GTBank

Guaranty Trust Bank plc
RC 152321

NIGERIA Macro-economic AND BANKING SECTOR THEMES FOR 2021

www.gtbank.com

NIGERIA
Macro-economic
AND BANKING SECTOR THEMES FOR 2021

This article presents our forecasts and opinions of the broad Nigerian macroeconomic and banking sectors trends that we expect would shape the economic landscape in 2021.

KEY THEMES / TRENDS FOR 2021 INCLUDE:

- Fiscal Policy and the 2021 FG Budget
- Total Debt Profile
- Interest Rate and Inflation
- Exchange Rate Policy, External Reserves and Capital Flows
- Oil Prices, Production and Security

REVIEW OF 2020

Celebrating Life

The *'Haka'* is a ceremonial dance of the Māori tribe of New Zealand usually performed in a group. It is characterized by energetic body movement, fierce facial expressions, and rhythmic loud chants. Māori mythology suggests that the *Haka* is a dance about the celebration of life. The most famous of many versions of the *Haka* is the *Ka Mate* which symbolizes the celebration of life triumphing over death and is performed by the New Zealand national rugby team, the All Blacks, before every match. When Covid-19 is long gone, may we gather in groups with our families and friends to dance the *Ka Mate* with all its passion and vigor.

As of the time of writing, Covid-19 had spread to over 220 countries, infecting about 103 million people with over 2.2 million fatalities. The pandemic inspired changes in the way we live and made 2020 a difficult year to forget. Asides the pandemic, 2020 was also a 'year of fire' as uncontrollable wildfires in Australia, Siberia, the Amazon and the West Coast of the US, reminded the world of the raging danger of climate change. Scientists argued that climate change also played a part in the worst locust plague in over 2 decades that swept through parts of East Africa and South Asia destroying crops and causing marked environmental and health challenges.

Moving to global politics, with Joe Biden sworn-in as the 46th President of the US, we are keen to see former President Trump's next move as his alleged part in inciting an insurrection of the Capitol Hill earned him an impeachment making him the first American president to be impeached twice. Biden's presidency is expected to represent, for many, a reassuring reset for an America significantly divided by the politics of President Trump.

Riding on the surge of bitcoin in 2020, China is set on making its currency, the Yuan, a dominant global currency with the launching of the world's first e-currency, the e-yuan. In a related development, most central banks are finalizing plans to launch their digital currencies to mitigate the raging threat of cryptocurrencies on fiat currencies and offer alternatives that could see people withdraw money from their bank accounts into their government-backed digital wallet. In the UK, the political weight of fishing came to bear as an entire section and several annexes were dedicated to fisheries in the Brexit trade deal agreed on Christmas Eve came to effect on January 1st, 2021. The Beirut port explosion resulting from the accidental ignition of over 2,700 tonnes of ammonium nitrate, coupled with the political instability and reeling effect of the covid-19 pandemic exacerbated an already dire economic condition in Lebanon. The death of George Floyd, a black man who died after a police officer knelt on his neck for almost 10 minutes, triggered massive protests against systemic racism and police brutality in the US; cascading into similar protests against injustice and corruption by government officials in several countries including Thailand, Bulgaria, Nigeria, etc. The sports world was thrown into mourning by the deaths of US basketball legend Kobe Bryant and Argentine football legend Diego Maradona; events that opened and closed the year. Health workers all over the world earned the super-hero title as they, not only worked round the clock to save lives and bring the pandemic under control but also battled to stay alive being endangered themselves.

Economically, the pandemic-induced lockdowns and movement restrictions disrupted international trade and impacted investment and human capital. This led to a collapse of global economic activity and drove many economies into a recession. The World Bank estimates that the global economy would have contracted by 4.3% in 2020 but opines a 4.1% expansion in 2021 predicated on proper pandemic management, accelerated and effective vaccination and improved monetary policies.

In Emerging Markets and Developing Economies (EMDEs) where it is estimated that a minimum of 10-year gains in per capita income had been eroded in 2020, the World Bank projects an expansion of about 5% in 2021 on the back of improved external demands, curtailed pandemic spread and better-than-expected recovery in China. Excluding China, projected growth is expected to slow to 3.4% as most EMDEs went into recession in 2020.

The spread of the virus in Sub-Saharan Africa (SSA) has been lower-than-expected despite the region's relatively weaker healthcare systems and huge informal sector players. The lower number of cases relative to prediction has been ascribed to the region's pre-dominantly young population who seem less vulnerable to the pandemic. There are however concerns that the true impact of the pandemic might be understated owing to inadequate testing capabilities and inaccurate monitoring of Covid-19 related illnesses and fatalities. The World Bank expects that the region shrunk by 3.7% in 2020 but projects a 2.7% growth in 2021 predicated on improved economic activity in the region's largest economies (Nigeria, South Africa, Angola, etc), resumption of tourism activity in some countries, higher international prices for agricultural exports, acceleration in investment (especially foreign direct investment) and the implementation of the African Continental Free Trade Area (AfCFTA) agreement. The region-specific downside risks to this projection include lower-than-expected growth in the region's key trading economies, lingering adverse effects of the pandemic, delayed distribution of the vaccines, additional lockdowns, muted investments and further delay in implementing AfCFTA.

Generally, the worst-hit countries will include those with a heavy reliance on services and tourism, relatively large domestic outbreaks of the covid-19 pandemic as well as those dependent on industrial commodity exports that suffered a sharp decline in demand. A related concern is the growing debt crisis arising from rising financial deficits occasioned by the increased government borrowings amidst plummeting revenues.

