Afrinvest

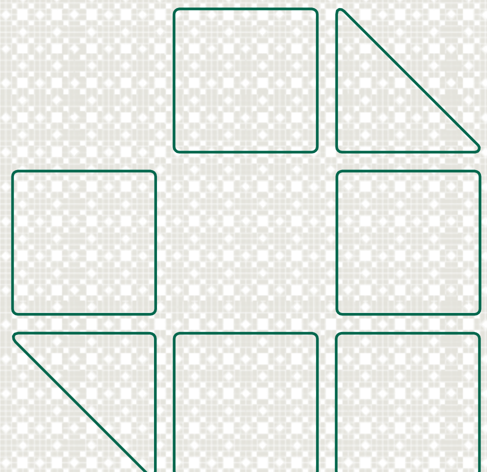
NIGERIAN BANKING SECTOR REPORT

GETTING NIGERIA TO WORK AGAIN!

NOVEMBER 2023

1

EXECUTIVE SUMMARY



Executive Summary

GLOBAL ECONOMIC REVIEW & OUTLOOK

Our 2022 Nigerian Banking Sector report themed "Brace for Impact" coincided with the onset of fresh global risks as the receding Covid-19 pandemic left deep footprints. This evolution of risks shifted focus from economy-stimulating policies to the introduction of guard rails for overheating economies. Specifically, the emergency adoption of the Modern Monetary Theory playbook in response to the pandemic dovetailed into a glut of financial liquidity. Although the broad stimulus deterred prolonged global recession, the absence of a commensurate productivity boost drove real and financial sector prices higher and threatened real output recovery.

To correct this, central banks have since embarked on historic policy normalisation and disinflation campaigns which – as theory predicts – curtail banks credit creation, constrain capital investment, and drag consumers spending. Similarly, the pandemic psychologically scarred the world, stoking deglobalisation trends, geo-political spates, and fracturing the global financial hegemony. This distrust manifested in the continuing Russia-NATO conflict, worsening US-China relations, BRICS de-dollarisation agenda, and the weakening of democracies especially in Sub-Saharan Africa – factors that have heightened uncertainty. Against this backdrop, expectations that the initial recovery momentum in 2021 would morph into a period of economic stability have not played out as expected.

In contrast to the 2022 global growth of 3.5% (2021: 6.3%), the IMF in the September World Economic Outlook (WEO) projects a 3.0% baseline for FY:2023 – a rate below the pre-pandemic average of 3.3% in 2018 and 2019. Even more pessimistic, the World Bank forecasts a 100bps drop in global growth to 2.1%, marking a sharp decline from 3.1% in 2021 and 2.6% before the pandemic outbreak. In Advanced Economies (AEs), IMF's growth outlook dimmed to 1.5% in 2023 (2022: 2.6%) due to tight financial conditions, geo-political conflicts, and energy goods supply deficiency, even as rising living costs cut down accumulated pandemic savings. The US economy is to stabilize at 2.1% (2022: 2.1%) while Euro Area real GDP has been downgraded to 0.7%, with Germany expected to contract 0.5%. In contrast, Emerging Market and Developing Economies (EMDEs) output growth should print at 4.0% in 2023 (2022: 4.1%), courtesy of firm rebound in China from 2022's low base and recovery in Russia. Oil and power sectors woes in Nigeria and South Africa respectively are the key risks for Sub-Saharan Africa, where real output growth should moderate 70bps to 3.3%.

Beyond 2023, the prevailing macroeconomic headwinds of elevated prices, higher-for-longer interest rate, currency volatility and escalating debt crisis portend systemic risk to the global banking and financial sector. Already more than $5.0tn of global corporate debt will mature in 2024, based on IMF reporting, requiring refinancing at significantly elevated interest rates. Banks cannot afford material increase in bad loans, as they have sizable unrealised losses on disappointing non-loan assets. Central banks have their hands full; the increasing debt burden on governments due to the tight financial markets would require some debt monetization, and fiscal bailouts might not be expansive enough to cover troubled banks. Hence, we anticipate critical revisions to global banking guidelines should the tightening cycle persist.

