

THE NIGERIAN MONEY MARKET: ISSUES AND CHALLENGES

BY

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1. INTRODUCTION

Money markets are integral to the financial infrastructure of industrial countries and are among the largest financial markets in the world. These markets, which serve as channels for the execution and transmission of monetary policy and as trading venues for the short-term instruments, anchor the entire term structure of interest rates. Money markets are central to the allocation of capital, the efficient distribution of liquidity among financial institutions, and the hedging of short-term risks. The markets also play an important role in the credit evaluation process and in the large-value payments systems where trades are settled.

The need for a money market arises because receipts of economic units do not always coincide with their expenditures. Thus, the money market functions by channeling short-term funds from the surplus units to the deficit units of the economy. Economic units with surplus funds can hold money balances that is, transactions balances in the form of currency or demand deposits to ensure that planned expenditures can be maintained independently of cash receipts. Holding these balances, however, involves a cost in the form of foregone interest. To minimize this

cost, economic units usually seek to hold the minimum money balances required for day-to-day transactions. They supplement these balances with holdings of money market instruments that can be converted to cash quickly and at a relatively low cost and that have low price risk due to their short maturities. The deficit units, which could be public or private, can meet their short-term cash demands by accessing the money market and raising funds there. The market is segmented into two parts: the primary and secondary markets. The primary market is the market for new issues of debt instruments, while the secondary market is the market for the exchange of previously issued instruments. Active secondary markets for money market instruments allow them to be sold prior to maturity.

In Nigeria, the development of the Nigerian money market arose from the need to stem the outflow of surplus funds into investment outlets in the London money and capital markets. Other factors included the need to develop market that would enhance effective and efficient monetary management and promotion of deposit money banks' (DMBs) portfolio management as well as facilitate short-term capital mobilization. With the commencement of Open Market Operations (OMO) by the CBN, the scope of the money market has been expanded. The number of participants in the market also increased with the establishment of five discount houses. Money market institutions constitute the hub of the financial system. These institutions include discount houses, deposit money and merchant banks, and special purpose banks. Consequently, the formal money market evolved in the early 1960s with the first issue of treasury bills of N8.0 million by the Central Bank of Nigeria in April 1960.

Money market instruments are generally characterized by a high



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degree of safety of principal and their maturities range from one day to one year. Unlike organized securities or commodities exchanges, the money market has no specific location. It is primarily a telephone market, so it is easily accessible from almost all parts of a nation as well as from foreign financial centers. Generally, the term 'money market' encompasses all forms of short-term lending and deposits, including savings and time deposits with commercial banks, but for the purpose of this paper on the Nigerian money market, it is taken strictly as trading in direct debt instruments, to the exclusion of intermediated debt instruments such as bank loans and deposits.

THE LIMITED PERFORMANCE OF THE NIGERIAN MONEY MARKET

Although the money market has witnessed some expansion in the review period, there are observed problems which the market has to contend with. The overall performance of the market since inception has been mixed. In particular, as propellers of economic growth and development, the money market in Nigeria has performed below its potential. The market is shallow when compared with some advanced and emerging countries, but fairly satisfactory relative to sub-

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Saharan African countries. First is the preponderance of government instruments. The market virtually depends on the Government as the prime mover of activity on the demand side of the market. For instance, during lean revenue periods, government deficit financing requirements usually fuelled the market with large issues of government instruments. Correspondingly, the market is faced with the problem of paucity of private sector instruments at a time when the philosophy and policy posture is for the private sector to take the initiative in all spheres of economic development. Similarly, the function of underwriting of issues of treasury securities by the CBN, coupled with the unattractive yield of the securities, until recently, have resulted to holding of disproportionately large portion of the securities by the Bank. Also, there have been increasing uncertainty and lack of confidence in the market arising from interest rate movements and distress in the banking system, though some progress has been made in this area. There is also the problem of the wide margin between lending and deposit rates. The market lacks the breadth, resilience and depth needed to effectively discharge its functions, particularly the intermediation function. This is reinforced by the observed tendency of some market operators to act as primary users rather than as intermediaries in the deposits they mobilize. Some improvements could be achieved in this regard by enhancing surveillance of the operators and developing professionalism in the activities of the sector.

The money market in Nigeria is overcoming its initial problems through the provision of information technology and communication. This has led to automation in the market thereby resulting into faster dissemination of material information and promotion of greater integration between market operators and investors. The fall out of these improved technologies is improved efficiency, greater transparency of operations and dramatic increase in turnover in the money market.

The objective of the paper is to examine the structure and

performance of the Nigerian Money Market, discuss its current prospects to play more supportive roles for economic activities in Nigeria, and highlight challenges as well as areas where policy intervention can help bring the market to its maximum potential.

The rest of the paper is structured into six parts. Chapter II discusses some literature review and analyses the developments in the money market of some selected developed and emerging economies. Chapter III reviews the evolution of the Nigerian money market. Chapter IV appraises the performance of the money market, while Chapter V identifies the challenges and prospects in the Nigerian money market and concludes the paper.

2. LITERATURE REVIEW AND COUNTRY EXPERIENCES

The importance of well-functioning financial markets in economic growth and development cannot be over-emphasized. A growing body of literature finds that the development of financial markets has a positive impact on growth. Through an efficient intermediation process, financial markets improve productivity of investment by channeling funds to the most profitable investment projects which translate into economic growth. The positive impact of financial developments at the macro level is usually measured by the depth of the markets which affects the size of investment. Money markets intermediation process improves productivity of investment by channeling funds to the most profitable investment projects which translates into economic growth.

The purpose, form and the peculiarities of money markets differ across countries depending on their levels of development (Uzoaga, 1981 and Onoh, 2002). The money markets in advanced economies are highly developed and usually dated. Some, notably the London money market, have been around for virtually two centuries (Vaish, 1991).

Money market serves as the first step of the transmission of monetary actions to economy (Piero Ugolini 2001). Accordingly, money market rates serve as a useful indicator of

expectations regarding future monetary actions. It promotes financial stability and facilitates the development of a liquid bond market.

Well-developed money markets exist in developed countries, particularly, in the high income ones, while those in the least developed countries (LDCs) mirror the state of their development. Here, the markets are narrow, poorly integrated and in instances even non-existent in the real sense of it. It is therefore not in doubt, and as indicated by several authors, including Vaish (1991), Sundharen (1994) and Encyclopedia Britannica On-line (2006), that the level of development of a money market serves as a barometer of the level of development of the economy of the country. They emphasized that the degree and tempo of development of one reflects the spate of development of the other. Both Vaish, (1991) and Sundharen (1994) cautioned, however, that the fact remains that there could be exceptions to the rule, as in the case of Australia. Up to the early 1990s, in spite of its developed commercial banking system and the presence of a central bank, they adjudged that an organized money market was non-existent. It is therefore not out of place to deduce that several other factors work in consonance.

