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WILL CBDCS SAIL OR SINK?

CLEARING THE FOG: PROFIT VS RIBA (INTEREST)

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CONTENTS

EDITOR'S NOTE 04

GLOBAL 05

WILL CBDCS SAIL OR SINK?

When the cryptocurrency craze hit the world, currency regulators – Central Banks around the world – feared that their worst fears had been actualized. A currency they had no control over had been created, giving people an alternative to fiat currencies.

AFRICA 07

AFRICA: THE PANDEMIC'S DEBT LEGACY

Money begets money. That is the logical justification for debt accumulation. The pursuit of economic prosperity or at least survival amidst limited economic growth explains why countries borrow.

FINANCE 10

CLEARING THE FOG: PROFIT VS RIBA (INTEREST)

Islamic finance is understood to be an interest-free, alternative mode of financing. However, this connotation does not necessarily mean its instruments are not able to generate meaningful returns (not interest), contrary to the view of getting only what you invest with zero returns.

AFRICA 12

AFRICA: MAXIMIZING REMITTANCES FOR DEVELOPMENT

For many people living in least-developed countries (LDCs), the dream is to seek greener pastures in developed countries where they can enjoy decent living conditions and earn more to improve their standard of living.

EDITOR'S NOTE

With less than two months to the end of the year, I am sure many people are already taking stock of their achievements or learning points for the year. But stock or no stock, we move gallantly!!! November is a month of deals and ridiculous discounts, as some businesses offer month-long promotions in commemoration of black Friday. A foodie like myself can be nothing short of excited at the thought of cheap grubs, especially since restaurants are probably the last group of businesses to return to normalcy after the pandemic.

It has been quite a recovery year for all sectors globally, but the upbeat momentum may have peaked. The IMF, in its quarterly World Economic outlook publication in October, cut its expectation for global growth in 2021 amid supply-demand mismatches and inflation. This suggests that the strong annual numbers seen in Q2-2021 are never to be seen again, at least until the next black swan event hits. One thing that is however not cooling is the cryptocurrency space. The price of bitcoin hit a fresh all-time high, for the first time in more than six months, amid fervor for the blockbuster debut of the first-ever bitcoin futures exchange-traded fund - ProShares Bitcoin Strategy ETF. Central banks are also not relenting on their efforts to introduce regulation in the space through their digital currencies. In view of this, I examined the feasibility of central bank digital currencies (CBDCs) in the current monetary framework in **Will CBDCs sail or sink?** (Page 05).

In **Africa: The pandemic's debt legacy** (Page 07), I also shone my torch on debt again amid renewed concerns of hidden debt in the Southern Africa region. **Ileri Adeoye**, a budding Economist, weighed in on how African countries can maximize remittances for development (Page 12) while an Islamic Finance expert, **Habeeb Gbenle** attempts to clear the fog that has blurred the difference between profit and interest Page 10).

As always, questions, comments and suggestions are welcome at info@mosopearubayi.com, and I will do well to respond as promptly as I can. Remember black Friday is only a few weeks away, make the most of it – even though I am aware most Nigerian vendors just inflate their retailing prices to make up for discounts offered.

Do have a drama and violence-free November.

Cheers.

Mosope Arubayi

WILL CBDCS SAIL OR SINK?

BY MOSOPE ARUBAY1

When the cryptocurrency craze hit the world, currency regulators – Central Banks around the world – feared that their worst fears had been actualized. A currency they had no control over had been created, giving people an alternative to fiat currencies. As cryptocurrencies gained increasing popularity in countries around the world, especially populous ones like Nigeria and China, regulators swung into stringent action, banning local banking institutions from dealing in and facilitating payments for crypto exchanges. However, the rage for cryptocurrencies could not be ignored and Central Bank Digital Currencies (CBDCs) were born.

If the sprint started in 2021, the Bahamas jumped the gun, as the country pioneered CBDCs with the launch of the Sand Dollar, which was pegged to the US dollar. China led the 2021 sprint with the launch of the e-yuan in April and has since conducted multiple trials in preparation for full take-off in 2022. Four months after Nigeria's crypto ban was announced, the government announced plans to introduce the e-Naira to be launched on the country's independence anniversary in October. Although delayed by a few weeks, the e-Naira was eventually launched in late October.

The digital currency's performance so far has done nothing to taper skepticism about its prospects as a perfect substitute to physical notes. Nigeria's CBDC pilot is now the second-largest - behind China's digital yuan - and aims to digitize payments and increase financial inclusion in Africa's most populous country. Other African countries in the race include Ghana, South Africa, Kenya, Tanzania, and Rwanda. Although progress levels in the latter countries are unknown, the future pursuit of this model by other African countries hinges on the success of the two frontrunners – Nigeria and Ghana.

CBDCs are a welcome development since we know that technology is here to stay as innovative twists to the legacy financial regulation model can help to address issues that have long inhibited perfect financial inclusion in various countries.