GLOBAL MONETARY POLICY REVIEW & OUTLOOK

The global financial system approached a precipice in March when Silicon Valley Bank (SVB) and Signature Bank – with 2022-FY assets of $209.0bn and $110.4bn respectively – failed. The US lenders folded, in the biggest banking crisis since 2008, due to bank run induced by a cocktail of asset-liability timing mismatch, inadequate deposit insurance, overconcentration of deposits and risks, contagion from the $119.0bn Credit Suisse deposit runoff, as well as ill-luck. However, the powder keg was set off by the normalisation of monetary policy and rapid

changes to interest rates. The resulting elevated yield environment deflated valuation of investment security portfolios, creating large unrealised losses and trapping borrowed funds.

In extraordinary moves to prevent further panic, US authorities – the Treasury Secretary, the Federal Deposit Insurance Corporation (FDIC), and the Federal Reserve (Feds) – employed the statutory systemic risk exception to guarantee both insured and uninsured deposits at affected banks. Furthermore, the Feds created the Bank Term Funding Program (BTFP), with $25.0bn backstop from the Treasury Department's Exchange Stabilization Fund, to provide liquidity support for eligible US depository institutions through March 11, 2024, at minimum. Similarly, the Swiss government took decisive steps to overlook shareholders, and broker a $3.25bn emergency takeover of Credit Suisse bank (the second largest Swiss bank) by UBS.

While these measures have provided comfort, the underlying risks persist. In the September Global Financial Stability report, the IMF argued that most banks can manage up to 10.0% bank runoff rate on deposits without needing to book losses on Hold-to-Maturity (HTM) bonds (advanced market: 5.0% to 10.0%, emerging market: 15.0%). The Fund argued that, without the intervention of central banks, at 15.0%, most banks would need to downsize their investment portfolio while a 25.0% rate would impair regulatory capital. Already, US banks have amassed an estimated $560.0bn in unrealized losses on their investment securities as of June – potential impairments on liquidity position and core capital integrity. In October, Bank of America alone incurred a record unrealised loss of $131.6bn on securities portfolio.

On the positive side, strong profitability and the Bank Term Funding Program can help absorb shocks, for now. Lenders have borrowed $107.7bn from the program as of October 5, but the astronomical growth of borrowing from the program and mounting headwinds for profitability amid global growth downgrade are of concern. Beyond the liquidity risks, banks around the world are already weighing scenarios of heightened loan repayment risks, implication of the depleting value of collaterals, and dwindling credit business as loans get pricey.

Risks to the global financial system have not always been about the banks alone. In China, the Evergrande Property crisis took unpleasant turns after the real estate giant filed for bankruptcy in US in August, then backed out of a $19.0bn debt restructuring deal and suffered further market valuation erosion (-98.6% since 2020 high). The contagion effect of a system collapse in China's real estate (c.30.0% of GDP according to some estimates) would reverberate across the global financial markets especially in countries where investors have significant exposure. So far, it is unclear whether the Chinese government would intervene fully and directly, and such a scenario would be positive for wading off immediate risks beyond China. In our view, there is need for lending institutions to strengthen risk frameworks, boost buffers, and expand business model going into 2024. We opine that the financial industry is still sitting on powder kegs as the unravelling of fiscal crisis, tighter monetary stance, a sharp downturn in banking sector profitability or China's property crisis can each set off a banking sector crisis. More so, there is a tangible risk that the tax-paying public could develop negative sentiment towards the banking sector (thus attempt to negatively influence government policy) if the use of taxpayer funds for bailouts is the theme for safeguarding the industry.

GLOBAL BANKING SECTOR PERFORMANCE REVIEW & OUTLOOK

Banking was challenging in 2022. Changes to monetary policy thrust depressed cheap funding flows and this, combined with elevated inflation, pressured both interest and non-interest expenses. Banks also had to navigate the murky waters of geo-political rifts that required enforcement of financial and trade sanctions. However, profitability was resilient buoyed by interest-based income and strategic realignment of the banking businesses.