Nigeria

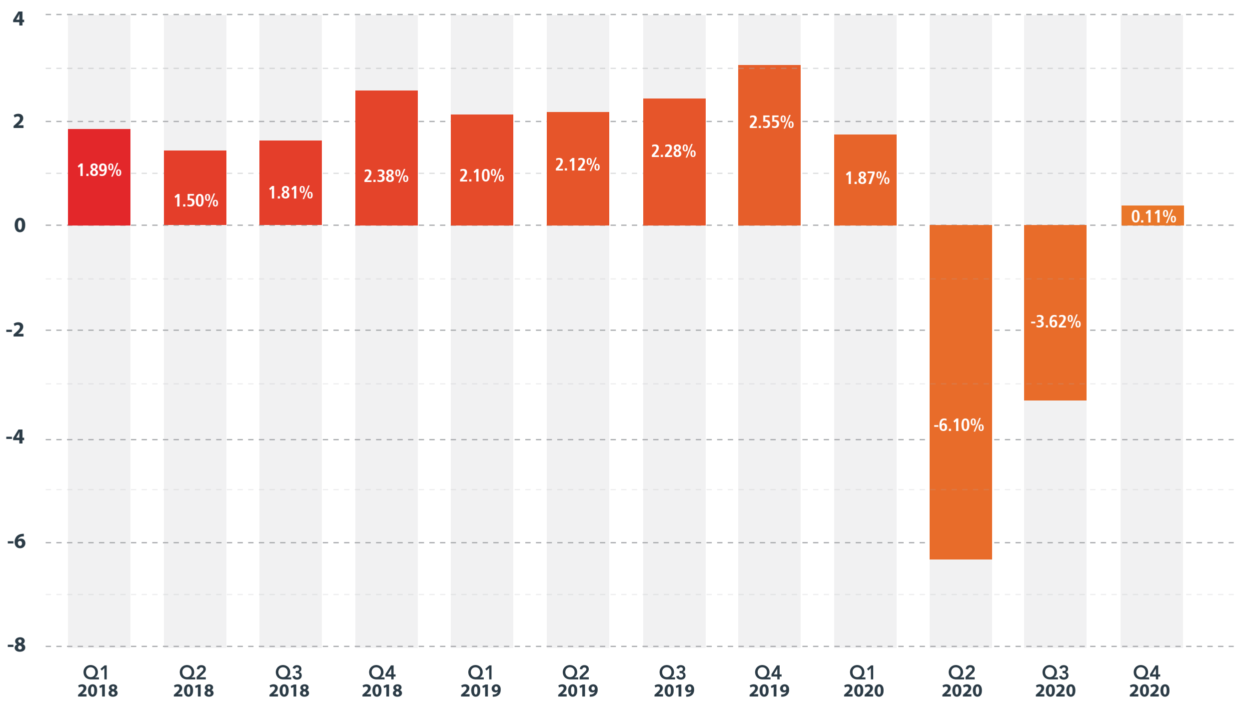
Aside the devastating impact of the covid-19 pandemic which triggered health and economic challenges, the aftermath of the peaceful #ENDSARS protests across the country by youths lending their voices against brutality and high-handedness of the Special Anti-Robbery Squad (SARS) of the Nigerian Police Force (NPF) cast a dark shadow on the year 2020. Relatedly, the deteriorating security situation amplified calls for a change of guard of security chiefs in the country. In his 2021 New Year message, whilst reassuring the youths of his administration's commitment to fulfilling their 5for5 demands and reforming the NPF, President Buhari also revealed plans to re-energize and re-organize the security apparatus and personnel of the security agencies to enhance their capacity to subdue criminal and extremist groups in the country. In line with his promise, President Buhari replaced the service chiefs, in January 2021.

The prolonged lockdown in Lagos, Ogun and Abuja as well as widespread movement restrictions in most states in a bid to flatten the curve of the covid-19 pandemic in Q2 2020 triggered a downturn in economic activities which led to a contraction in 16 of the 19 economic sectors according to the National Bureau of Statistics (NBS) GDP Q2 2020 report. This coupled with the decline in price and demand for oil resulted in negative growth in two (2) consecutive quarters of -6.10% and -3.62% in Q2 and Q3 2020 respectively compared to 1.87% and 2.55% growth in the preceding quarters of Q1 2020 and Q4 2019 respectively. While the economy recovered into growth territory of 0.11% in Q4 2020 as a result of yuletide spending and relative improvement of economic activities, the annual GDP for 2020 contracted by 1.92%.

With the recovery of oil prices, the discovery of effective Covid-19 vaccines coupled with a pick-up in economic activities, we project that the economy will expand by 1.8% in 2021. We note the federal government's plans to rebase the country's GDP through the commencement of the National Business Sample Survey (NBSS). This is in line with the United Nations Statistical Commission's recommendation of GDP rebasing every five (5) years. The process of rebasing involves replacing an old base year with a more recent one. The last rebasing was done in 2013 where the government replaced the base year from 1990 to 2010 data which resulted in an 89% growth in GDP from US$270 billion to US$510 billion. This planned rebasing would replace the 2010 data with the more recent 2018/2019 data. We expect this exercise to drive the Inclusion of some economic activities in the computation framework and back-casting to recompute GDP estimates for prior years. We anticipate the rebasing exercise to have a positive impact on the country's GDP numbers and related metrics. The rebasing exercise Is expected to be completed in 2022.

.

GDP growth



Source: NBS

Some other prospects of macro-economic importance in 2021 include:

Business and Regulatory Environment

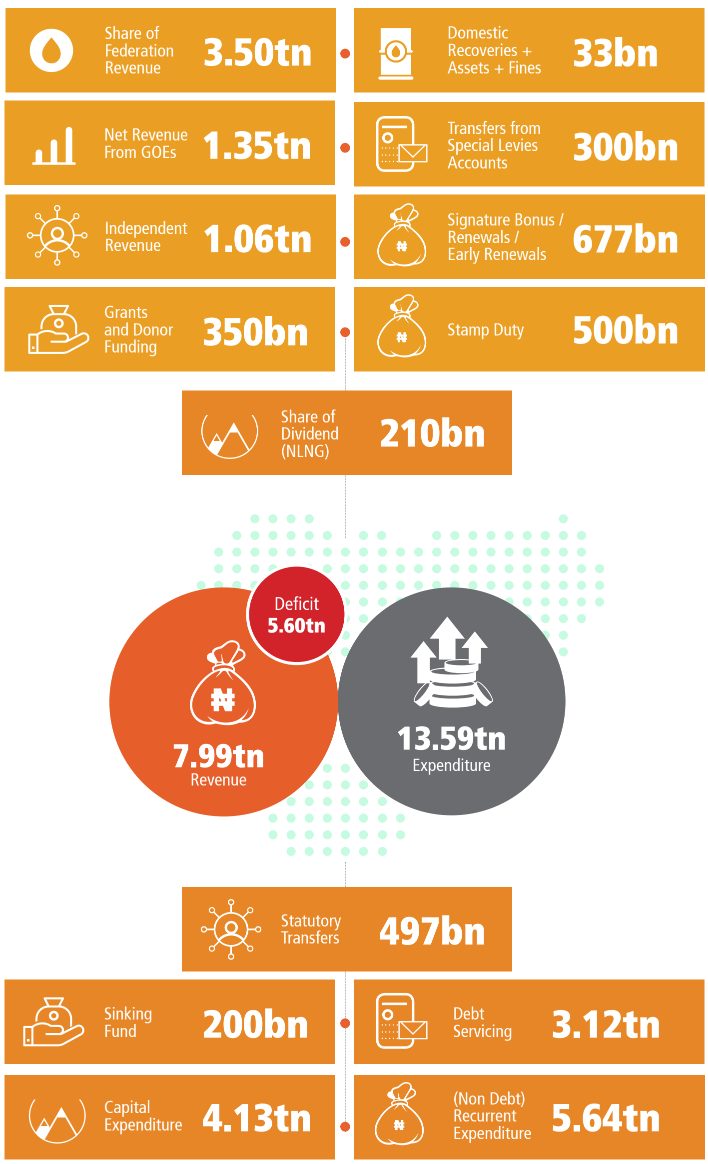
The business environment came under significant pressure due to negative GDP growth and the crash in oil prices. A combination of rising double-digit inflation and the general increase in utility cost weighed negatively on household incomes and business operations. Despite these challenges, the Nigerian equity market was the toast of investors as it emerged as the world's best-performing stock market in 2020 with a growth of 50%. We anticipate a slight improvement in the operating environment arising from a possible increase in FX liquidity, better understanding of and management of the spread of the virus and increased government spend.

