

THE IMPLICATIONS OF THE GLOBAL FINANCIAL MELTDOWN FOR NIGERIA

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Abstract

The current global financial crisis, unprecedented in the history of the modern world, has been described as Wall Street's biggest crisis since the Great Depression in October 1929. From the Wall Street financial headquarters in the United States, across to Europe, Japan and China, the global financial system around which modern free market economy and capitalism is built is crashing like a pack of cards. In the case of the developing countries of which Nigeria is one, the implications are noticeable in the areas of crash in shares prices, dwindling revenues, few direct investments from developed countries, dwindling remittances from Nigerians abroad, developed non-oil exports, possible erosion of foreign reserves among others. Nigeria is called upon to re-orientate the economy towards production activity, deploy the available financial resources adequately, and utilize the excess crude oil revenues more judiciously, among other suggestions.

Introduction

Current Global Crisis started as a 'financial crisis' but now a 'Global Economic Crisis'. The crisis is unprecedented in severity of credit contraction

(credit crunch & capital crunch). The roots are in banking rather than in securities market or foreign exchange. The Crisis started in the U.S. (due to certain laxities in the US financial system), spread to Europe, and has become global. Even countries not affected by the financial crisis are now affected by 'second-round effects' as the crisis now becomes 'economic'.

The global financial and economic crisis presents significant challenges for African countries. It has also exposed weaknesses in the functioning of the global economy and led to calls for the reform of the international financial architecture. Although the crisis was triggered by events in the United States housing market, it has spread to all regions of the world with dire consequences for global trade, investment and growth. The crisis represents a serious setback for Africa because it is taking place at a time when the region is making progress in economic performance and management. Since 2000, the African region has had an average growth rate of real output above 5 per cent and inflation has declined to single digits. There have also been significant improvements in governance and a reduction in armed conflicts, making the

region more attractive for private capital flows. Net private capital flows to Africa increased from \$17.1 billion dollars in 2002 to \$81 billion dollars in 2007 (ECA and APF, 2008). The global financial and economic crisis threatens to reverse these gains in economic performance and management.

Historical Development of the Financial Crisis

Opinions vary on how the present global financial crisis started. One frequently canvassed origin was the financial instability in the USA caused in part by the failure and / or sub-prime mortgage lending difficulties of the investment banking industry in the US. Specific mention had been made of Lehman Brothers, Merrill Lynch, Morgan Stanley and PJ Morgan chase as well as government-backed mortgage giants Fannie Mae and Freddie Mac (Aluko, 2008:48).

Mortgage brokers and borrowers all are responsible for making loans and borrowing money on terms that were not fully understood by buyers, or ignored by them, and offered by unscrupulous lenders who violated that basic law of economies: *Never Lend Money To People Who Cannot Pay It Back*: A good home loan will have 20% down payment from borrower's earned saving and a fixed interest rate for 30 years with total monthly payment that includes principal, interest, homeowner's insurance having a total that the borrower can pay for easily out of current income which has been verified by the loan committee that approves the loan. Violation of these simple basic laws in common sense, results in inability to make the payments which precipitates foreclosure which puts the borrower on the street and the house sits empty-bringing in on income for anyone. The failure to regulate the activities of lenders and borrowers with hard laws encourages poor business practices which usually result in financial failure.

A further support to the historical origin of this crisis was noted in daily champion (2008:29) where it was observed that critics have blamed oversight

and failures by US and other regulators to detect the problems as prime reasons for the financial crisis. Continuing, the paper noted that the crisis broke out in the United States around August 2007. Mortgage investments sourced with the housing market's collapse and the fallout quickly spread and foreclosures skyrocketed. The troubles crimped auto and student loans and locked up lending for many consumers and business worldwide.

We can deduce from the discussion above that the global financial meltdown started in the United State of America Primarily from her Mortgage investments and the auto industry. Given that the US is the largest economy in the world, it stands to be appreciated that what ails the economy will of necessity reach other countries of the world in varying degrees. It is, therefore, a question of playing the ostrich for person in authority to pretend that their countries will be isolated from the financial crunch ravaging the world economy.

Global situation

We shall in this section review statements credited to informed sources on the state of the world financial meltdown.