As of half-year 2023, profitability for North American banks have eased. Profit Before Tax (PBT) margin and Return on Equity (ROE) moderated to 35.9% and 12.0% respectively, against 40.5% and 14.2% in the comparable period of 2022. The decline followed a build-up in impairments as banks attempted to create more risk assets. Precisely, Cost-of-Risk (CoR) rose to 0.3% against -0.4% following an uptick in Loan-to-Deposit ratio (LDR) of 3.6ppts to 61.9% and expansion of asset base by 2.7%.

Sweeping through the region, Canadian banks recorded the best Capital Adequacy Ratio (CAR) among our selection. The capital buffers of Toronto-Dominion Bank (TD) Bank and Bank of Montreal rose to 20.7% each compared to 19.1% and 17.6% respectively in the base period. Bank of Montreal operated the most efficient structure (Cost-to-Income: 46.0% vs 61.2% regional average). Meanwhile, US JP Morgan was the most profitable given ROE and ROA of 17.1% and 1.2% respectively. Looking ahead, the crystallisation of credit risks, implosion of pressured securities portfolios and softening of deposits mobilisation top risks to the regional banks.

In Latin America and the Caribbean, deteriorating macroeconomic fundamentals undermined asset quality and the growth of risky assets weakened regional CAR (-0.3ppts to 17.6%). In growing loan book (+2.6ppts LDR), banks incurred additional 0.8ppts in CoR. However, the banks managed cost-effectively (51.1% vs 56.2%) to support bottom-line performance (PBT margin: +100bps). Among the selected banks, Grupo Financiero Banorte and Grupo Financiero Inbursa (Mexico) had CAR and COR of 22.9% and 0.9% respectively, outperforming peers. In terms of operational efficiency, Banco Santander (Chile) remained the region's best with a CIR of 41.0%. We anticipate sustained cost efficiency despite the negative impact of regional political challenges, price and FX volatility, and steep rate hikes.

Thus far, European banks have posted an impressive run with higher profitability across both the Western European (WE) and Eastern European (EE) fronts. Precisely, average PBT margin, ROE, and ROA of WE banks rose to 36.0%, 13.6%, and 0.8%, respectively (previously: 34.3%, 10.5% and 0.6% respectively) while corresponding metrics for EE lenders advanced by 8.8ppts, 0.6ppt and 2.7ppts to 18.5%, 1.8% and 36.1%, sequentially. There was noticeable divergence in the risk approach of European banks; WE lenders adopted a conservative framework due to escalating impairments provisioning while EE banks grew loan books and managed risks better. Hence, average CAR for the latter improved to 17.6% (2022: 17.1%) against the decline in WE's CAR to 19.3% (2022: 20.8%). That said, Skandinaviska Enskilda Banken (Sweden) is the most robust lender by buffer (22.5%). In 2023, European banks are expected to sustain the positive stride given favourable inflation trajectory, possibility of pause in tightening cycle, and stabilising political landscape.

Asia-Pacific banks recorded the best capital-to-risk asset ratio across all regions as CAR and CoR improved to 19.8% and 0.5% (2022: 19.2% and 0.6%). The solid risk management, combined with cost efficiency, translated to stronger profitability metrics as PBT margin, ROE and ROA firmed to 52.1%, 14.2%, and 1.4% respectively. Among the selected banks, Bank Central Asia Tbk PT (Indonesia) recorded the strongest CAR of 26.8% while National Australia Bank noted the least CoR (0.0%). On the other hand, Bank of China was the most efficient operationally (CIR 23.4%).

The Middle Eastern & African banks were the most profitable, averaging PBT margin, ROE, and ROA of 54.7%, 16.1% and 1.6% sequentially. Core banking business was a key driver of the performance as the lenders financed customers without harming asset and capital quality. Thus, CAR and CoR printed at 17.6% and 0.6% respectively. Among the selected banks, Qatar National Bank was the most efficient with a CIR of 20.5% while Bank Leumi Le-Israel BM (Israel) reported the best asset quality (CoR: 0.1%). Instability in the Middle East on account to the Israel-Hamas war is a major headwind to the region's banks in 2023. However robust capital adequacy and commendable risk management should provide legroom for absorbing new risks in the short term.