We expect the monetary thrust to be relatively accommodative with the primary focus of monetary authorities maintained on spurring growth, achieving exchange rate stability and improving FX availability.

Fiscal Environment and the 2021 Budget

Following the return to the January – December budget cycle in 2020, President Buhari signed the 2021 Appropriation Bill into law in December 2020. The budget dubbed 'Budget of Economic Recovery and Resilience' was increased by N505 billion from N13.08 trillion to N13.58 trillion by the National Assembly. The 2021 approved budget is 28.2% higher than the 2020 budget with a targeted revenue of N7.99 trillion, total expenditure of N13.59 trillion and an estimated deficit of N5.60 trillion. The deficit is projected to be financed with proceeds from privatization, drawdown of already approved loans and new borrowings. A total of N5.64 trillion and N4.13 trillion were earmarked for Recurrent and Capital Expenditure respectively. The estimates for debt servicing and statutory transfers stood at N3.12 trillion and N479 billion. Notably, debt servicing as a percentage of projected revenue and expenditure stands at 39.1% and 23%.

2021 Approved Budget Framework



Source: Ministry of Finance, Budget and National Planning

The 2021 budget is predicated on a benchmark oil price of US$40 per barrel (pb), oil production of 1.86 mbpd (including Condensates), exchange rate of N379/US$1, GDP growth rate of 3% and inflation rate of 11.95%. Save for the projected inflation rate, we note that these budget assumptions are in line with present economic realities. Following the introduction of finance bills to accompany annual budgets in 2019 in a bid to improve revenue through regular tax reforms, and encourage investment, the 2020 Finance Act introduced over 80 amendments to 14 various laws and became effective on January 1st, 2021.

Some notable changes contained in the Act include:

- Low-income earners that earn minimum wage or less, are now exempt from personal income tax.
- Telecommunications services provided in Nigeria will now fall under the category of goods liable for excise duties.
- Reduction of import duties on tractors from 35% to 5%, mass transit vehicles of more than 10 passengers and trucks from 35% to 10%, and cars from 30% to 5%.
- VAT exempt status for commercial airline tickets and lease of agricultural equipment for agricultural purposes.
- Establishment of a Crisis Intervention Fund (CIF) of N500 billion or other sums approved by the National Assembly.
- Setting up a sub-fund of the CIF to be known as Unclaimed Funds Trust Fund (UFTF) where unclaimed dividends and unutilized funds in dormant accounts outstanding for 6 years or more will be warehoused as a special debt of the government.
- Deleting of electronic bank transfer as transaction liable for stamp duties and introducing electronic money transfer levy of N50 on N10,000 or more on electronic transfer deposits in any financial institution.

We applaud the government's decision to exclude low-income earners from personal income tax payments as this will enhance the disposable income of that segment of the populace. Similarly, the reduction of import duties on select categories of vehicles should also help to reduce the prices of the referenced vehicles. However, the establishment of the Unclaimed Funds Trust Funds has raised questions about the constitutionality of abrogating such funds by the federal government. Some have argued that this specific provision may indicate the government's desperation and leaves a lot to be imagined for subsequent finance bills. It is not unlikely that the legality of the executive and legislative to enact such an Act could be challenged in a court of competent jurisdiction by civil society organizations in the coming weeks.

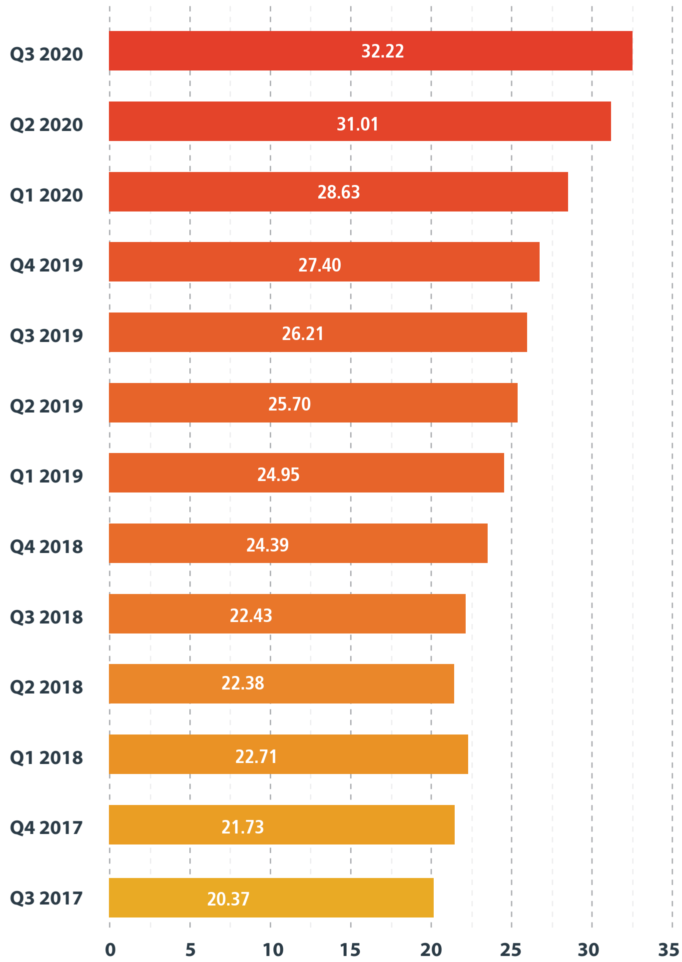
Nigeria's perennial non-oil revenue challenge has continued to undermine the government's diversification plans as mere lip service. In view of the economic and health impact of the pandemic, the revenue projections (especially the non-oil revenue) of the 2021 budget appears ambitious. That said, we applaud the government's decision to deregulate the price of PMS and are optimistic that the resulting cost savings would be used for other developmental projects.

Debt Profile

The global economy is facing a synchronized and ravaging economic crisis owing to the covid-19 pandemic. Global debt is projected to have soared to a record US$277 billion by the end of 2020 as governments and corporates continue spending to stem the impact of the pandemic. This has worsened the debt problems of developing countries as most of them entered the pandemic with high levels of debt. Consequently, the limited fiscal space aggravated the economic and social impact of the pandemic necessitating the need for increased borrowing, which further escalated the debt situation of the country. The latest data released by the debt management office (DMO) puts Nigeria's total debt stock at N32.22 trillion (US$84.6 billion) as of September 2020, representing a year-on-year increase of 22.9% from N26.21 trillion reported in September 2019.

