-70% in the next 5 years (2014-2018). This is the disciplined market strategy which involves raising the employability of those left behind by industrialisation, making the labour market more flexible, providing social safety-net for the most vulnerable, and ensuring that there are no distortions in institutions and weaknesses in policy implementation that may hinder effective operation of markets. This policy basket ensures that the market-based system is properly operated to allow a majority of the people work and earn basic living through employment or entrepreneurship. The participation of a greater number of people in the market (inclusiveness) creates greater diversity which brings forth ideas. Clear rules and good practices prevail in a disciplined market which readily turns ideas into business because anything of value can be traded in a well functioning market. The strategy also calls for the strength-

ening of training and educational systems to raise the employability of the youth, providing technical and financial support for startups. Ultimately, these efforts will help the big industries to move up the value chain and the SMEs to operate without special intervention, thereby creating employment along the way (Geun-hye,2014).

At times, some government activities expand the number of those within the poverty bracket. It might sound paradoxical but it is the truth. I have propounded that government MDAs should always carry out poverty impact assessment before embarking on any policies and programmes so as to decide upfront whether a programme is holistically worth it. Dr Adesina of the Ministry of Agriculture (2014) has also insisted that we should develop a Poverty Accountability Index and use that to measure a politician's electability in the country.

It is a paradox that Nigeria grows despite tight liquidity and high interest rates regime. Perhaps, we are truly more foreign exchange sensitive that interest rate sensitive but the tight monetary stance is not a plus for development. And when we have a financial system that is more attuned to speculation than making investment that would create jobs, increase productivity and redeploy surpluses to maximize social returns, as it was in the US before 2008, then we are in trouble. As we discussed earlier, there is growing inequality which leads to weak demand. Under the circumstances, the sectors that should be growing to reflect the needs and desires of a wider segment of the society like education and health, and which have been hitherto publicly financed, are rather being shortchanged at the budgetary table. This worsens the developmental equation and drives us further away from inclusiveness.

Budgeting is an instrument of political and economic reengineering, when if properly designed and executed, ensures that the developmental aspirations of the country and its citizens are achieved. But when the budget is prepared in such a way that the preferences and priorities leave out a large section of the population, then the desire for inclusiveness becomes a mere desire. With the economic insurgency in the oil sector, there are doubts if the oil production benchmark would be met. This could disorganize other macroeconomic and fiscal projections. Furthermore, that 73% of the budget is committed to consumption poses yet another challenge. We can only keep looking forward to better days in our budgetary and implementation processes.

(Ik Muo is a lecturer at the Department of Business Administration, Olabisi Onabanjo University, Ago-Iwoye, Ogun State.)

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Facts & Figures

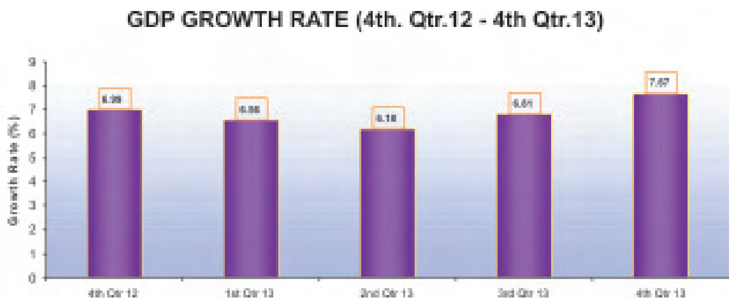
Ibrahim Abubakar

MACROECONOMIC ENVIRONMENT

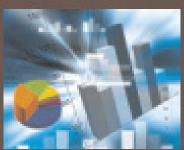
The Nigerian economy turned in a solid performance in the fourth quarter 2013. Some of the indicators grew more than expected while others got off to a shaky start. Gross Domestic Product (GDP), for instance, expanded at a faster rate than in the preceding quarter. The nation's currency, the naira, remained steady against other major currencies. In the capital market, stock prices bounced back to recover some earlier losses. The Monetary Policy Rate remained steady all through. However, inflation drifted higher but ended virtually unchanged. The external reserves shrank, but remained within a comfort zone. In the international crude oil market, prices wobbled but recovered and ended the year strongly.