CBDCs combine the power of blockchain technology with the power of regulatory oversight to monitor financial activities. This, however, is the major argument against CBDCs according to critics. To many, the beauty of blockchain lies in the decentralized system it operates on, which makes it impossible for a single entity to control or regulate the system.

At the end of the race to launch CBDCs, central banks expect economic rewards in form of increased financial inclusion among the populace, improved transparency in transactions to allow them to tackle economic crime and fraud, reduction in transaction costs through the elimination of financial intermediaries from transactions especially remittances, improved liquidity by allowing faster transaction speeds especially for cross-border transactions. Cumulatively, these benefits are expected to boost a country's GDP if rapid adoption is achieved in the next 10 years.

While CBDCs offer a complement to the legacy money supply model of central banks, concerns remain about the stability of the system they are built on, The ability of countries – especially LDCs – to maintain such systems, and the ever-present threat of cyber security. However, the benefits seemingly outweigh the risk as more regulatory banks globally jump on the digital currencies wagon. It is safe to say that money is evolving yet again, and only time will tell if CBDCs will sail or sink.

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AFRICA: THE PANDEMIC'S DEBT LEGACY

BY MOSOPE ARUBAYI

Money begets money. That is the logical justification for debt accumulation. The pursuit of economic prosperity or at least survival amidst limited economic growth explains why countries borrow. Debt is considered a stimulant – borrow, invest in productive activities, and reap the benefits of growth. However, as countries emerge from the troughs of the pandemic-induced spending spree, an enormous debt overhang threatens the economic health of countries for years to come.

The recent International Debt Statistics report published by the World Bank underscored the significant increase in debt levels across all geographical regions in 2020. The report which covered data from 123 low and middle-income countries showed that net financial (debt and equity) flows to low-and middle-income countries fell for the second consecutive year in 2020 to $909mn, with China accounting for over half.

Over the past decade, almost 60% of net aggregate financial flows to low- and middle-income countries from external creditors and investors have gone to China. China has become

not only low- and middle-income countries' largest borrower, but also the group's largest creditor as the country's rapid economic growth over the past two decades has propelled overseas lending. China extends loans to low- and middle-income countries on concessional and non-concessional terms.

Many LDCs have become increasingly dependent on non-concessional loans extended by Chinese policy banks - the China Development Bank, and the Agricultural Development Bank of China - through bond issuance in the domestic (CIBM) and international capital markets. Low- and middle-income countries' combined debt to China was $170bn at the end-2020 - more than three times the comparable level in 2011 -, just shy of $177bn owed to the IDA.

Most of the debt owed to China relates to large infrastructure projects and operations in the extractive industries. Countries in Sub-Saharan Africa accounted for 45% of end-2020 obligations to China. The situation is worsened by concerns that the true size of indebtedness to China remains is questionable in some countries, due to debt transparency problems. Cases of hidden debt in countries like Mozambique, DR Congo, and Zambia, further aggravate the debt crisis facing these countries.

Debt sustainability is out the window, gloomy days lay ahead post-pandemic as a debt crisis looms, and we may not know the true extent of debt burdens due to transparency concerns

Debt sustainability is out the window, gloomy days lay ahead post-pandemic as a debt crisis looms, and we may not know the true extent of debt burdens due to transparency concerns. The scheduled expiration of the DSSI debt service suspension period at the end of December 2021 increases the urgency for countries to promptly manage their debt levels. However, despite the grim scenario, all hope is not lost for LDCs that rely heavily on debt to sustain the economy. Great economies have been built on debt – case in point, the USA and China. But structural bottlenecks that inhibit the productive use of debt must be eliminated in the short run.

Going forward, strong debt management strategies must be developed and implemented to achieve long-term debt sustainability, as the world grapples with multiple waves of the virus and debt levels remain bloated. Comprehensive, accurate, and clear data are the cornerstone of result-bearing economic policies. As such, holistic data is required to shape the solutions that would taper debt-induced fiscal pressures in the coming years. Transparency scores countries some goodwill points in the international market, improving investors' trust in the administration and management of funds.

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CLEARING THE FOG: PROFIT VS RIBA (INTEREST)

BY HABEEB GBENLE

Islamic finance is understood to be an interest-free, alternative mode of financing. However, this connotation does not necessarily mean its instruments are not able to generate meaningful returns (not interest), contrary to the view of getting only what you invest with zero returns. This alternative mode of financing has left people wondering about how returns are generated, if not based on interest. In Islam, money is not recognized as the subject matter of trade and it has no intrinsic utility; it is simply a medium of exchange. Each unit of money should be equal to another unit of the same denomination, therefore, there is no room for making a profit through the exchange of these monetary units.

Profit is generated when something of value or with intrinsic utility is traded or sold. Fundamentally, interest is simply making money from money and any profit earned through dealing in money (of the same currency) or the papers representing them is called **interest**, hence prohibited. To corroborate this point, Aristotle in his words had said that **money was barren, and that to derive interest from lending it out was to put it to unnatural use**. Therefore, attempting to clear the fog, the proof of this confusion can be traced to more than 1400 years ago where Allah says in Q2 v 275 that "**Because they say, trade is**

like riba (interest)...But Allah forbids riba (interest) and permits trade." This verse did not just confirm the difference but also debunks attempts in proving their similitude.