In December 2020, the World Bank approved a US$1.5 billion loan as a five-year Country Partnership Framework (CPF) to help boost Nigeria's economy. Commenting on the loan approval, the World Bank Country Director for Nigeria, Shubham Chaudhuri, was quoted to have said "To realize its long-term potential, the country has to make tangible progress on key challenges and pursue some bold reforms. Our (the World Bank) engagement will focus on supporting Nigeria's effort to reduce poverty and promote sustained private sector-led growth". While we couldn't agree more with Mr. Chaudhuri, there are concerns about the utilization of these loans. Nigerians would expect that these funds are utilized for projects that will improve the living standards of the common man. Notably, total debt stock is expected to have increased to N34 trillion (in naira terms) when adjusted for the World bank loan and naira devaluation against the US dollars from N306 to N379.

Total Debt Profile (N' trillion)



Source: DMO

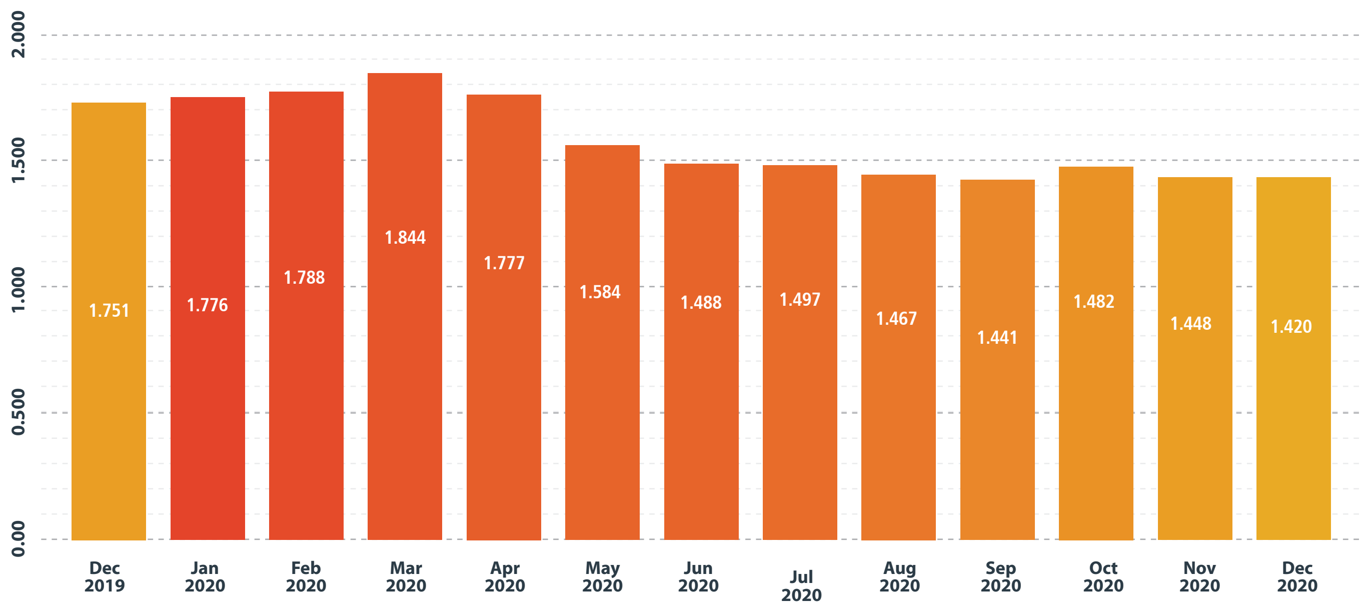
Oil Price and Production

In At the height of the pandemic outbreak in April 2020, oil prices slumped to their lowest in decades as Brent crude traded at a historic low of US$19 pb and the US WTI crumbled into negative territory at -US$37 pb. As countries eased lockdown and movement restrictions, oil demand increased. This coupled with OPEC's deal with allies to curb production output helped to spur the price recovery with Brent crude trading at US$51.09 pb on the first trading day of 2021.

The widespread distribution of effective vaccines has dissipated concerns that the second wave and outbreak of new variants of the pandemic will trigger a decline in oil prices and require further oil production cuts amidst fresh rounds of lockdowns and economic disruptions.

In line with OPEC+ production cut agreement, Nigeria's oil production is not expected to exceed 1.529 mbpd (excluding Condensates) for the January – April 2021 period. Thankfully, the oil price and production estimates used for the 2021 Budget are somewhat realistic and supportive of current price and production levels. Whilst we remain cautiously optimistic that the severity of the second wave would not result in economic downturns at levels witnessed during the first outbreak following the launch of various effective vaccines and better non-pharmaceutical knowledge and measures of managing its spread and impact, we are not oblivious of the negative impact that a further drop in price and/or production output will have on Nigeria's fragile economic recovery. However, China's impressive uptick in economic activities would be a net positive for oil prices. China being the second largest consumer of world oil, behind the US, accounts for over 14% of global oil demand.

Nigeria's Oil Production Volume (mbpd)



Source: OPEC

Another factor limiting oil demand is the increased pressure for cleaner energy and responsible investing which is accelerating the adoption of environmental social and governance (ESG) policies. Globally, investors and shareholders are subjecting oil & gas companies to various assessments regarding their plans to transitioning into more sustainable and cleaner energy using ESG factors.

The need for regulatory and legislative reforms in the Nigerian oil & gas sector cannot be overemphasized. We are optimistic that the passage of the, yet again, revised version of the Petroleum Industry Bill (PIB) by the National Assembly would attract investment into the sector. Notably, FDI into the Nigeria oil & gas sector has maintained a declining trajectory in recent years as the total capital inflow of US$6.6 million reported in Q2 2020 was the lowest the industry has recorded since 2015. While this dismal capital inflow can easily be attributed to the global economic downturn, the lack of a competitive regulatory and fiscal framework has been identified as the overriding cause of the progressive decline. We are encouraged by the commitment of the upper legislative chamber to the full passage of the PIB 2020 by the first quarter of 2021, at the latest. We believe that the enactment of the bill would improve the competitive landscape and change the fortunes of the sector.

That said, we expect Nigeria to continue to comply with the prevailing OPEC agreed cuts and expect oil prices to average US$50 pb levels in 2021. The downside risk of this outlook remains slower-than-expected vaccine distribution and the inability of governments to contain further spread of the virus.

Security

The deteriorating security situation has been attributed to overstretched security architecture, inadequate personnel and the absence of a well-articulated operational strategy for battling widespread insecurity in the country. The gruesome killing of 43 farmers in Borno, the kidnap (and eventual release) of over 300 boys of a Junior Secondary School in Kankara, Katsina, the increasing activities of bandits and gunmen in different parts of the country and several reports of kidnapping of citizens for ransom exacerbated the clamour for a change in the country's security strategy. The arson, burning and lootings of businesses, public infrastructure and police stations that followed the shooting of peaceful #ENDSARS protesters by security forces further dampened the already fragile security situation of the country.