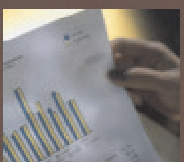
GROSS DOMESTIC PRODUCT

Gross Domestic Product (GDP) in the fourth quarter was estimated at 7.67 percent, a marked improvement when compared to the preceding quarter. The non-oil sector was the main driver of this growth with agriculture continuing its dominance over other sectors. Despite the intermittent dry spells in north-central and southwestern parts of the country as well as civil insecurity in Borno and Yobe states, rainfall was abundant, contributing to a bumper harvest. For the oil sector, the dividends of the amnesty deal with Niger Delta militants continued to push production in the right direction, with output jumping by 1.04 percent between November and December. Real GDP Growth for 2013 has been projected at 6.87 percent, significantly higher than the 6.58 percent recorded in 2012.



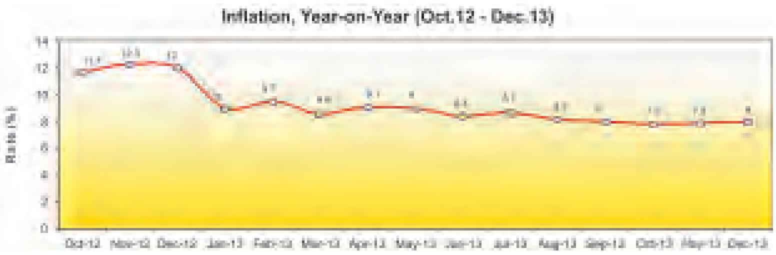
Source: National Bureau of Statistics





INFLATION

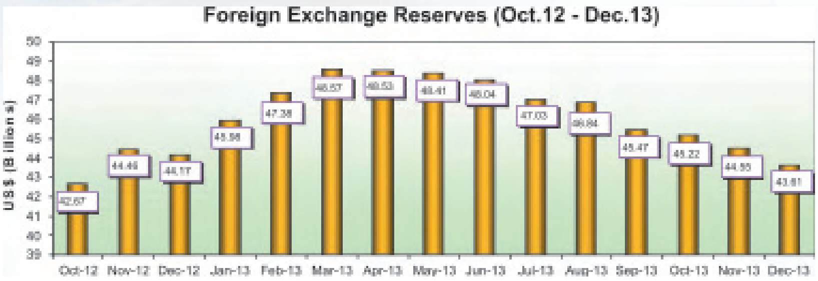
Inflation was mixed in the fourth quarter 2013 despite finishing somewhat unchanged. The headline inflation closed the year at 8 percent and has remained around the authority's single digit target since the beginning of the year. Earlier in October, inflation slowed for the third straight month to a new 5-year low of 7.8 percent, as result of lower food prices due to the harvest season. However, inflationary pressure resurfaced in November due to higher prices of meat, fish, bread and cereals. The food inflation continued its uptick in December as result of the festive season. Core inflation also trended upwards all through the period. The increase was due to higher cost of maintenance, transport, house hold appliances and pharmaceutical products. Inflationary risk remains a threat in the months ahead due to increased spending in the run-up to the 2015 elections.



Source: National Bureau of Statistics

EXTERNAL RESERVES

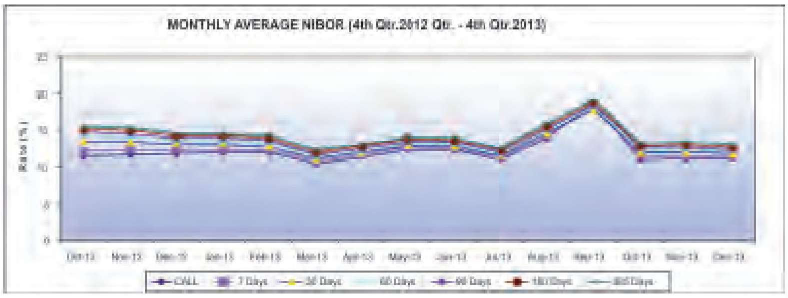
The nation's external reserves contracted in the fourth quarter 2013, despite the high price of oil in international markets. It shrank by about 10.2 percent after climbing to its highest level in more than four year in May. The decrease in the reserves level was driven mainly by a slowdown in portfolio and Foreign Direct Investment flows during the quarter resulting in increased funding of the foreign exchange market by the CBN to stabilize the currency. The stock of external reserves stood at US$43.61 billion as at end December, 2013, capable of financing up to 11 month worth of imports. In the short to medium term, the authorities project improvements in the stock of external reserves, resulting from higher crude oil prices and output.