- The US government has bailed out Citigroup Inc. agreeing to shoulder most of the potential losses on \$306 billion of high risk assets and inject \$20 billion of new capital in its biggest rescuer of a bank yet. Citigroup's rescuer marks the latest government effort to contain a widening financial meltdown that has caused the disappearance or bankruptcies of companies including Bear Stearns Cues, Lehman Brother Holding Inc. and Washington Mutual Inc. (Reuters, 2008:1).
- The price of oil per barrel has moved from \$48.20 barrel which is the lowest price so far since three years to a bit over \$50pb.

The OPEC ministers had an emergency meeting which failed to produce any agreement among them. Most oil ministers played the self interest game and were considering what was best to their individual countries since after this report, oil per barrel had moved below \$47.

- As noted by Ayankola (2008:18), unfortunately for the OPEC, the world economic crisis is showing no sign of easing off. The United State, the biggest economy in the world and the biggest consumer of oil, is witnessing a huge drop in demand because of the financial meltdown and president elect, Barrack Obama, is already talking about seeking for alternative energy. In Europe, the situation is also not any better. Many of the European economies are also on the brink of recession with demand for crude oil dropping sharply. China and India which are the two economic power blocks among the Asia tigers are not left out as crude oil demand had also dropped.
- Kuwait is a prosperous country by all standards of assessment but she is not left out of the financial crisis. Wiggles worth (2008:38) reported that despite Kuwait being one of the richest countries in the world due to its ownership of 10 percent of global oil reserves, she has been unsettled by the financial crisis. Investors and traders from the middle classes have demonstrated against the government while politicians are threatening to grill the prime Minister in parliament on a series of controversies. Kuwait is the only Gulf country to have been forced to publicly bail out a bank after Gulf Bank lost \$1.4bn (#933m, \$1.1bn) in derivative trading.
- Barrack Obama unveiled an economic team steeped in fighting crisis and likely to push for an unprecedented government role in reviving growth and stabilizing the

financial system (global business, 2008:39).

- In the property and environment section of daily champion (2008:32), it was noted that the financial crunch had eventually hit Dubai. Quoting the Architects Journal, the report noted that "architects and developers in Dubai are freezing recruitment and making redundancies as the emirate's real estate market begins to crumble."
- Gordon brown (Prime Minister of Britain) had warned that the world is facing "the first truly global financial crisis (Gordon Brown, Msthaba, July 4, 2008). Gordon further positioned that both the World Bank and UN were out of date and should be reformed to tackle the emerging problems. 64 *Journal of Money, Investment and Banking - Issue 11 (2009)*
- The economic problems afflicting many countries suffering recession have been blamed on the sub-prime mortgage crisis in the US that has led to plunging property prices and billions in losses by banks.
- Khan (2008:25) blamed the current global meltdown to the exuberance of the developed economies which was largely credit based without the requisite regulation to control the current spin-off.

The world situation as far as this global financial crisis is concerned is very fluid. Changes take place at enormous speed thus making definite statements and projections very difficult. The instances cited above point to the fact that most developed countries have been affected and are being affected by the global crisis. Since African in general and Nigeria in particular depend on the developed countries most of their food items and industrial equipment, they cannot be totally free from the crisis.

The worrying issues are that Nigeria seems to

believe that the financial crisis might not affect her adversely. This is a misplaced wish as the implications have started to manifest all over us.

Impact of the Crisis on Africa

In the first few months of the financial crisis, there was the widely held view that the impact on African countries would be minimal because of their low integration into the global economy. Furthermore, African countries tend to have very small inter-bank markets and several countries have restrictions on new financial products as well as market entry, which should shield them from the direct effects of the global financial crisis. Recent developments have, however, shown that the negative contagion effects of the crisis are already evident in the Africa region.

It is also interesting to note that the crisis is affecting all categories of countries in the region those considered to have good economic policies and governance; those with poor macroeconomic records; fragile States; small and large economies; oil- and non-oil exporting countries. A key implication of this assertion is that the real effects of the crisis in the region are not simply due to the nature of macroeconomic policies and governance in African countries. Consequently, there is the need to provide assistance to countries in the region to enable them to withstand the global slowdown and protect vulnerable groups.

Is Nigeria Immune to the Meltdown?

Few months ago, we were told how the Nigerian economy and its financial system have been made so strong that it is impervious to the negative externalities of the global financial crisis. The recapitalization of the banks and the inflationary bubbles in the stock market were quick references to the pillars that ensured the strength of the economy and the financial system. By implication, the Nigeria economy was put at par with the fabled Crusoe economy in which he (Crusoe) alone acted without exchanging anything with anybody.