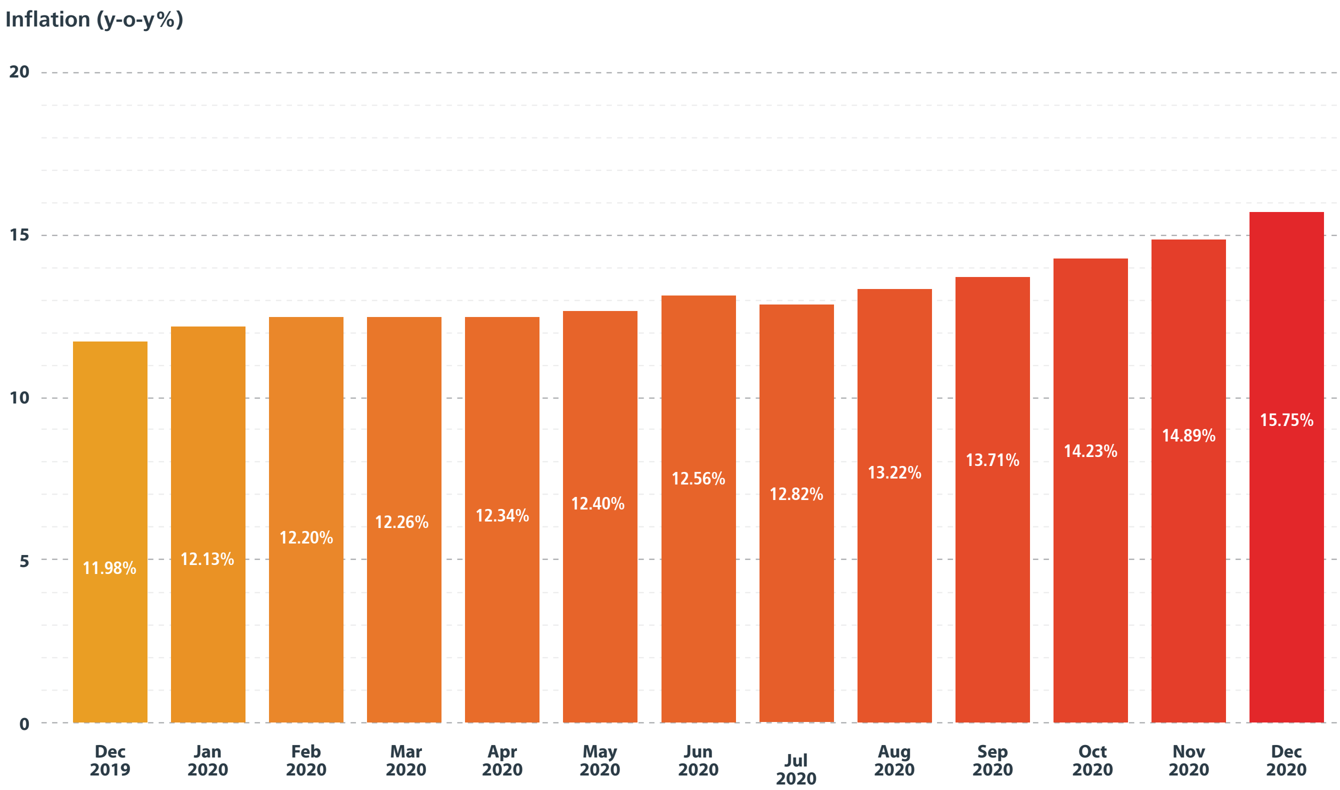
In a bid to strengthen regional security, combat kidnapping and killings and promote communal policing in the region, the South West Governors launched its regional policing outfit code-named Amotekun. This has prompted similar conversations in other regions, and it is not unlikely that these regions will tow a similar path in the near future. We note the need for improved security in the country but would rather a more central and coordinated approach to addressing it. There is an overwhelming need to overhaul the strategy of securing Nigeria to involve traditional rulers, religious leaders and citizens in day-to-day policing for improved intelligence gathering and communal policing. Notably, we commend and assess as a step in the right direction the recently launched community policing initiative of the NPF with N13 billion earmarked for the initiative and the recruitment of about 10,000 police constables to be deployed to their states of origin and country homes to serve.

We expect the government to broaden the conversations around police reforms to include reforms of the other military and paramilitary groups to promote and re-energize the country's security architecture with a view to ensuring that the right to safety and protection of every Nigerian is guaranteed.

Monetary Policy – Interest Rate and Inflation

As the economy struggled amidst the devastating effect of covid-19, the monetary authorities focused on stimulating growth in the face of GDP contractions, rising inflation and FX illiquidity challenges. Accordingly, the monetary policy committee (MPC) reduced the monetary policy rate (MPR) by 200 bps to 11.5% and increased the Cash Reserve ratio (CRR) of banks to 27.5% from 22.5%. The CBN also implemented relief packages targeted at injecting funds into select sectors adjudged as the most affected by the covid-19 pandemic.

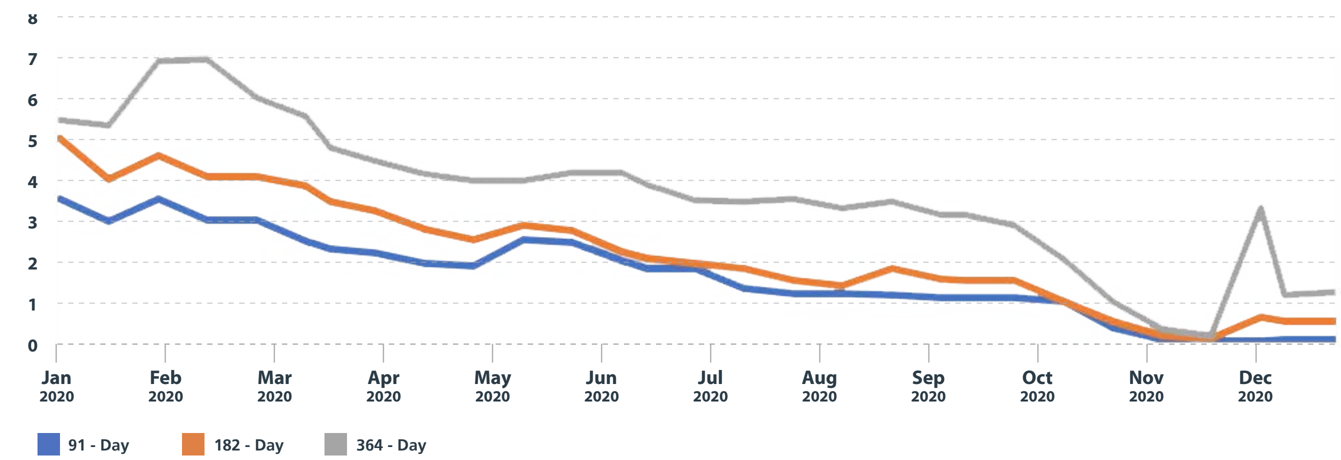
Headline inflation maintained an upward trajectory throughout the year and closed the year at a 3-year high of 15.75% year-on-year in December 2020 accelerating from 14.89% y-o-y in November 2020. The increase in electricity tariffs, hike in the PMS pump price, continued congestion at the Lagos port and relatively higher exchange rates could see inflation remain elevated in 2021. These factors coupled with the disruption of the 2020 planting season amidst government-approved movement restrictions as well as a high 2020 base will keep average inflation for 2021 elevated at 16% levels. We note that while the re-opening of the land borders should ease the pressure on food prices, the government needs to do a lot more on the fiscal side to crash food prices. Annual Food inflation, which accounts for almost 60% of the inflation basket, rose to its highest since November 2017 accelerating to 19.6% in December 2020 from 18.3% reported in November 2020.