Source: Central Bank of Nigeria

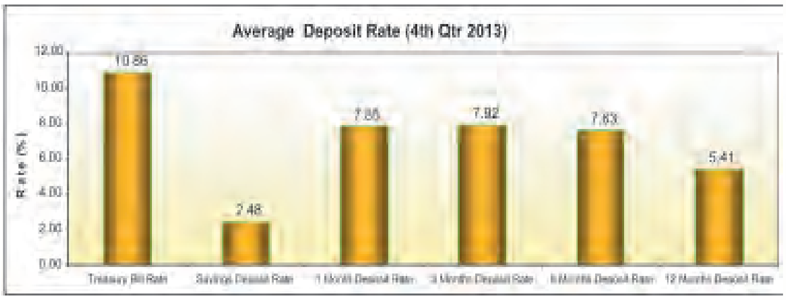
INTEREST RATE

The Monetary Policy Committee delivered no surprises and kept interest rate on hold in its November 18 and 19, 2013 meetings. The decision was in line with expectations as it was the fourteenth consecutive hold since the Monetary Policy Rate (MPR) was raised by 275 basis points from 9.25 percent to 12.0 per cent in October 2011, to curb inflationary pressures.



Source: FMDQOTC

The average interbank rate witnessed significant swings in the fourth quarter 2013 with pendulum movements across most tenors. Volatility was higher on the shorter term tenors due to mop up operations by the CBN. For instance, overnight rates shot up to about 15.75 percent in October from 11.25 in September. However, rates crashed in November due to an inflow of N586.41billion from Statutory Revenue Allocation. Despite the pendulum movements, rates remained stable in December due to an inflow of N437billion from treasury bills maturities and N675.65billion from Statutory Revenue Allocation.

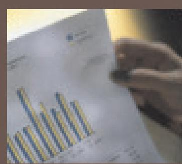


Source: Central Bank of Nigeria

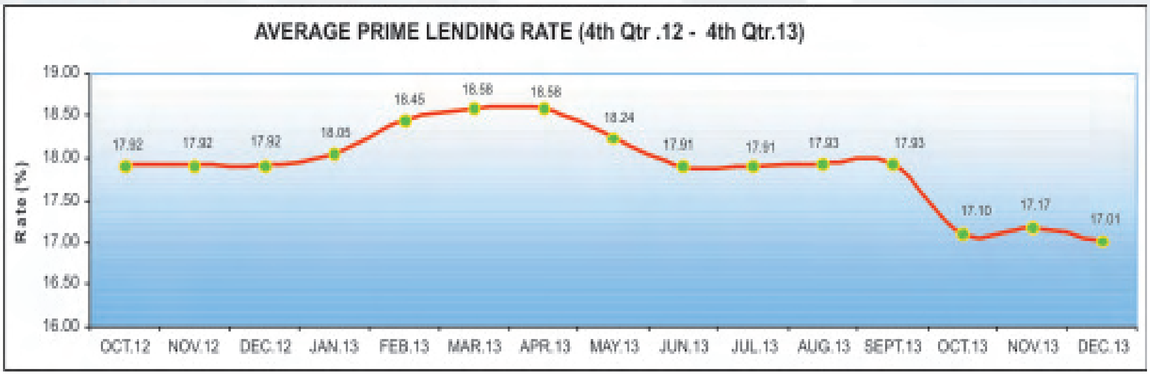
Facts & Figures







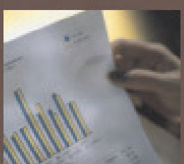

The average Prime Lending Rate (PLR) dropped slightly during the period, hovering around 17.01 percent as at end December 2013. Returns on the average deposit rate went up slightly across most investment horizons, with volatility higher on the 30 Days and 60 Days tenors.



