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Keynote Address: Executive seminar on "Global Capital Flows, Financial Markets and Macroeconomic Stability"

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Keynote Address

Sanusi L. Sanusi, CON

*Deputy Governors,
CBN Departmental Directors,
Branch Controllers,
Eminent Resource Persons,
Distinguished Executives,
Ladies and Gentlemen.*

It is my pleasure to be here to deliver the Keynote Address at this year's CBN In-house Annual Executive Seminar jointly organised by the Research and Human Resources Departments of the Bank. The seminar is a unique forum for the executive staff to brainstorm on contemporary economic and financial issues in order to keep abreast of developments in the global arena, and as well strengthen their policy making capacity towards resolving the numerous seemingly intractable problems besetting the banking/financial system in particular, and the whole economy at large.

The theme of this year's seminar "Global Capital Flows, Financial Markets and Macroeconomic Stability" is quite appropriate given Nigeria's recent unpleasant experience during the 2007/9 global economic and financial crises, and the need for an appraisal of the policy responses in the aftermath of the crisis. You will recall that the Nigerian economy suffered severe blow from the effects of the capital flows reversal triggered by the collapse of the Lehman Brothers in the US, which precipitated spontaneous capital recall within the global financial system. Consequently, the Nigerian stock market collapsed and the banking system experienced immense liquidity crunch with adverse impact on credit for productive activities in the economy. The adverse effects would have been more devastating, if not for the timely intervention of the government, particularly the banking sector reforms and the CBN's initiatives in easing the financial conditions to moderate the catastrophic impact of the massive capital outflows.

Let me state categorically that the stability of the financial markets is central to the overall macroeconomic stability in any economy. This is based on the premise that the financial market is the hub on which intermediation processes within an economy revolves. The financial markets do not only facilitate the mobilisation of funds; they also guarantee the utilisation and transfers of funds both within and

outside the shores of an economy. Thus, the financial markets obviously are important platform; which links the domestic economy and the rest of the world. It would therefore not be out of place to state that the long-term sustainable economic growth of any economy depends on robust and stable financial markets capable of raising the rates of accumulation of financial resources as well as intermediate such resources for effective productive usage.

As we all know, globalisation has fostered economic and financial integrations of developing and advanced economies. This has continued to manifest in capital flows from the developed to emerging developing and transition economies, and also in the reversal of flows from these countries to the developed economies. Along with its numerous benefits, capital flows have brought with it considerable challenges, making it difficult for policy makers to manage their financial and economic impacts. Globalisation has thus exposed the less developed financial markets to the vagaries of capital flows volatility.

Furthermore, it is worthwhile to note that capital inflows either through foreign direct investments, portfolio (equity) investments or external loans confer benefits on the recipient economies. This is most often revealed in foreign resources complementing domestic savings for investment, thereby deepening the domestic financial markets. However, the magnitude and speed of inflows could pose significant risks to the economy, particularly in developing and emerging countries. It is a known fact that huge capital inflows may raise concern about excessive appreciation in the exchange rate with the attendant adverse impact on exports and growth. It may also contribute to unsustainable expansion of credit, resulting in asset price bubbles and financial fragility. Indeed, capital flows have been identified to be responsible for the changes in liquidity levels and the accumulation of financial vulnerabilities that precipitated serious crisis in many countries. In particular, the boom and bust pattern that characterise the financial markets reflected the volatility and reversals associated with capital flows and the possibility of triggering considerable macroeconomic instability.

Ladies and Gentlemen, the trends in global effort to address the problem of slow growth, particularly in the developed economies have resulted in expansionary macroeconomic policies at such scales that remain unprecedented in recent history. The aftermath has been the improvement in public confidence in countries that implemented fiscal stimulus and unconventional monetary policy to rescue their financial systems. This has also led to the resumption of capital inflows in many developing, transition and emerging economies. Nigeria is not left out of this new trend of capital movements as the economy in recent times has

been experiencing significant increase in capital inflows, particularly, through portfolio investment. It is in this context that we must be mindful of the volatile nature of such flows and the likely capital reversal if economic fundamentals are not right as well as the implications for financial and macroeconomic stability. This is pertinent to avoid a repeat of the horrid experience of the recent past.

Managing the fallout of the quantitative easing in advanced economies may require a system-wide prudential supervision (micro and macro) to stabilise the financial markets and maintain macroeconomic stability. The core principles of effective supervision must, therefore, be applied within the context of the changing global environment to guarantee financial stability. The slow recovery of the global financial markets requires the right judgment, if the benefits from the lessons learnt to avoid the risk of spillover into the economy are to be achieved. The lessons learnt from the global economic and financial crises deem it necessary for us to understand the ramifications of the above issues, towards building strong institutions to enthrone proactive regulatory and supervisory frameworks that allow for the optimisation of the benefits derivable from substantial capital inflows.

There is no gainsaying that the monetary authorities need to develop more effective mechanisms to identify and take into account the risks associated with global capital flows in an effort to develop the financial markets and enthrone a more stable macroeconomic environment. Therefore, in line with this development, the Bank has since adopted the risk-based supervision paradigm and implemented the Basel Capital Accord initiatives. The new macro-prudential guidelines based on forward-looking capital provisioning and driven by stress tests are also being implemented. The Bank places high premium on transparency and accountability supported by good corporate governance ethics. The gradual integration of the Nigeria's domestic financial markets makes it imperative for the CBN to ensure a robust financial system supported by effective/efficient regulation and supervision of the financial institutions and markets.

Permit me to reassure you that the Bank remains committed to strengthening its internal capacities so as to be able to initiate policies that would ensure smooth and orderly development of the financial markets. It is my sincere hope that this seminar would, among others, identify superior mechanisms for effective management of capital flows in such a way that would deepen the financial markets and engender overall macroeconomic stability.

Let me reiterate that as global financial markets are fast becoming borderless and highly integrated, policy makers need to devote adequate attention and resources to financial system supervisory and regulatory processes. This is very crucial for Nigeria, given its quest of becoming one of the top 20 economies in the world by 2020.

Ladies and gentlemen, I am aware that experienced resource persons have been assembled to lead discussions at this seminar to elucidate on the vexed and complex issues of the theme. On this note, I implore all participants to take full advantage of this seminar by participating in every aspect of the discussions. It is my fervent believe that your deliberations would reveal series of policy options that would help to effectively and efficiently manage capital flows, strengthen the financial system and ensure the attainment of the objective of macroeconomic stability.

I wish you all a successful and fruitful deliberation.
Thank you for listening.