Source: NBS

In view of strong system liquidity and the easing stance of the CBN, interest rates across all tenures of all instruments crashed to record low levels with OMO yield at the primary markets averaging 6.97% in 2020 compared to a 2019 average of 12.16%. Despite the recent increase in interest rate to incentivize portfolio investors, we expect a further increase largely due to the additional government borrowings of N2.3 trillion in the course of the year. Secondly, depressed yields could continue to mount pressure on the currency as investors scramble for FX in the face of limited, low yielding investment outlets.

NTB PMA yield (%)

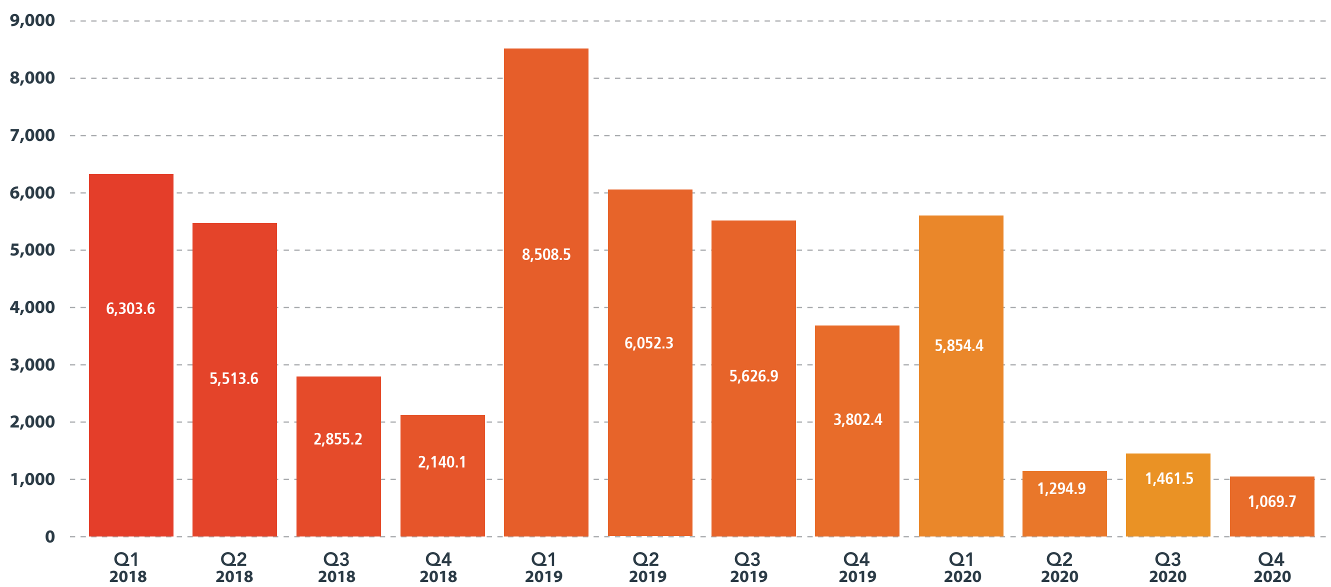


Source: In-house Analysts

Capital Inflow, External Reserves and Exchange Rate

According to the NBS quarterly reports, total capital inflows stood at US$5.85 billion in Q1 2020, declined to US$1.3 billion in Q2 2020, and recovered marginally to US$1.46 billion in Q3 2020. A cursory review of earlier reports shows that the first quarters have recorded the most flows since 2018. However, the sharp decline recorded between Q1 and Q2 2020 was primarily as a result of the pandemic-inspired foreign and domestic supply chain disruption and widespread movement restrictions in Q2 2020. Capital importation declined by 26.8% q-o-q in Q4 2020 and dropped by 71.4% y-o-y compared to Q4 2019, as economic activities gathered momentum. Notably across the capital Inflow components, portfolio investment which accounted for 73.6% (US$4.3 billion) of total capital inflows in Q1 2020 dropped to US$35.2 million which represents 3.3% of total capital inflow in Q4 2020 while FDI and Other Investments came in at US$251.3 million and US$783.3 million representing 23.5% and 73.2% of total capital inflows respectively. On a year-on-year basis, capital Inflow fell by 59.6% from US$23.99 billion in 2019 to US$9.7 billion in 2020.

Capital Inflow (US$' million)