Source: Central Bank of Nigeria

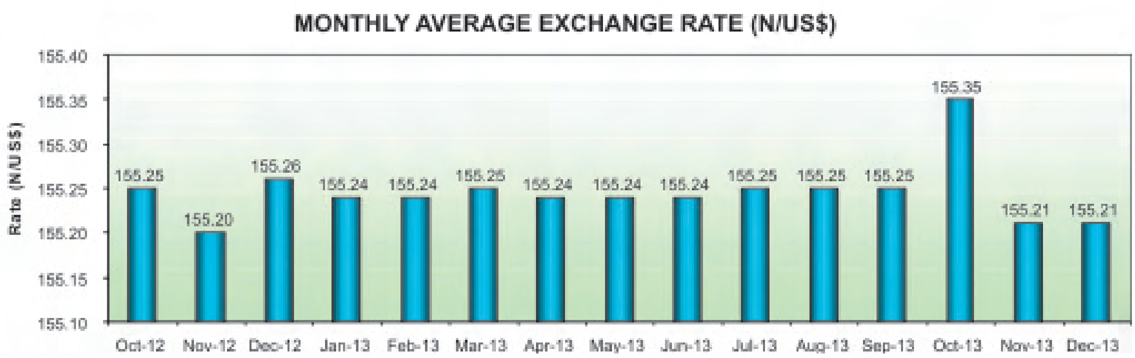







EXCHANGE RATE

The nation's currency, the naira, was fairly steady in the fourth quarter 2013, holding up well against major world currencies. It remained within a range of around N155.70/US$1. The naira enjoyed strong gains against the dollar thanks to a run of positive economic news. Earlier in October, the naira shot up to its strongest level since June due to stronger-than-expected demand by foreign investors pouring funds into government securities as well as adequate dollar sales from the oil majors. The dollar liquidity however drained in December due to strong demand from importers buying stock for the Christmas season. To ease pressure the CBN in December increased dollar supply to $400million from an average of $300million. In its twice weekly auction, the apex bank offered about $7.05billion and sold $6.79billion during the period. The premium however narrowed between the official and interbank market from 3.8 percent as at end September 2012 to 2.6 percent in December. In the short to medium term, the authorities expressed concerns over the widening gap between the official and the BDC exchange rates. However, the naira is projected to remain stable in the near term.