The authors enumerate the most fundamental of these factors, in other words, the characteristics of developed money markets that enable them play the pivotal role of economic development include:

- Presence of a fully autonomous, efficient and effectively functioning central bank, which invariably serves as both *de jure* and *de facto* apex of the country's monetary and banking system;
- Operation of a highly developed and organized commercial banking system, with the role of being a major operator and vital link between the central bank on one hand and the other segments of the money market on the other;
- Existence of large, vibrant and well diversified sub-markets,

<p>which together engender both healthy competition and true integration in the market, as well as enable long lending; even when and if they borrow short, the sub-markets would have a level playing field to maneuver and invest broadly, vertically and horizontally, and get funds speedily, whenever the need arose;</p> <ul style="list-style-type: none"> • Trade in a wide range real short term instruments and presence of dealers that operate at a dynamic tempo, inject and sustain the required life in the market; • Availability of sufficient resources, both internally pooled and supplied from outside, to finance transactions, adequately, on an ongoing basis; and • Existence of on-going international linkages and free flow of investments and transactions across geographical borders. <p>The above factors must necessarily exist simultaneously. The absence of any one would result in a compromise of sorts and jeopardize the existence and continuance of a well-developed money market in all ramifications. This is specifically why well developed money markets are absent in most of the developing world, especially in the African economies. The markets are usually deficient in one or the factor. The worst hit is Sub-Sahara Africa, where money markets are virtually non-existent in some of its LDCs. At best, they are at various levels of rudimentary stages of development. Such markets face fundamental challenges in effective and efficient pooling of idle short-term funds for channeling to the deficit internal and external sectors, to finance businesses and government needs.</p> <p>Characteristics of underdeveloped economies' money markets are high degree of specialization, absence of integration, strict confinement to a class or limited range of business, and limited competition with limited interaction. Others are diversity and wide margins in interest rates as well as seasonal stringency of funds.</p>	<p>Money markets in the LDCs are usually without sufficient depth and breadth. As such, they are constrained to serve the purpose of absorbing large volume of transactions without significant effects on security prices and interest rates (Iyegbuniwe, 2005)</p> <p>Unlike the capital market, the money market has a higher degree of liquidity of instruments bought and sold. According to Onyido (1994:20), the money market primarily exists as a means of liquidity adjustment while the capital market provides the bridge by which the saving of surplus units may be transformed into long-term investments of deficit units. The rate of interest (yield) is the primary factor which motivates savers to part with their funds in the capital market while the safety and liquidity of the financial instrument is at least as important as its rate of return in the money market.</p> <p>EXPERIENCES OF OTHER COUNTRIES</p> <p>INDIA</p> <p>The Reserve Bank of India has accorded prime attention to the development of the money market as it is the key link in the transmission mechanism of monetary policy to financial markets and finally, to the real economy. In the past, the development of the Indian money market was hindered by the system of administered interest rates, directed credit, and lack of proper accounting and risk management systems. With the onset of reforms and the transition to indirect, market-based instruments of monetary policy in the 1990s, the Reserve Bank made conscious efforts to develop an efficient, stable and liquid money market by creating favourable policy environment through appropriate institutional changes, instruments, technologies and market practices. These policy initiatives over time have led to the development of a relatively deep, liquid and vibrant money market in the country.</p> <p>In line with the objective of widening and deepening the money market and imparting greater liquidity to the market for facilitating efficient price discovery, new instruments, such as collateralized lending and borrowing obligation (CBLO), have been</p>	<p>introduced. Money market instruments such as market repo and CBLO have provided avenues for non-banks to manage their short-term liquidity mismatches and facilitated the transformation of the call money market into a pure inter-bank market. Furthermore, issuance norms and maturity profiles of other money market instruments such as commercial paper (CP) and certificates of deposit (CDs) have been modified over time to encourage wider participation while strengthening the transmission of policy signals across the various market segments. The abolition of ad hoc Treasury Bills and introduction of auction Treasury Bills paved the way for the emergence of a risk free rate, which has become a benchmark for pricing other money market instruments. Concomitantly, with the increased market orientation of monetary policy along with greater global integration of domestic markets, the Reserve Bank's emphasis has been on setting prudential limits on borrowing and lending in the call money market, encouraging migration towards the collateralised segments and developing derivative instruments for hedging market risks. This has been complemented by the institutionalization of the Clearing Corporation of India Limited (CCIL) as a central counterparty. The upgrading of payment system technologies has also enabled market participants to improve their asset liability management. Cumulatively, these measures have widened and deepened the money market in terms of instruments and participants, enhanced transparency and improved the signaling mechanism of monetary policy while ensuring financial stability.</p> <p>Canada</p> <p>Since the mid-1970's, the market for Government of Canada treasury bills and marketable bonds has shown innovation and, until the mid-1990's, rapid growth. The Government of Canada, and the Bank of Canada, had a commitment to promoting efficient, liquid and competitive domestic markets. The Bank views money markets as an effective channel for conducting monetary policy and, in recent years, to promote broader stability in the financial system. The</p>
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government continues to monitor the financial markets to provide it with stable, low-cost funding as well as promoting well-functioning markets in Government of Canada securities. Because of the "risk-free" nature of Government securities, they provide the benchmark against which all other domestic fixed income instruments are priced. They also form the basis for other money transactions, such as swaps, repos and a host of other financial market derivatives. Government of Canada securities also have been attractive portfolio investments for international investors which has contributed to the market's liquidity.

Over the years, the Bank and the Department of Finance have worked to improve the efficiency of Canadian financial markets through their own initiatives and by supporting those of others, including various regulatory agencies. This cooperative approach to market development has created an active market for short-term corporate paper and has led to the introduction of numerous new products such as short-term interest rate derivatives (e.g. Bankers' Acceptances future contracts, called BAX, traded on the Montreal Exchange and a myriad of over-the-counter derivative products). In more recent years there has also been a rapid growth in securitized commercial paper in the domestic market, and the longer-term corporate market has expanded in Canada after being relatively dormant since the early 1970's.

Recent Initiatives in the Canadian Market for Government of Canada Securities

In light of the significant improvement in the Government's financial position in recent years, the Department of Finance and the Bank of Canada, in close consultation with a broad range of financial market participants (investment dealers, investors, banks and various regulatory agencies) have focused their efforts on ensuring a liquid, well-functioning market for Government of Canada securities. Some of the initiatives include the following.