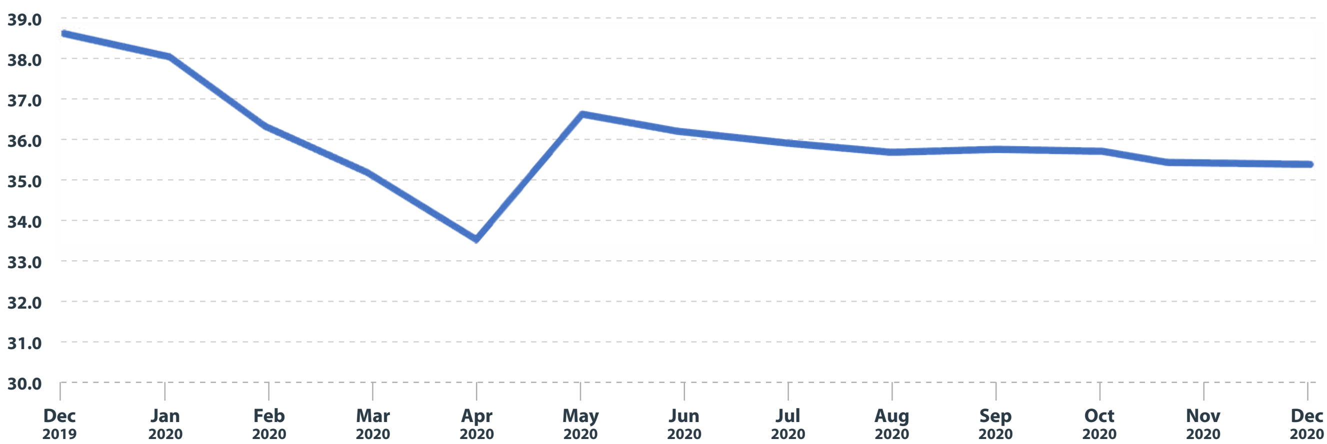


Source: NBS

As always, the CBN's exchange rate policy preference is influenced by the global oil prices, capital inflows and the position of the country's reserves. Thus, in the face of falling oil prices, dwindling capital inflows and depressed external reserves, the CBN's desire for a fairly stable currency remained a challenge. As a result, the CBN adjusted its exchange rate three times in 2020 with the last adjustment bringing the exchange rate to N379/US$1 which represented a 24% depreciation. Prior to the final adjustment, the divergence between the official and parallel rates accelerated to 2016 levels as the dollar exchanged for as high as N505 at the parallel market. In a move to improve FX liquidity, the CBN directed banks to pay remittance recipients of International Money Transfer Operators (IMTO) funds in foreign currency. This helped to improve supply to the parallel market and reduce the pressure on the naira. However, the World Bank expects remittances into the country to decline relative to 2020 levels, driven mainly by weak economic growth and lower employment levels in migrant-host countries and depreciation of the currencies of remittance-source countries against the US dollars.

External reserves declined 8.2% from US$38.5 billion reported on the first trading day in 2020 to US$35.4 billion on the last day of 2020. The reserves inched up to US$36.3 billion as at January 29, 2021 on the back of improved oil prices but dropped to US$35.5 billion as at February 17th, 2021 due to the redemption of Nigeria's 6.75% US$500 million January 2021 Eurobond at the end of January 2021 . That said, higher IMTO flows and relatively higher oil prices coupled with the disbursement of already approved loans and planned external borrowings are positives for strong extenal reserves to cater to the corresponding demand in the market.

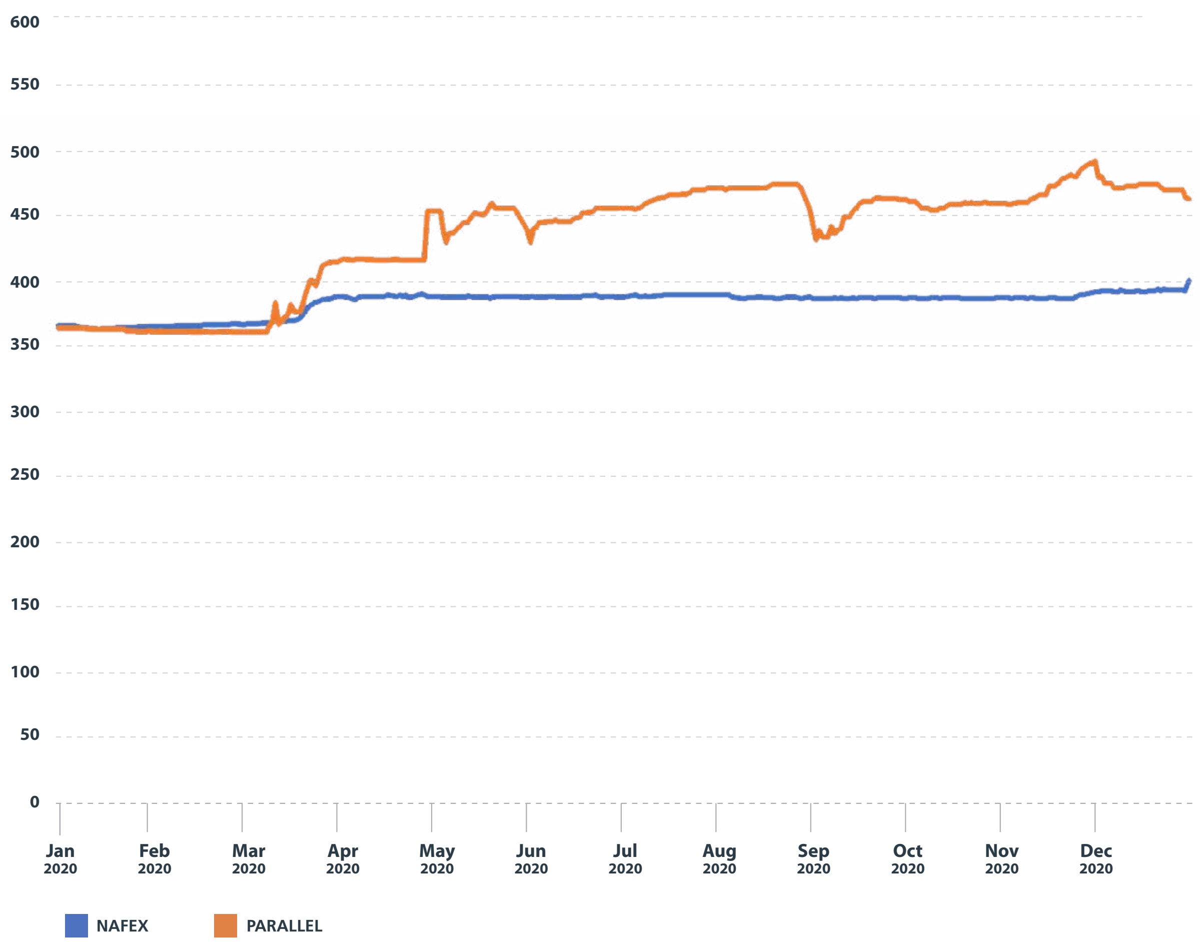
External Reserves (US$'Bn))



Source: CBN

We expect a tightening of the gap between the parallel market rate and the official rate due to a marginal adjustment of the currency in 2021. Our expectation of the appreciation of parallel market rates is predicated on increased supply to that market , however It should be noted that, a devaluation in the official market usually triggers an immediate devaluation in the parallel market even if short-lived. Notably, a further devaluation to levels closer to the general consensus of the true value of the naira is expected to trigger increased foreign portfolio flows into the country.

Exchange Rate(US$ / ₦)



Source: In-house Analysts

African Continental Free Trade Area (AfCFTA)

The African Continental Free Trade Area (AfCFTA) agreement aims to create a single market for goods and services in Africa. With an estimated GDP of US$2.2 trillion, the continent seeks to generate substantial economic benefits from the implementation of the agreement. With a revised effective date of January 1st, 2021, over 90% of tariffs on goods produced in Africa will be removed as non-tariff barriers to trade are eliminated and free movement of persons within the region are guaranteed.

AfCFTA has the potential to accelerate economic growth in the continent in the coming years, as most economies in the region look to recover from the raging economic recession. The lack of infrastructural assets such as good roads and rail lines connecting the different countries within the region could however pose a huge obstacle to effective intra-continental trade. With 54 out of the 55 countries on board the agreement, Nigeria's ratification of the agreement in November 2020 signified the country's commitment to intra-Africa trade and necessitated the re-opening of the country's land borders. It is difficult to identify the sectors that would benefit from the agreement in the short-term following concerns of dumping and smuggling of the goods into the country due to the country's porous borders, posing a huge threat to local manufacturers. Inefficient customs procedures, insecurity and lack of stable power and road networks have also been identified as the country-specific shortcomings in the face of the agreement.