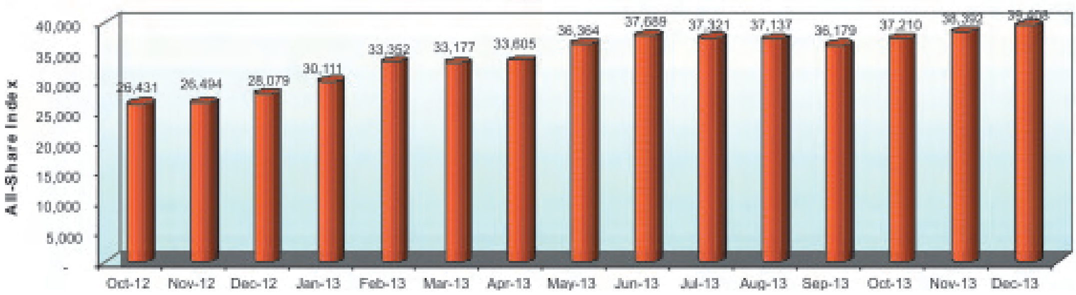


Source: Central Bank of Nigeria

CAPITAL MARKET

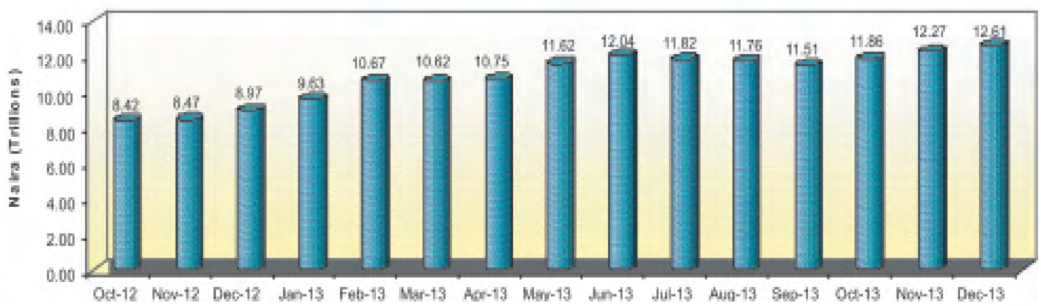
The capital market turned in another strong performance in the fourth quarter 2013 wrapping up the year in an impressive fashion. It closed the year with its strongest performance since 2008, climbing to a 67 months high as the All Share Index (ASI) and market capitalization finished solidly at 41,329.19 and N31.226trillion, respectively, from 36,585.08 and N11.652trillion in the preceding quarter. Investors had reasons to cheer as the market returned about 12.9 percent when compared with the modest gain of about 7.9 percent in the comparative period of 2012. More and more investors switched from bonds to shares in search of better returns. However, some investors remained cautiously optimistic, adopting a 'hold' strategy. On the positive side, confidence was boosted as the rules for operating the Investor Protection Fund were drafted and submitted to the Securities and Exchange Commission. A number of quoted companies such as Total, Nestle, Chemical Allied Products, and Sim Capital Alliance Value Fund paid impressive dividends of N2.00, N1.50, N1.25 and N8.24. With sentiments higher, Osun State issued the first N10billion Islamic Sukuk Bond at 14.75 percent. In the international capital market Nigeria's Eurobond recorded price gains.

ALL SHARE INDEX (ASI) (4th Qtr.12 - 4th Qtr.13)

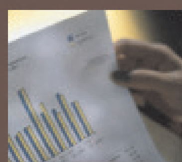


Source: Nigerian Stock Exchange

NSE MARKET CAPITALISATION (4th Qtr.12 - 4th Qtr.13)



Source: Nigerian Stock Exchange



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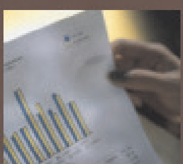
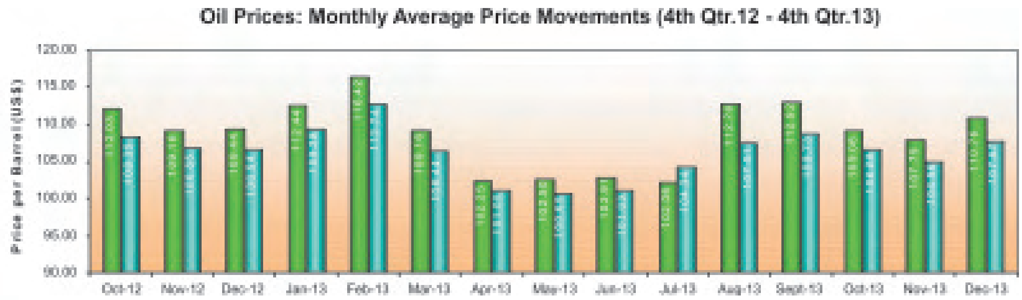


OIL & GAS

Crude oil prices were on a roller coaster ride in the fourth quarter 2013, plunging in the first half but staging a late recovery at the tail end of the quarter. Oil prices lost about 3.8 percent, after gaining nearly 6 percent in the previous quarter. Despite the volatility, crude oil prices held up strong in 2013, finishing the year with a 7.2 percent gain, its fourth annual increase in five years. Nigeria's brand of crude oil, bonny light, traded within a band of $103-$92 per barrel. Industry analysts attributed the volatile trend to groundbreaking agreement between Iran and six world powers which eased tensions in the region; supply disruption in Libya, Nigeria, Kuwait, United Arab Emirates and Venezuela; rising U.S. light sweet crude oil production; seasonal demand for heating oil due to the winter season; tension and instability in South Sudan and hopes over the US economy which grew ahead of previous expectations.



Source: OPEC, Energy Information Administration

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