However, as the recession in the Nigerian stock market became even more worrisome, the formal admittance of the fact that indeed Nigeria is not a closed or insulated economy as many people have been erroneously led to believe became necessary. Consequently, the Central Bank traced the problem in the equities market to the withdrawal of funds by foreign institutions and private investors which means that indeed Nigeria is equally exposed!

Trade and exchange of goods and services underscore every economic life aside that of Crusoe on the island. The limitations imposed by nature and the environment in terms of individual, organizational or even national capacities and resources, make it indispensable that humans while acting in their own self interest will seek to make up for these inadequacies through trade or other means such as aid. Considered at a national level therefore, trade is thus a mutually beneficial exchange that extends from the desire to better a country's lot which precisely no country can afford to exist without. Thus if we seek to find out whether Nigeria is indeed free from the global financial crisis, we have to critically examine the points and direction of impact of changes in real and financial trade and exchange between Nigeria and the rest of the world. Those points and directions unveil the extent of Nigeria's possible exposure.

Expectedly, Nigeria has experienced and is experiencing these situations as recognized below.

- Prof Charles Soludo, former Governor of CBN was quoted as reassuring Nigerians that Nigerian banks will not be affected by the global financial meltdown. This assurance was based on the volume of Nigeria's external reserves estimated at over \$60 billion which according to him safe despite the crumbling financial institutions abroad (2008:46).
- The continuous slide in both oil prices and the volume of oil sold translate to less revenues to

the government accounts. The Nigerian Government (Federal, State and Local) needs to apply some fiscal measures to stem expenditures. This would mean that some projects have to be suspended and salaries may not be paid as and when due with the accompanying disruptions of works and increase in social unrest.

- Operators in the nation's industrial sector were beginning to nurse the fear of possible credit squeeze as the global financial meltdown remains unabated even as they face fresh difficulties over non-oil exports to the United State of America. The fear is that a troubled USA economy will surely affected Nigerian manufacturers as they trade in dollars and export most of their goods to the country. In addition, obtaining credit facilities will become more difficult.
- It was further reported that the Nigerian manufacturers are in worse situation to respond to the emerging financial crisis due to the following factors-multiple taxation, high interest and lending rates by banks, poor infrastructure, and high cost of energy among others. These factors will combine to further increase the cost of production and make their products less competitive in the international market.

THE EFFECTS OF THE GLOBAL FINANCIAL CRISIS ON THE NIGERIAN ECONOMY

The Global Financial Crisis and Nigeria's Oil and Gas Sector

Nigeria's oil and gas sector plays a pivotal role in the nation's economy, accounting for 80 percent of annual government revenue and over 92 percent of its foreign exchange earnings. The sector also accounts for about one-half of the nation's annual GDP. The nation is endowed with a huge stock of oil and gas resources, making it a dominant player in the global oil and gas industry.

Nigeria's crude oil reserves are estimated at 36.5 billion barrels, ranking the country as the eleventh largest crude oil reserves holder in the world and the sixth largest exporter. Until recently, Nigeria's daily crude oil production was 2.4 million barrels per day. Although Nigeria is acknowledged for crude oil production, it also has considerable natural gas resources, estimated at 187 trillion standard cubic feet. This places the nation amongst the largest natural gas reserve holders in the world (EIA, 2007.2).

A combination of factors has constrained crude oil production in Nigeria, particularly in the past few years. Since late 2006, armed militants in the Niger Delta, where the bulk of the nation's oil and gas is produced, have stepped up attacks against crude oil infrastructure, oil company personnel and security forces. The armed conflict has steadily escalated, resulting in large-scale destruction of industry infrastructure, bunkering of crude oil, kidnapping and hostage-taking. This development has undermined the morale of oil workers and often led to the spiking of crude oil prices at international markets. Consequently, oil production has been shut-in in parts of the Niger Delta, reducing by up to 20 percent daily productive outputs (ICG, 2006.8).

Crude oil production in Nigeria has been further constrained by the emergent global financial crisis. Responding to sustained decline in demand for crude oil; international crude oil prices, which peaked at \$147.00 per barrel in July, 2008, has declined sharply to less than \$40.00 by early 2009. Consequently, the Organization of Petroleum Exporting Countries (OPEC), in a concerted effort to stem declining oil prices, decided to reduce production output of members, including Nigeria's, with its production quota reduced to 1.903 million barrels per day (mb/d). In December 2008, OPEC cut Nigeria's crude oil production further by 319,000 b/d. Consequently, a combination of militant attacks on oil facilities and

OPEC quota has constrained Nigeria's oil production significantly. When this development is further combined with the sharp drop in international oil prices, the consequences are grave to government's revenue profile in particular and the nation's economy in general. Unless the global financial crisis is reversed in the near future, Nigeria will continue to suffer huge revenue losses from plummeting international oil prices.

