Special Remarks

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It is my honour and pleasure to make this Special Remark at the opening ceremony of the annual Executive Seminar jointly organised by the Research and Human Resources Departments. The theme of this year's Seminar "Global Capital Flows, Financial Markets and Macroeconomic Stability" could not have come at a more appropriate time, as Nigeria witnesses huge capital inflows. The Seminar will therefore provide the opportunity for Executives of the Bank, to engage in productive exchange of views and ideas on the subject, and to reflect on both the positive impacts and the inherent risks.

Let me observe that globalisation driven largely by deregulation, liberalisation and advancement in information and communication technology has led to integrated financial markets and high capital mobility. Recently, the development has manifested in surge of private capital flows from advanced economies to developing, emerging markets and transition countries. Indeed, the major challenge is that of understanding the drivers of capital flows and the effects of its sudden surge or reversal on the financial markets and the macro-economy. A key issue is whether or not capital flows are mainly driven by a country's strong economic fundamental and, thus are likely to remain stable over time or are primarily driven by rent-seeking in the form of arbitrage.

Distinguished ladies and gentlemen, although the philosophy behind global capital flows is a desirable one, they can also pose serious risks. They could be volatile and large, relative to the size of a country's financial markets or economy. This can lead to booms and busts in credit or asset prices and make countries more vulnerable to contagion from global instability. Volatile capital flows can also affect the liquidity in the domestic financial system. Given that capital inflows normally lead to an appreciation in both nominal and real exchange rates, attempts by monetary authorities to intervene and resist appreciation entail accumulation of foreign reserves. Domestic liquidity may also increase if the intervention is not fully sterilized. This then causes an increase in liquidity flows into asset markets and, hence, asset prices may surge and exert inflationary pressure in the domestic economy.

Distinguished participants, free flow of capital contributes to the growth prospects by moving capital from where it is to where it is most efficient through the activities of the financial markets. An important element in the development of

the financial market is macroeconomic stability. Sustainable growth, low inflation, steady employment growth, low levels of unemployment and a balanced public finance are indicators of macroeconomic stability. Excessive volatility in these variables might impair the distribution of income and assets, and reduce societal welfare.

Excessive capital inflows may also produce undesirable macroeconomic effects, particularly short-term capital such as portfolio funds, which are easily reversed and tend to follow the boom-bust cycles. Large volatility and substantial exchange rate movements constitute an important channel through which portfolio flows can potentially have an adverse impact on the domestic economy. During a boom cycle, surging inflows often lead to significant