The improvement of the government's financial situation has meant that

there has been an absolute drop in the amount of its outstanding market debt. In December 2000 this debt amounted to Can\$414 billion, while in December 1996 it stood at Can\$439 billion. The composition of the Canadian dollar denominated debt has also changed dramatically in recent years.

In order to maintain a well-functioning domestic market and keep borrowing costs low, the Government focused on the key aspects of liquidity, transparency, regularity and integrity. For this reason, the government borrows on a regular, pre-announced basis in key segments of the market, builds large bond benchmarks and maintains effective rules for Government of Canada auctions. Market participants are consulted extensively on the government's debt strategy and adjustments to its debt programmes. The Bank of Canada plays an important role in advising the government on its debt strategy and implementing the debt program on behalf of the government as its fiscal agent.

The Bank of Canada has also adjusted its own participation at the regular treasury bill and bond auctions to mitigate, to the extent possible, the effect of declining net new issuance. As the government increased the average term to maturity of its outstanding debt, the Bank of Canada reduced its holdings of treasury bills and increased its holdings of bonds to be broadly in line with the structure of outstanding debt. This adjustment was made in part to reflect the way in which monetary policy is implemented in Canada. The framework for implementing monetary policy in Canada has changed dramatically from the days when the Bank Rate was set weekly at 25 basis points above the average yield on the auction of 90-day treasury bills. The Bank's operating target for monetary policy is now the middle of a 50 basis point target band for overnight financing, which the Bank can reinforce if necessary through conducting repo operations (or reverses) with a designated group of primary securities dealers (similar to the previous "jobber" designation). This has meant that the Bank no longer has the same need for substantial holdings of treasury bills

on its own balance sheet for potential open market operations. Therefore, the Bank made changes to its own auction participation to reflect not only changes to the manner in which monetary policy was being conducted, but also to ensure that the public float of treasury bills was as large as possible during a period of rapidly declining net new issuance by the government.

The changes that affected the amount and issuance of government securities, as well as the desire to maintain and enhance market liquidity and efficiency, has led to a number of initiatives on the part of authorities and market participants. Among the measures taken were changes to the auction rules for government securities and their oversight by the Bank of Canada, as well as guidelines governing a code of conduct in secondary markets for fixed income products in Canada adopted by the Investment Dealers Association of Canada (IDA). In addition, the Bank of Canada and the federal government have modified bond and treasury bill auctions to maintain benchmark sizes as large as possible.

Korea

In Korea, the money market embraces the call market and a wide range of other financial markets, including those for treasury bills, monetary stabilization bond, negotiable certificates of deposit, repurchase agreements and commercial paper. As part of government series of measures designed to channel curb-market funds into financial transactions and to organize the short-term financial market more systematically, various new financial instruments have been introduced and have contributed to broadening and activating the money market, with additional measures taken to realign and activate the market in accordance with financial deregulation.

In furtherance to develop money market in Korea, a US dollar call market is in existence, which fosters foreign exchange market. Similarly, Japanese Yen, Deutsche Mark and Pound Sterling markets were inaugurated in the 1990s to diversify

and strengthened the market. Participants include foreign exchange banks. The maturities are classified as overnight, tomorrow/next, spot/next, 1 week and 1 month to 12 months with interest rates being determined freely in relation to the rate prevailing in the international finance market, such as the London Inter-bank offered (LIBOR). The volume of foreign currency call transactions has grown very rapidly.

India

In India, prior to the 1990s, the financial markets were marked by administered interest rates, quantitative ceilings, statutory pre-emption, captive market for government securities, excessive reliance on central bank financing, pegged exchange rate, and current and capital account restrictions. Therefore, as part of structural reforms in the early 1990s, wide-ranging reforms were introduced in the Indian financial sector, including financial markets. Reforms in the financial markets encompassed all segments - the money market, the credit market, the government securities market, the foreign exchange market, the equity market and the private corporate debt market.

As a result of various reform measures, the structure of financial markets has witnessed a remarkable change in terms of financial instruments traded in various segments of the financial market, and market participants. Although various segments of the financial market, in general, have certainly become deeper and more liquid, there is still some way to go before all the segments of the financial market are fully developed.

The U.S Market

The United States of America's money market carries out the largest volume of transactions of any such market in the world. Its participants include the most heterogeneous group of financial and non-financial institutions to be found in any money market; it permits trading in an unusually wide variety of money substitutes; and it is less centralized geographically than the money market of any other country. New York City is the major center of the US money market

activities and most international trading activities take place there.

There was a significant change in the U.S. banking laws after the great depression of the 1930s which includes the withdrawal of all gold from internal circulation and was held by the U.S. Treasury for use only in settling net flows of international payments among governments or central banks; legislative recognition of the primary importance of unified open-market operations by the Federal Reserve System; delegation to the board of governors of the Federal Reserve System of authority to raise or reduce the ratios required between reserves and commercial bank deposits; reduction in the size of banks existing in the early 1920s by almost half of the 30,000 separate banks by the mid-1930s; systematic change in the essential character of commercial banking in the U.S. remained that of a "unit" (or single-outlet) banking system in contrast to those of most other countries, which had a small number of large branch-banking organizations.

This system has led inevitably to striking differences between money market arrangements in the United States and those of other countries. At times, some smaller banks almost inevitably find that the wholesale facilities of the money market cannot provide promptly the funds needed to meet unexpected reserve drains, as deposits move around the country from one bank to another. To provide temporary relief, pending a return flow of funds or more gradual disposal of other liquid assets in the money market, such banks have the privilege, if they are members of the Federal Reserve System, of borrowing for reasonable periods at their own Federal Reserve Bank. At times some large banks, which serve as depositories for part of the liquid balances of many of the smaller ones (including those that are not members of the Federal Reserve System) also, find that demands converging on them are much greater than expected. These large banks, too, can borrow temporarily at a Federal Reserve Bank if other money market facilities are not adequate to their needs. Because these borrowing needs are unavoidably frequent and, as a rule, do not indicate poor

management, the discount rate charged by the Federal Reserve banks on such borrowing is not ordinarily put at punitive or severe penalty levels thus, contrary to practice in many other countries, the central bank does not always maintain its interest rate well above those prevailing on marketable money market instruments. To avoid abuse, there is continuous surveillance of the borrowing banks by the Federal Reserve Bank. This practice of borrowing at a Federal Reserve Bank has developed the market for "federal funds." This specialized part of the money market provides for the direct transfer to a member bank of balances on the books of a Federal Reserve Bank in return for payment of a variable rate of interest called the "federal funds rate." These funds are immediately available. There are transactions, too, in funds that are on deposit at commercial banks by means of loans between banks, or through loans by one large depositor to another. Because these must be collected through a clearing process, they are usually called "clearinghouse funds."