The Global Financial Crisis and the Nigerian Capital Market

The global financial crisis has hit the Nigerian capital market particularly hard. Until recently, the Nigeria Stock Exchange had been acknowledged as a dynamic market, which offered attractive returns to investors. This development had drawn investors from around the world, fueling sharp rises in the prices of shares to unprecedented levels. The yield on returns in the past few years had also been acknowledged as one of the highest around the world. However, optimism associated with the Nigerian capital market came to an abrupt halt by mid-2008. The nation's stock market has since witnessed a sustained decline in market capitalization from a high of N12.64 trillion on May 3, to a low of N 6.21 trillion on 31st December,

2008. The loss of capitalization in 2008, which stood at 28.1 percent of the total market value of equities at the nation's stock market, has been attributed to paucity of funds, fueled by the emergent global financial crisis. The free-fall in the prices of equities was attributed to the withdrawal of foreign investors from the market in reaction to the global financial crisis (Osunkeye, 2008:25).

The massive losses sustained by investors on the capital market caused commercial banks to withdraw financial support for brokers in the market, further plunging prices to lower depths. By end-2008, the market capitalization of the 213 listed equities had dropped precipitously, valued at N7 trillion or 73.1 percent of the aggregate market capitalization. This is in sharp contrast to 2007, when 212 equities accounted for N10.3 trillion or 77.5 percent of market capitalization. Indeed, the Nigerian Stock Exchange All-share Index dropped by 45.8 percent or 26,539.44 points to close at 31,450.78, a reversal of the record-setting growth of 74.73 percent recorded in 2007 (Okeke, 2009:5). Table 2 shows the value of the nation's most capitalized companies on the Nigeria Stock Exchange in 2008.

Table 1: Equities with the Highest Market Capitalization on the Nigerian Stock Exchange.

S/N	Company	Market Capitalization (N' Billion)
1	First Bank of Nigeria Plc	524848
2	Zenith Bank Plc	368,385
3	Nigerian Breweries Plc	308,931
4	United Bank for Africa Plc	283,467
5	Ecobank Transnational Incorporated	273,396
6	Oceanic Bank International Plc	267,767
7	Intercontinental Bank Plc	243,055
8	African Petroleum Plc	231,888
9	Platinum Habib Bank Plc	206,387
10	Stanbic IBTC Bank Plc	204, 375.

Source: Okeke, 2009: 15

The erosion of prices on the nation's capital market has triggered a panic amongst investors, unsettling the activities of many stock brokerage firms. Many brokerage firms have become insolvent following the withdrawal of financial support from the banks, which in turn have sustained huge losses on their exposure to stock brokers. Consequently, capital market operatives have embarked on massive job-cuts in a bid to stave-off imminent collapse. Some operatives have even suggested the temporary closure of the stock exchange to avert complete collapse of the nation's capital market in a panic reaction to the unfolding global financial crisis (Ugwu and Adepctun, 2009:27).

Implications for Nigeria

The global financial crisis has continued to impact on the Nigerian economy. Some of the implications are as follows.

- The Nollywood (Nigerian Movies Industry) has experienced the influx of Ghanaians who now serve as cheap alternatives to their Nigerian counterparts. The global cash crunch has affected the industry such that investors are not prepared to spend so much money on A-list actors/actresses that would cost between N800,000 and N1,000,000. they therefore look out to Ghana actors/actresses who would not only charge low rates but would help widen the market into Ghana
- The Nigerian economy is dependent on oil revenue and the fall in oil price has affected the revenue from oil since the recent fall in oil price. Oil price has been on a steep fall in the international market creating worries for the government coupled with the decline in oil production from 2.25 million barrel per day (bpd) to 2.0 million bpd. The decline in both price and volume reflected in the Federation Account Allocation Committee (FAAC) October report which shows mineral revenue at N466.22 billion as against N495.56 billion generated in September 2008 (Nwachukwu, 2008:7).

The implications of the global financial meltdown in Nigeria have been adequately captured in the communiqué issued by the ASUU National President, Prof. Ukachukwu Awuzie (2008:37).