Basic economics teaches us that there are four factors of production which include land, labour, capital, and entrepreneurship, and their factor payments are rent, wages, interest, and profit respectively. With this clarity, one might wonder why we have these confusions between interest and profit. The reason for this is not far-fetched as it was known that even great economists, just like1400 years ago, also fell into this error. Capitalistic economists like Adam Smith, Ricardo, Boehm-Bawerk, John Stuart Mills, Irvin Fisher, have at one point or the other, misused the word 'profit' in place of 'interest'. Even Samuelson who is deemed as one of the most competent in the field of economics declared that there is virtually no difference between profit and Interest.

With this, it should be clear that these great economists had a thorough grasp and understood the concepts of profit and interest but for some subjective reasons, they have unconsciously blurred the distinction between profit and interest, bringing us into this resultant consequence of interchanging these two concepts. In all, most economists have conceded to the fact that the theory of interest has for a long time been a weak spot in the science of economics.

On the other hand, the Islamic economic principle opines that capital and entrepreneurship are embedded together to generate a factor payment in profit as opposed to the capitalist view of rewarding capital with interest and entrepreneurship with profit. Every capital contributed (in the form of money) into a commercially viable enterprise assumes the risk of loss and is therefore entitled to a proportionate share in the actual profit. In this manner, 'capital' is deemed an intrinsic element of 'entrepreneurship', so far as the risk of the business is concerned. Therefore, instead of a fixed return as interest, it derives profit.

From an Islamic finance standpoint, the institution of interest is reprehensible, and we must stop confusing it with other economic categories. To achieve shared growth, stability, and distributive justice, the boundaries between profit and interest need to be visually adhered to, and perhaps clearer policies can begin to emanate to achieve the desired socio-economic objectives.

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AFRICA: MAXIMIZING REMITTANCES FOR DEVELOPMENT

BY ILERIOLUWA ADEOYE

For many people living in least-developed countries (LDCs), the dream is to seek greener pastures in developed countries where they can enjoy decent living conditions and earn more to improve their standard of living. In typical trickle-down fashion, once a level of comfort is attained, the next line of action is improving that of their relatives in their home countries. In doing this, migrants remit funds to their home countries.

This narrative plays out in many developing countries where an increasing percentage of the population relies on remittances for support. Last year, although the global economy was crippled by the unexpected advent of the pandemic, remittances to LDCs to countries in Latin America and the Caribbean, South Asia, and the Middle East, and North Africa (MENA) regions still increased by 6.5%, 5.2%, and 2.3% respectively. However, foreign remittances to East Asia and the Pacific, Europe and Central Asia, and Sub-Saharan Africa (SSA) declined by 7.9%, 9.7%, and 12.5% respectively. In 2020, the top five remittance recipients were India, China, Mexico, the Philippines, and Egypt. India has been the largest recipient of remittances since 2008. As a share of gross domestic product (GDP), by contrast, the top five recipients in 2020 were smaller economies including Tonga, Lebanon, Kyrgyz Republic, Tajikistan, and El Salvador. This highlights the significant role remittances play in the development of LDCs.

In the past year, fiscal stimulus in developed countries t

hat fast-tracked the recovery process, and policies to incentivize channeling remittances through official routes in receiving countries have supported remittance flows to LDCs. The increasing popularity of digital money transfer mechanisms, which has lower transaction cost has also contributed to the receipt of higher remittance transfers. However, despite the resilience shown even in the face of the pandemic, remittance flows are largely inhibited by a myriad of factors.

The increasing reliance on foreign remittances by LDCs has necessitated the need for policy strategies to increase inflows.

The official channels through which funds flow from migrants to recipients in LDCs, especially in African countries, have been unpatronized due to high transaction costs and rigorous foreign exchange transfer processes. As a result, informal channels are preferred to official remittance channels. Unfavourable tax policies further compound the problem in the formal channels. However, the informal channels are not flawless as high premium on the exchange rate and high risk of fraud also de-incentivize transfers.

The increasing reliance on foreign remittances by LDCs has necessitated the need for policy strategies to increase inflows. Liberalization policies, tax incentives, and special exchange windows are some routes that have been explored by LDCs including Bangladesh, Pakistan, and Egypt. Egypt's liberalization policies in 2016 have yielded higher inflows since then and catapulted the country to the top five group of recipients while Bangladesh and Pakistan's tax incentives supported inflows in 2020. To benefit from the increase in remittance inflows expected in the post-pandemic world, other LDCs may take a cue from these successful initiatives to boost inflows and support their growth objectives. In addition, reducing transaction costs and simplifying the transfer process are crucial to achieving this goal.

THE STOCK MARKET IS FILLED WITH INDIVIDUALS WHO KNOW THE PRICE OF EVERYTHING, BUT THE VALUE OF NOTHING

PHILLIP FISHER