United Kingdom

Since 1997, the Bank of England has implemented its monetary policy via the official two-week repo rate. This is the rate at which the Bank conducts repo transactions with its counterparties as part of its open market operations. The official rate is closely tracked by the two-week market-determined GC repo rate. The Bank's rate is typically higher though; among other possible reasons, market participants appear willing to pay a premium for the more flexible collateral arrangements allowed by Bank repo (Brooke and Cooper (2000)). The 1997 reforms also widened the range of counterparties that are able to participate in the Bank's auctions. They include a wide range of financial institutions that are active in the sterling money markets. The adoption of the two-week repo rate as the target for monetary policy followed on the heels of the January 1996 gilt repo reforms. While gilt repo arrangements had been available since the early 1990s, their use was relatively restrictive. The 1996 reforms removed these restrictions on participation and allowed for the

development of a liquid gilt repo market. Consequently, the amounts outstanding in the gilt repo market expanded from £72 billion in 1997 to £128 billion at the end of 2000.

The Bank conducts its open market operations using a range of short-term money market instruments. These include repo of gilts and eligible bills (Treasury bills and eligible local authority and bank bills), and outright purchase of eligible bills. The maturity of the Bank's open market operations is principally at two weeks, with minor variations, depending on liquidity needs. The pool of securities eligible for use in the Bank's open market operations has been extended since 1997, most notably in August 1999, when euro-denominated securities issued by governments and central banks in the European Economic Association were added to the list. Table A provides a breakdown of the Bank's open market operations by instrument type. Prior to 1997, open market operations were mainly conducted via outright purchases or sales of eligible bank bills and sterling Treasury bills. A key rate was the so-called minimum Band 1 dealing rate, the minimum rate at which the Bank was willing to discount bills with up to 14 days maturity. As a reaction to the September 1992 ERM crisis, the Bank introduced repo facilities of gilts and loans related to export and shipbuilding credit. These were re-offered on a number of occasions thereafter, and from April 1994 became a permanent part of the Bank's open market operations. They were conducted twice a month with a maturity of generally two or four weeks. From 1997 to 1998, there were two daily rounds where the Bank's counterparties could bid for two-week repo or outright sales (12:00 noon and 2:30 pm), and sometimes an additional early round (9:45 am) depending on liquidity conditions. In June 1998, this was modified to two regular daily rounds (9:45 am and 2:30 pm) for two-week repo and outright sales. In addition, two end-of-day facilities were created for overnight repo. At 3:30 pm, all counterparties can bid for additional funds at a penal rate (currently 100 basis points above the Bank's repo rate). As such, the Bank introduced a ceiling for the overnight rate. After the close of the money markets, the 4:20

pm facility allows settlement banks to obtain additional funds (at a penal rate of 150 basis points above the official rate) that might be needed in order to balance their account with the Bank at the end of the day. In June 2001, the Bank of England introduced an overnight deposit facility (remunerated at 100 basis points below the Bank's repo rate). This facility is made available to the Bank's counterparties at 3:30 pm.

Lessons Learned and Challenges Ahead

Developing an efficient treasury bill market led to the expansion of private capital markets, both short and long-term, and also provided the public sector with access to the broader capital markets in later years as government borrowing requirements soared through the 1980's into the early 1990's.

The clear and ongoing policy objective of developing an active money market was instrumental to the success of the initiatives undertaken. Financial market participants were willing to work cooperatively with public authorities in an environment that was consistent with their own business interests. One of the overriding objectives, from the outset, was to make the market for Government of Canada securities attractive for investors, both domestic and international. International participation in the secondary market was very important to provide liquidity, especially during periods of large government financing requirements.

The approach Canada pursued almost 40 years ago may not be entirely appropriate in today's world. In particular, Canadian authorities showed preferential treatment to domestic banks and dealers to encourage them to become more active in Canadian fixed income markets, especially those for Government of Canada securities.

In addition, Canada undertook initiatives that provided domestic firms, and in later years, foreign firms with Canadian operations, with appropriate incentives to expand their capital markets activities. However, today, the environment is dramatically different. Smaller financial centres,

such as Canada, are faced with different competitive forces as financial markets have become more globalized and improvements in communications and information technology have changed the economics of capital market activities, especially those related to government fixed income securities. The continuing movement towards a more globalized economy presents challenges to public authorities as they strive to pursue policies that preserve and enhance the continued efficiency and competitiveness of capital markets.

3. OVERVIEW OF THE NIGERIAN MONEY MARKET

3.1 THE JOURNEY SO FAR:

Prior to the establishment of the CBN in 1959, there was no formal or organized domestic money market in Nigeria. What existed then was an integral part of the London money market. The market operated by moving funds from the London money market to Nigeria for the purpose of financing export produce. With the establishment of the CBN and the subsequent attainment of political independence in 1960, the CBN became involved in the active development of Nigeria's money market. In line with the Treasury Bills Ordinance of 1959, the Bank designed and issued the first Nigerian Treasury Bills in April 1960. Also, the Bank introduced the Finance Bill Scheme in 1962 to provide funds for the marketing boards to help boost their export of agricultural produce. In 1968, Treasury Certificates were issued for the first time as short-to-medium term government securities to help bridge the gap in government fiscal operations. Other forms of money market instruments like Certificates of Deposit (CDs), Bankers Unit Fund (BUF) and Special Deposits with the CBN were introduced between 1974 and 1976. The Nigerian money market now constitutes a very important segment of Nigeria's financial system, and with the commencement of secondary market activities for Nigerian government debt securities known as Open Market Operations (OMO) in 1993, the money market has assumed a more prominent role in the conduct of Monetary Policy. The market comprises the inter-bank

funds market and the short-term securities market and the operators include the Debt Management Office (DMO), the CBN (which is also the regulatory authority), the Deposit Money Banks (DMBs), the Discount Houses and the investing public.

Since its formal emergence in the 1960s, entrenchment in the 1970s and 1980s, and continuous growth from the 1990s to date, the money market has served the following major purposes. It has helped localize the credit base and has prevented the uncontrolled outflow of funds to foreign money markets. Importantly, the retention of funds within has contributed immensely to meeting domestic investment needs of the private sector. Another vital purpose of the Nigerian money market is that it has facilitated the mobilization of funds to meet the credit requirements of government. The market, in addition, enables the banks to economize on their cash holdings and adjust their liquidity positions as conveniently as possible. It is also responsible for money creation through credit.