NIGERIAN BANKING INDUSTRY

Overview of 2020

Following the introduction of minimum LDR and the restriction of OMO bills investment in 2019, the CBN sustained its management of system liquidity through heterodox monetary policies. Specifically, the system was awash with liquidity as bills issued in 2019 matured into the system with limited attractive re-investment options.

Consequently, the CBN increased CRR to 27.5% to mop-up net OMO inflows from the system. This coupled with the CRR debits resulted in an effective CRR as high as 50% and liquidity ratio pressure for most banks. In an attempt to improve liquidity and support economic recovery, the CBN introduced special bills for banks which saw the apex bank release some of the excess CRR above regulatory minimum to banks. The CBN also appears to have eased on the enforcement of its minimum LDR of 65% as no bank has been penalised of late for non-compliance.

In the wake of the pandemic, the CBN rolled out relief packages including the reduction of interest rates on CBN intervention loans from 9% to 5%, a one-year moratorium on CBN loans, regulatory forbearance to restructure loans in impacted sectors, etc. The industry stocks were preferred by investors after their impressive performance in a year of unprecedented disruptions, policy shocks and currency devaluation. Consequently, the NSE Banking Index for 2020 grew by 10.14%.

Outlook for 2021

We expect the CBN to sustain its policy stance going into 2021 driven largely by the need to improve credit flow to spur economic growth. In a move to attract portfolio flows and reduce consistent exit of investors, the CBN increased yields of fixed Income securities.

The additional borrowings by the government as well as relatively lower OMO maturities into the system may result in a further increase in interest rates but not expected to be significantly higher than present levels. We note the impact of the second wave of the pandemic but also do not foresee widespread lockdowns as was with the first wave as effective vaccines are being rolled out and medical practitioners have a better understanding of the virus.

A huge positive for the industry was the massive customer migration to digital platforms as a result of movement restrictions imposed by the government which drove better-than-expected fees from digital channels. In addition, the revaluation gains on the back of significant naira devaluation are expected to drive further improvement in non-interest revenue for Banks.

On the cost side, the work-from-home (WFH) policy afforded most firms the rare opportunity of re-evaluating their cost profile and make amends where necessary. We expect OPEX to remain contained in 2021, with travel expenses and other operational costs expected to remain lower relative to 2019 levels.

Asset Quality

In addition to the apex bank's regulatory forbearance, some banks offered 3-6 months moratorium to some segment of customers and proactively restructured some of their exposures. Despite low demand for credit at the beginning of the year and limited capacity of banks to lend owing to CRR debits, industry loan book rallied and recorded growth as economic activities regained momentum. Total industry loans stood at N25.2 trillion as of December 2020 growing by 44% from N17.5 trillion reported in December 2019. Industry players have attributed this growth to limited investment outlets for funds which has encouraged Banks to grow their loan book despite the adverse economic impact of the pandemic. Another reason for this increase, is the naira devaluation which increased the FX portion of industry loans. While this could have been a strong factor, the uptick of economic activities as lockdown measures were eased was also a factor as there was increased credit demand by SME and Retails customers.

NPLs remained relatively stable despite the challenges presented by the pandemic in 2020. One would expect that the impact of the pandemic, coupled with the effect of the devaluation of the naira on select sectors, could begin to become more apparent on the books of banks in the course of 2021.

Liquidity

A robust system liquidity dominated the money market in 2020 fostered by a number of factors including the bifurcation of the Nigeria Treasury Bills (NTB) and the OMO securities in Q3 of 2019 and the redemption of about N9 trillion of the N13 trillion in maturing OMO securities within the year. Following the decision of the CBN to re-issue only about N5.1 trillion in OMO securities during the year, and a lack of alternative investment outlets for the maturing proceeds, liquidity spiked rapidly resulting in a crash in interest rates across board. In a bid to manage the resultant liquidity spike, the CBN resorted to various monetary intervention activities including the introduction of arbitrary special CRR debits aimed at withdrawing liquidity from the system.

In contrast, system liquidity in 2021 is expected to be tighter. For one, only N4.3 trillion in OMO securities will be maturing this year, with over 50% of that maturing within the first quarter of the year which implies about N2.5 trillion of liquidity injection into the system in Q1, with attendant CRR implications assuming that the CBN maintains its trend of reissuing a portion of the maturing securities. This could result in the outflow of more funds from the market in form of CRR. From Q2 2021 however, we expect a shift in the liquidity situation of the market, based on the significantly reduced OMO maturities of N1.7 trillion. In the absence of other liquidity injection sources, market liquidity is expected to tighten significantly with a resultant decline in special CRR debits.

As a result of the tightening of liquidity conditions expected in the market from Q2 2021, we anticipate a rise in volatilities within the money market and fixed income space. We also anticipate a renewed scramble for deposits by banks and other financial institutions to meet demands on them for funds. Money market rates, should on average, rise steadily across the period with a resultant pull on deposit and lending rates. In view of the above, the CBN might have to consider the possibility of releasing some of the CRR sterilized by it.

Capitalization

Prior to the currency devaluations in 2020, some banks barely managed to stay above the regulatory minimum capital adequacy ratio (CAR) of 15% . With the devaluation of the naira, we suspect that the true capital positions of these banks will be further challenged, erasing existing capital buffers. Consequently, we expect banks with shortfalls in their capital positions to retain more of its earnings to shore up their capital and keep themselves within touching distance of the minimum regulatory capital requirement. It is also not unlikely that the apex bank will offer some form of regulatory forbearance to banks that fall short of the minimum regulatory capital.

Competitive Landscape

The new Banking and Other Financial Institutions Act (BOFIA) 2020 could change the competitive environment of the industry going into 2021. Notably, the act broadens CBN's regulatory oversight function to include fintechs as it prohibits the operations of unlicensed financial institutions. This will very likely result in capped fees for Fintechs and increased operational and regulatory costs. We project that this might increase their cost and stifle their drive in the long to medium term and facilitate a levelling of the playing field for traditional banks and their non-bank competitors.

The new act further stipulates that loans in excess of N3 million without collateral will now require regulatory approval. This will change the dynamics for most SMEs that depend on revenue-based financing, and retail customers that require salary-based consumer loans offered by banks as an additional hurdle has been added to the loan procurement process. Whilst the act seeks to strengthen the financial services sectors and enhance healthy competition amongst players, there are concerns that the powers given to the CBN in the new act could make financial services providers move slowly and adapt with lesser agility.

Furthermore, the release of operating guidelines and licensing of payment service banks (PSB) in 2020 is expected to intensify competition in the sector as it gives Telcos an entry into the banking industry. The competitive landscape in 2021 will be shaped by the apex bank's level of adherence to the new act, the resilience of non-bank competitors and the reaction of traditional banks to the changing landscape.

GTBank

www.gtbank.com