The implications include:

- The crisis has precipitated a reduction in the demand for exports especially oil. Its impact was seen on the oil prices which fell by more than 50% in the last quarter of 2008 and that has negatively affected the revenue earned, as oil is Nigeria's main source of revenue.
- There is cut in the foreign capital inflow into Nigeria and other African countries. General flows will dry up and because of the small size in our market even limited withdrawals could have significant impact and as the crisis deepens there will be major capital withdrawal. This will affected Nigeria's rate of economic growth negatively.
- The remittances by Nigerians who work and stay abroad will be reduced as they are affected by the crisis. They lead to a reduction of welfare of their dependents in Nigeria.
- The post consolidation period has exposed a lot of Nigerian banks to global parties as they have entered business relationships with some foreign banks that are badly affected by the crisis. Some of them have booked considerable credits from such embattled financial institutions and with the credit crunch they will not be able to get the required credit.
- Nigeria will be less and less able to pay for the enormous imports that the rulers need to legitimize their political rule.
- The economic effects of global capitalist crisis may eventually lead to a social crisis in Nigeria
- Reduction in foreign direct investments resulting lower economic growth Public private partnership in the areas of power plants, rail and road will suffer.
- Withdrawal of lines of credits by international banks from local banks

- Reduction in earnings from the major export product (oil) which will affect over into a currency crisis since the dollar is the transactions currency for service countries of the world
- The safety of Nigeria's foreign reserve as noted by Aluko (2008:49), out of the Nigeria's foreign reserves (October 1, 2008), 87.3% (\$42.30) of the naira value of N5.617 trillion (442billion) was denominated in US dollars; 8.7% in Euro currency; 1.78% in British pound sterling; 0.95% in Japanese yen and the rest (1.27%) in other currencies. Further analysis shows that while the yen had appreciated against the dollar by 11.65%, the Euro has declined by 11.15%, the pound sterling 11.545 and the Swiss franc by 4.98% from this picture it is hard to expect that the Nigeria's foreign reserves are intact.
- All the three tiers of government must reach an agreement on how the excess crude oil revenues should be used to avoid spending beyond what the economy can absorb thus preserving the macroeconomic stability. 68 *Journal of Money, Investment and Banking - Issue 11 (2009)*
- The CBN should continuous monitor the level of liquidity in the system so as to maintain a reasonable balance of cash flow in the economic system.
- There is need for education of the share holders (investors) in Nigeria to appreciate the price movements in the NSE can never be one way positive trend. Sometimes prices could also drop with the tendency to move up later.
- The Federal Government should consider drawing down part of the huge foreign reserves and use it for developing strategic areas which will alleviate the suffering of most Nigerians. This should be embarked upon as soon as the global financial crisis settles down.
- Despite the slide in share price in Nigeria, she is still adjudged as the investor's delight. Investors should, therefore, be alert so as to take advantage of emerging business opportunities.
- Government through the FIRS should not contemplate any tax increase during this crisis period. The country should rather put in places the enabling environment that would enhance the productive capacities of the various companies in Nigeria. At a time when countries in the advanced world are bailing out their companies, the least Nigeria would do is not to increases taxes on our own companies and individuals.
- Banning product innovations should be done with absolute caution to avoid the sub-prime experience in USA.
- Lending rates to investor should be reduced to encourage investments in sensitive

Recommendations for Response to the Global Financial Crisis

Some suggestion put forward include those made by others and the lecture. Among such suggestions are:

- The Nigerian state must return to a welfare state in reversal of the anti-welfare since the military and purse frantically from 1999-2008. The organization of the economy for the benefit of the rich must be reversed (ASUU Communique, 2008:37).
- Governments at all levels must deploy the dwindling available resources appropriately to solve people's needs as against using the resources for political settlements. The sanitization arm of the government, the Economic and Financial Crime Commission (EFCC) must step up actions towards stopping dubious government executive from stealing public funds.
- The Nigerian economy must be production based with a productive economy directed primary at the rural areas rather than the urban areas (ASUU communique, 2008:37)

developmental projects.

- Government should develop mechanism that will support sensitive companies that could face financial crisis as is the case with some developed countries experiences during this financial crisis.

Conclusion

We'll like to conclude this paper by saying that linkage to the international financial system by the Nigeria banks may be weak but not totally absent. To the extent that there is a linkage at all means that Nigeria, CBN and the banks are subject to the vagaries of the global economy to a moderate extent. This is not time to celebrate the temporary stability in the Nigeria economy but a time to take proactive actions to forestall our economy from the negative impact of the financial crisis.

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