3.2 FUNCTIONS OF THE NIGERIAN MONEY MARKET

The major function of the Nigerian money market is to facilitate the raising of short-term funds from the surplus sectors to the deficit sectors of the economy. The money market allows money available for short periods to be directed to those who can use it. In addition to facilitating the liquidity management of economic actors, money markets fulfill a number of additional economic functions

- facilitates the conduct of monetary policy through market-based instruments;
- provides anchor for the short end of the yield curve;
- supports the development of foreign exchange market;
- provides the authorities with better signals of market expectations;
- allows banks and their customers to better manage their liquidity;

- strengthens competition in financial intermediation;
- helps to promote private issuance of negotiable certificates of deposit, promissory notes, and commercial paper; and
- short-term instruments support the development of longer term corporate bond markets.
- The money market allows institutions to hold a proportion of their funds in liquid assets that will enable them realize cash quickly should the need arise.
- The money market is used to take care of imbalances in the supply of money between the financial system as a whole and the government.

3.3 PARTICIPANTS IN THE NIGERIAN MONEY MARKET

A number of institutions are active in the market, and perhaps it boasts of the most active participants in the Nigerian financial markets. The key participants are the Federal Ministry of Finance (FMF), Debt Management Office (DMO), Central Bank of Nigeria (CBN), deposit money banks (DMBs), discount houses, businesses and individuals.

Federal Ministry of Finance

The Federal Ministry of Finance (FMF) is responsible for the fiscal policies of the Federal Government. It, however, collaborates with the CBN, because fiscal policies are at the core of all financial policies. Fiscal and monetary policies and the activities of the FMF and the CBN have to move in tandem, for a stable money market to operate.

The FMF and the Bank shared responsibilities for licensing and supervising DMBs up to 1991, when the CBN became the sole authority for these. Suffice to mention, there have been changes, over the years, in the responsibilities, which the two monetary authorities have had, concerning their roles. From the inception of the market to 1965, the power of bank examination rested with a division in the FMF, which was in charge of on-site supervision. The

division merged with the Banking Scrutiny section of the CBN that had been responsible for off-site supervision, to form the Banking Supervision Department of the CBN. However, earlier, from its being otherwise largely autonomous since inception, the Amendment Decree No. 3, of 1963 put the CBN under the ambit of the FMF. This arrangement continued until the intervention by the CBN Act No. 24 in 1991. The FMF, once more, regained control with the 1997 amendment to this act, and became the reporting channel to the Presidency, while a Director General in the ministry became a member of the CBN Board of Directors. An amendment in 1998 suspended this control. The indirect linkage with the Presidency through the FMF had been undermining efficiency in the CBN, especially its ability to operate an independent monetary policy, devoid of political undertones.

Notwithstanding, the FMF continues to interact with the CBN. It interfaces with the money market through its function of mobilizing domestic financial resources for the development purposes of the Federal Government (FG). In 2005, the ministry inaugurated a committee to facilitate a buoyant secondary market for FG Bonds. The virile secondary market, driven by the forces of demand and supply, aimed to become a robust platform, to stimulate the trade in the government securities. Money market institutions, notable among which are the banks, are to partake actively. Even though the bonds are de facto medium to long-term instruments that the FMF issued on behalf of the FG, the CBN commenced the conversion and auctioning of some of the shorter tenor ones through the OMO market. The tenors were of 21, 25, 35, and 49 days.

Central Bank of Nigeria

The Banking Act of 1958 established the CBN, the apex regulatory and supervisory body of the Nigerian money market. The Bank commenced operations on 01 July 1959. In its pursuance of its core mandate of promotion of monetary stability, the Bank has as one of its responsibilities the development and growth of the money market. The functions of maintenance of a sound and efficient

financial system, being banker and financial adviser to the FG and lender of last resort to the banks all interplay with the money market. For example, it issues securities on behalf of the FG, provides it with rediscount facilities for its short-term debt instruments and other eligible assets and is the last source of credit to the DMBs. Over time, the CBN role has varied, from a purely traditional central bank role at inception to include developmental roles, of varying degrees, from the 1980s to mid-2000s.

Debt Management Office

In September 2001, the FG set up the semi-autonomous Debt Management Office (DMO) as a one-stop clearing for all Nigerian government debts. The office used to be in the CBN. To ensure cognate continuity, a complement of core personnel from the Bank and the FMF were pooled together. The conception of the office centralizes exclusively on the country's debt situation and it, thus, coordinates the records and streamlines the management. Core activities include debt service forecasts, debt service payments, and advising on debt negotiations as well as new borrowings. DMO's relationship with the money market is perceivable in its sharpened strategic focus and operational efficiency in domestic debt management.

Discount Houses

These are non-bank financial institutions devoted to trading in money market securities in the secondary market. Established first in 1993, discount houses provide discounting and rediscounting facilities in government short-term securities, there are five of them currently operating in Nigeria. They provide the Deposit money banks with a convenient window for liquidity management by contracting loans from banks, repayable at call. Discount Houses intervene between the monetary authority, Central Bank of Nigeria and the deposit money banks (DMBs) in mobilising funds for investments in securities and take positions depending on the liquidity profile of the financial system. They do this by providing discounting/rediscounting facilities in government short-term securities.

They invest mainly in government treasury bills and to a lesser extent, in commercial bills issued by blue-chip companies and accepted by banks. They provide primary liquidity in the Nigerian financial sector through buying and selling of securities in huge volumes, for very short periods of time from 1 day up to 90 days on average. In effect, they act as market maker in money market instruments and as agents in OMO auctions.

Deposit Money Banks (DMBs)

DMBs are the largest partners with the CBN in money market transactions. They serve as the channel for the transmission of CBN's monetary policy. They also serve as intermediaries between the CBN and the public in the sale and purchase of instruments. Furthermore, they are the principal borrowers at the CBN discount window.

Public and private corporate

These entities could be either lenders (investors) or borrowers in the money market. Private blue chip companies usually issue BAs and CPs to take care of certain working capital requirements. They also sometimes invest in government debt instruments or other corporate debt instruments. Individuals/households participate in the money market when they invest any surplus income in money market instruments.

3.4 REGULATORS OF THE NIGERIAN MONEY MARKET.

3.4.1 The Central Bank of Nigeria

The Central Bank of Nigeria (CBN) is the apex regulatory authority of the financial system in the country. It was established by the CBN Act of 1958 and commenced operations in 1959. The promulgation of the CBN decree 24 and Banks and Other Financial Institutions (BOFI) Decree 25, both in 1991 gave the bank more flexibility in regulation and supervision of the banking sector and licensing finance companies which hitherto operated outside any regulatory framework.

One of the principal objectives of the bank as stipulated in the CBN Act of 1958 is to promote monetary stability and a sound financial system. To achieve the objective of promoting and maintaining the monetary and

price stability in the economy, the CBN formulates policies to control the amount of money in circulation, control other banks and major players in the financial market, control rates of banks credits and therefore the supply of money in the economy. The instruments used by CBN to achieve these functions are: Open Market Operation (OMO), bank rate, rediscount rate, direct control of banks liquidity, direct control of bank credit, special deposits, moral suasion and minimum cash ratio.

3.4.2 The Nigeria Deposit Insurance Corporation (NDIC)

The corporation was established through the promulgation of Decree No. 22 of 15th June 1988. This was part of the economic reform measures taken by the then government, to strengthen the safety net for the banking sector following its liberalization policy and the introduction of the 1986 Structural Adjustment Programme (SAP) in Nigeria. The Corporation supervises banks so as to protect depositors; ensure monetary stability; ensure effective and efficient payment system, and promote competition and innovation in the banking system.

Supervision of insured banks is an integral part of the mechanism for ensuring safe and sound banking practices and the Corporation has continued to accord this top priority. This entails on-site examination and off-site surveillance, both of which are mutually reinforcing. The off-site supervision provides an early warning signal which is useful in prioritizing on-site examinations and assessing potential problem areas.

3.4.3 The Federal Ministry of Finance (FMF)

The Federal Ministry of Finance was established in 1958 by the Finance (Control and Management) Ordinance, to replace the then Finance Department. The Ordinance conferred on the Ministry the responsibility for the control and Management of the public finance of the Federation. The ministry advises the Federal Government on its fiscal operations and collaborates with the CBN on monetary matters.

3.5 INVESTMENT WINDOWS IN THE NIGERIAN MONEY MARKET

This is a market for short-term debt instruments. The major function of the money markets is to facilitate the raising of short-term funds from the surplus sectors to the deficit sectors of the economy. The deficit units, which could be public or private, obtain funds from the market to bridge budgetary gaps by trading in short-term securities such as Treasury Bills, Treasury Certificates, Call Money, Certificates of Deposits (CDs), and Commercial Papers (CPs). The instruments are liquid and are comparatively safer than other financial markets' securities. The trade-off is that they offer significantly lower rates of return.

Treasury Bills: These are short-term securities that mature in one year or less from their issue date, with maturity structure of 3-month, 6-month and one year. The bills are purchased at a discount and serve as the benchmark risk free instrument in the money market. Treasury bills are issued through a competitive bid auction.

Certificate of Deposit (CD): this a time deposit with a universal bank. They bear a specific maturity date ranging from 3 months to 12 months. CD offers yields that are slightly higher than t-bills because of the existence of default risk. It is next in line to T-bill in order of liquidity and its guaranteed by NDIC up to a limit of N200,000.

Banker's Acceptance (BA): This is a short term credit investment created by a non-bank institution and guaranteed by a bank. The yield is higher than that of CD and it is traded at a discount. It is particularly useful for financing exports and imports.

Commercial Paper (CP): This is issued by large corporations and blue chip companies that have high credit ratings. CP is an unsecured debt instrument and trades at a discount. It has maturities of between 1 month and 9 months and offers yields that are slightly higher than most BAs. It is used to finance short-term working capital needs.

Repos: Repo is the short form used for repurchase agreement, and is widely used by a dealer in government securities who sells T-bill to a lender with an agreement to repurchase the instrument at an agreed date in future, and at an agreed price. They are usually for short term, ranging from overnight to 30 days. In a repo transaction, the lender of money acquires full ownership of the underlying security and thus may sell it in the event of default.

Reverse Repo: This is the exact opposite of Repo. It is a collateralized loan, realized through the sale and subsequent repurchase of a security at a specified date and price. It is the combination of an immediate sale of a security with the agreement to reverse the transaction at a specified future date

4.0 APPRAISAL OF THE NIGERIAN MONEY MARKET

The Nigerian money market has grown steadily over the years. From 12 in 1960, the number of commercial banks operating in the country grew steadily to 29 in 1986 and peaked at

66 in 1992. Thereafter, owing to the liquidation of fifteen banks over the years the number declined to 51 at the end of 1998 and rose again to 89 in 2005. As at end-December 2006, owing to the consolidation of the banking system, twenty-five banks emerged from a total of 89 banks that existed as at end-December 2005. It further reduced to 24 banks at end 2007, following the merging of Stanbic Bank and IBTC. Their branch network rose faster from 160 in 1960 to 2,407 in 1996 but declined to 2,185 in 1998 and rose again to 4,579 in 2007.

The total value of money market assets outstanding which stood at N123.66 billion in 1996, grew significantly to N247.35 billion in 1997, following the conversion of long-dated treasury bonds and outstanding CBN direct advances to Government into treasury bills. By 2002, it had grown to N518.72 billion and stood at N2,250.1 billion at end-2007. Government short-term securities, comprising treasury bills and treasury certificates have constituted the bulk of the total value of money market assets in Nigeria. With the discontinuation of the issuing of treasury certificates since

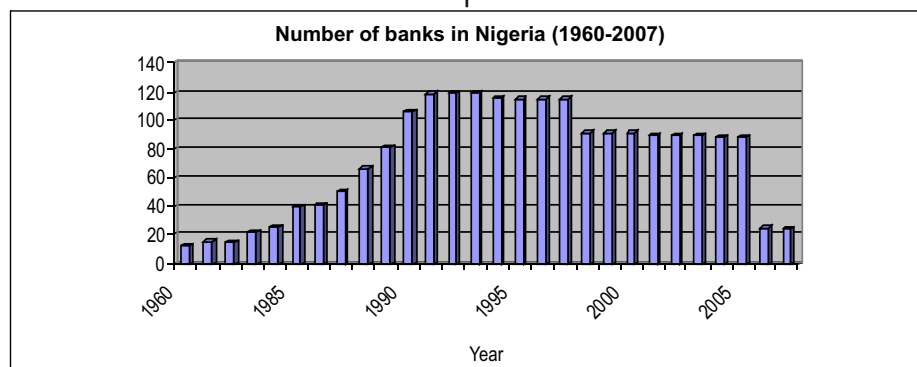


Table 1: VALUE OF MONEY MARKET INSTRUMENTS (=N=b)

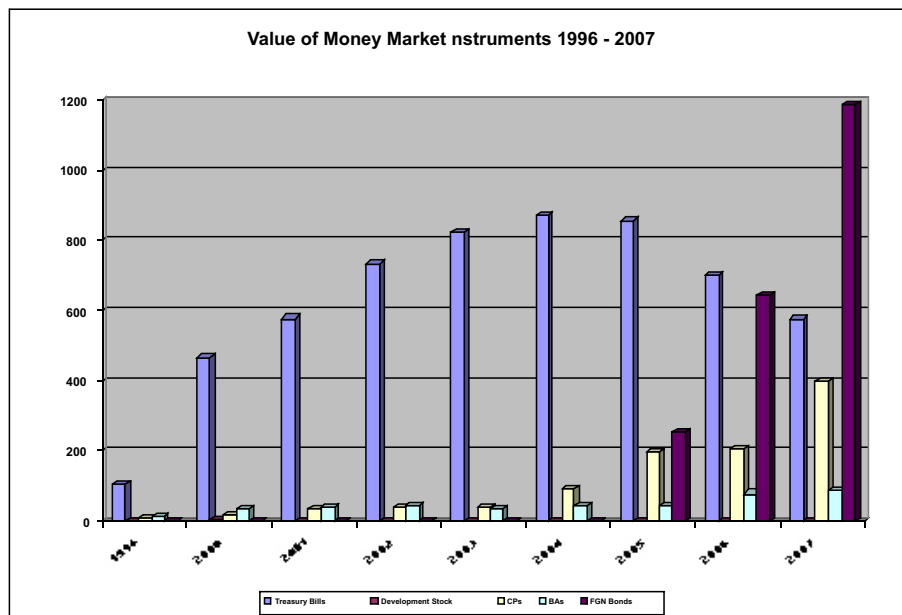
Year	T bills	EDS	Cert. of Deposit	CPs	BAs	FGN Bonds	Total
1996	103.33	0.00	0.10	8.02	12.20	0.00	123.65
1997	221.80	0.00	0.00	13.60	12.00	0.00	247.40
1998	221.80	0.79	0.00	7.25	17.47	0.00	247.31
1999	361.76	0.95	0.00	20.48	11.97	0.00	395.16
2000	465.54	2.41	0.00	19.00	31.77	0.00	518.72
2001	578.54	1.83	0.00	35.38	36.50	0.00	652.25
2002	733.76	1.63	0.00	37.14	42.62	0.00	815.15
2003	825.10	1.47	0.00	37.30	32.90	0.00	896.77
2004	871.58	1.25	0.00	88.83	41.62	0.00	1,003.28
2005	854.83	0.98	0.00	194.59	41.12	250.83	1,342.35
2006	701.40	0.72	0.00	204.6	78.50	643.94	1,629.17
2007	574.90	0.62	0.00	400.8	87.60	1186.19	2,250.11

Source: 2007 CBN Statistical Bulletin and Annual Report and Statement of Account.

1996, treasury bills have consistently constituted the bulk of the total value of money market assets. With the re-introduction of the FGN Bond in 2003, bonds have also contributed largely to the total value of money market assets.

Relative to the size of the economy (as measured by the GDP), money market assets grew from 3.0 per cent in 1996 to 9.8 per cent at end-2007. As a percentage of Currency in Circulation (CiC), money market assets grew from 98.1 per cent in 1996 to 234.2 per cent in 2007. The same trend is observable for the growth of money market assets relative to Quasi-Money (QM), as this proportion grew from 86.6 per cent to 100.0 per cent by end-2007. Relative to total demand deposits, the value of money market assets grew from 129 per cent in 1996 to 195.5 per cent in 1999, but fell to 122.9 per cent in 2007. Another useful measure of the performance of the banking sector is the extent to which it is able to promote banking habit usually captured by the currency ratio (ratio of currency outside banks to broadly define money supply). Between 1970 and 1980, there was a steady decline in this ratio from 36.0 per cent to 22.1 per cent, reflecting increased patronage of the banks. The ratio rose to about 25 per cent during the early 1980s but started to decline again by 1984 until 1989 when it resumed its upward trend. The upward trend coincided with the period of several distresses in the banking sector, with the accompanying general loss of public confidence in the banking system. By 1994, the ratio rose to 34.2 per cent, about the level recorded in 1970. With the distress resolution and the gradual restoration of confidence in the banking sector, the ratio declined again to 29.81 per cent in 1998, 26.65 per cent in 2000 and further to 15.2 per cent in 2007 partly reflecting the impact of the increased use of electronic and other forms of payments, particularly ATM and other card products.

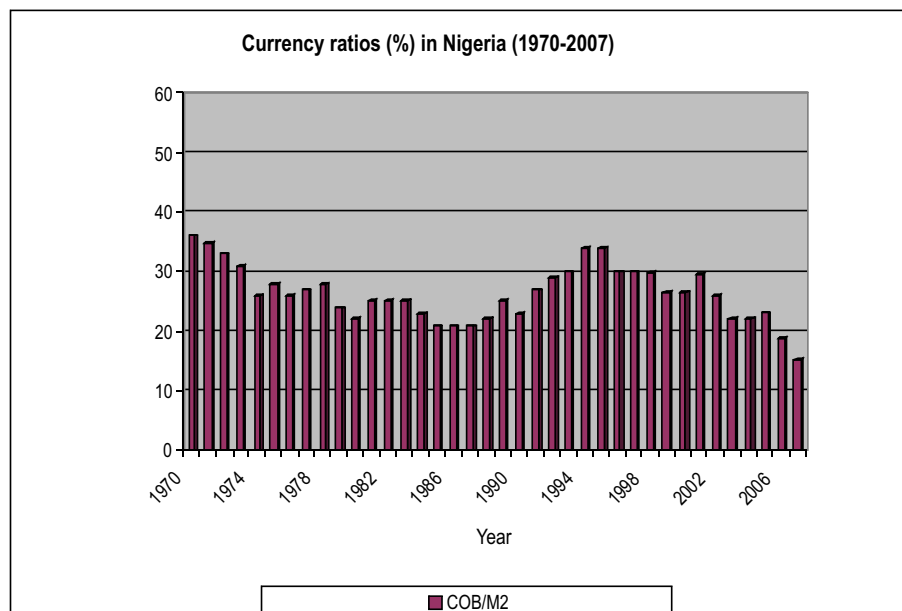
A major function of banks is the mobilization of savings for financing investment. Between 1970 and 1987, there was a significant increase in savings mobilization as reflected in savings to GDP ratio which



Relative Size of Nigeria's Money Market (1996 - 2007)

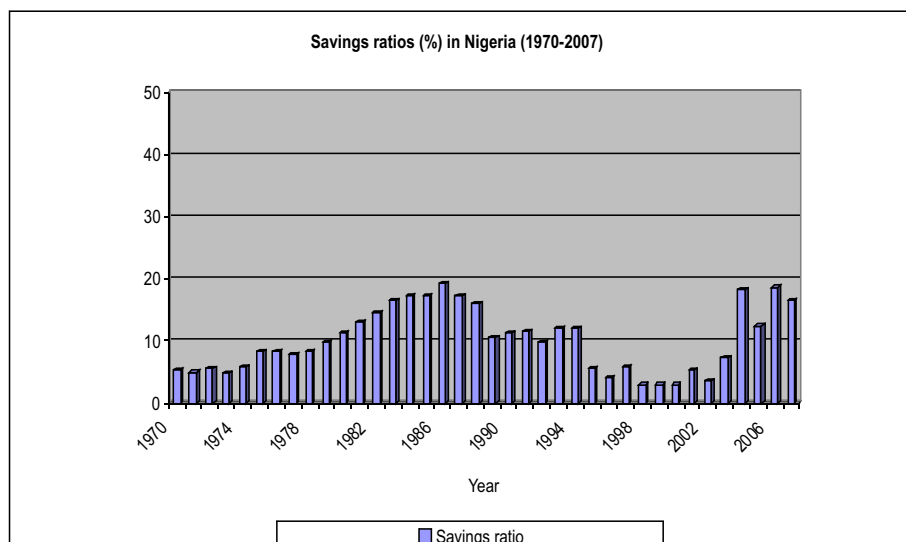
	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
MMA/GDP (per cent)	2.99	5.75	6.03	8.23	7.57	7.67	8.35	8.85	8.59	7.71	8.8	9.9
MMA/CiC (per cent)	98.11	170.79	143.47	189.47	167.06	134.08	143.93	178.54	183.82	178.72	209.1	234.2
MMA/QM (per cent)	86.55	153.53	119.44	128.86	130.22	108.39	102.05	118.05	107.54	105.38	93.65	100.0
MMA/DD (per cent)	128.95	197.23	173.86	195.48	150.35	120.76	132.30	155.23	137.71	121.28	130.95	122.87

Source: CBN Statistical Bulletin, 2006 and CBN Annual Report, 2007.



maintained an upward trend in the 1970s through early 1980s, rising from 5.5 per cent in 1970 to a peak of 19.1 per cent in 1986. Thereafter, it trended downward to 3.0 per cent in 1998, lower than that attained over twenty years ago (Table 7.7). It

however rose to 5.3 per cent in 2001 and 16.4 per cent in 2007. The lack luster performance of the 1990s was largely attributable to the distress situation in banking sector and consequent loss of confidence in the sector.



5.0 CHALLENGES FACING THE NIGERIAN MONEY MARKET

Among the biggest challenges of the Nigerian Money market is the creation of a highly liquid market in which investors can buy and sell with relative ease, where large transactions are consummated without significant changes in prices. This becomes necessary, given the backdrop that well informed international investors generally consider the level of a market's liquidity before investing in such a market. They will only consider a market which provides ease of entry and exit. Situations where the central bank needs to withdraw liquidity from the system in a systematic and structural way (hereafter referred to as structural liquidity surplus) have complicated monetary policy or interfered with its transmission in countries with shallow market. A structural liquidity surplus may build up due to capital or foreign aid inflows or export booms in commodity-producing countries, leading to an increase in international reserves. In particular, when the volume of transactions in the markets is not commensurate with the size of the central bank's operations, liquidity absorbing capacity of money market operations have led to overshooting and volatility of interest rates. At times, the inability of the central bank to undertake effective monetary policy actions to deal with excess liquidity has resulted in excessive domestic lending or pressures on the exchange rate. More broadly, excess liquidity has blunted the impact of changes in monetary policy on interest rates and bank lending, and liquidity absorbing

monetary operations has had little impact on interest rates, credit conditions, or bank lending.

Weak domestic payment systems have also hindered efficient liquidity management and have obstructed the development of money markets. Most notably, the difficulty encountered by the banks in tracking their position at the central bank has encouraged maintenance of large excess reserves to meet settlement contingencies, and it has discouraged inter-bank trading. Therefore, short-term rates have been slow to respond well to changes in liquidity conditions resulting from the central bank's monetary operations, and the central bank has encountered difficulties in managing liquidity in the system.

Also, the absence of efficient and cost effective systems for transferring ownership of the securities traded in the secondary market, or the funds to pay for them has obstructed market development or repurchases transactions. In turn, the lack of a repurchase framework has delayed the introduction of collateralized lending in the inter-bank market, therefore helping back inter-bank trading, particularly when there has been limited trust between participants.

In comparison with money markets of developed economies, the depth of the Nigerian money market still needs further restructuring. There are not enough investment outlets in the market. The appropriate legal framework needs to be put in place for the smooth introduction and

operation of existing and new products. There is therefore the need to further empower the regulatory institutions (such as CBN) to enable them check and nip in the bud any perceived or potential irregularity that may arise as a result of the introduction of new products or in the transaction of the existing ones.

However, prospect of the Nigerian Money market is very bright. It has, among others, the potential to attract more investors into the economy. A money market that is perceived by investors as vibrant, well-regulated and rewarding in terms of return on investment would easily attract foreign participants. In the bid to attract more foreign capital into the Nigerian money market, there is the need to improve on our market indicators. As improvement in our market float, the volume of trading and market liquidity etc would go a long way in arriving at better market indicators when compared on a global basis. The pension fund and other reforms in the economy also offer very bright prospects for the money market.

In the bid to catch up with global developments and improve the quality of their service delivery, Nigeria banks have no doubt invested much on technology: and have widely adopted electronic and telecommunication networks for delivering a wide range of value added products and services. The money market, as the citadel of the private sector can render financial services capable of revamping a nation's economy. But for it to render such services with optimal efficiency, the assistance of government is needed in the area of fiscal policies and provision of efficient infrastructure, telecommunications and investment incentives. For the entire system to function properly, therefore, fiscal policies and incentives that can stimulate both investors and users of long-term funds should be put in place by government. It is important to note that the place of the money market as a catalyst for Nigeria's socio-economic development will remain more significant in the years to come, as it helps to support national growth and development. The money market should, therefore, be accorded a pride of place in national economic management.

6.0 CONCLUSION

The Nigerian money market is still developing. There is thus a lot to be done to improve the market, since it mirrors and records the economic pulse of the nation. It also influences economic development. It is therefore vital for the CBN not to relent in its efforts to continuously revolutionize

the Nigerian money market and bring it to world standards. Only then will the market be able to serve not only local needs, of the Nigerian economy, but also external first, the West African sub-region, regional and continental level. To achieve this lofty goals all hands must be on deck. This includes not only the monetary authorities, but, in addition, all

participants in the market, notably, the DMBs, discount houses, FCs, businesses and individuals. The instruments too should be part of the process. It is worthy of note that the dominant role of the NTBs and government in the money market signals a dire need for change, to make the money market more private-sector-led.

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