EVOLVING TRENDS IN THE GLOBAL BANKING INDUSTRY

Banking is evolving beyond the traditional concepts of finance in the world of big data marked by increasing shifts towards stakeholder capitalism. Embedded finance which helps non-finance businesses to seamlessly integrate financial services and create new value in the global market is projected to jump 17x to $384.8bn by 2029. The anticipated leap provides incentives for banks to leverage their robust financial infrastructure in supporting non-finance businesses with embedded finance solutions. Also, the monumental leap in Central Bank Digital Currency (CBDC) adoption since the year 2020 means sooner than later, banking would take a forward leap into a revolutionary future. The adoption of a CBDC offers a multitude of benefits for both the monetary authorities and their constituents. CBDC holds immense promise in fostering financial inclusion.

By providing a secure and accessible digital alternative to physical cash, CBDCs have the potential to reach unbanked and underbanked populations, bringing them into the formal financial system. Additionally, CBDCs can drive competition and resilience in domestic payments markets, potentially reducing transaction costs and increasing efficiency in payments. Digital currencies could also eliminate credit risk and negate the need for correspondent banks in cross-border transactions.

Likewise, Debt-for-nature swaps could become mainstream for countries at risk of defaulting on external debts. Debt-for-nature swaps work by involving the government of the debtor country and conservation organizations. The government commits to a repayment plan, usually through the country's central bank using the local or national currency. Usually, the outstanding value of debt is reduced based on conditions that promote environmental conversation. Some of the largest Debt for Nature deals so far are recent swap deals of $1.6bn and $500.0m by Ecuador and Gabon respectively. Debt-for-nature is currently shaping up the global economy and the banking system become a popular tool for developing countries with natural resources to finance their debt and develop the existing natural resources.

DOMESTIC MACROECONOMIC REVIEW & OUTLOOK

In our 2022 BSR "Brace for Impact" published last October, we projected a bumpy ride for both the broader economy and the banking sector over the short-to-medium term, despite expectation of a change in government (fiscal) by mid-2023. Although the rhetoric and the actual manifestos of the three leading candidates for the presidential poll leaned toward market-friendly reforms, we had anticipated that delivering economic relief in the near term would be a daunting task. This submission was based on our assessment of economic fractures that have resulted from years of policy misalignments, especially in the last eight years.

True to our prognosis, economic growth momentum which peaked at a 7-year high of 3.4% in 2021 eased to 3.1% in 2022 and to 2.4% by H1:2023. This was driven mainly by the prolonged recession in the oil economy (since Q2:2020) and the underwhelming performance of the agriculture (average growth: 1.1%) and industries (average growth: -2.7%) sectors over the six quarters between Q1:2022 and Q2:2023. Nevertheless, the financial institutions' activity – a sub-sector under services and the proxy for the banking sector GDP – maintained stellar performance with an average growth of 23.2% in the review period.

This, on one hand, was aided by increased access to banking solutions (via service offerings on mobile platforms), vertical and horizontal business expansion drives (e.g., Guaranty and Sterling Bank morphed into a HoldCo structure in 2022 and 2023 respectively), and increased entry of neo-banks and fintech players. On the other hand, the positive rub-off effect of the modest pick-up in the interest rate environment on balance sheet performance (due to CBN's intensified MPR hikes) and lately in Q2:2023, revaluation gains on FCY assets post-FX rate alignment move.

Meanwhile, Nigeria's inflation misery has worsened in 2023. Compared to the 2022 annual average rate of 18.8% and CBN's multi-year target of 9.0%, NBS data as of September 2023 puts the YTD average inflation rate at a decade-high of 23.3% – a close shot to our FY:2023 average projection of 25.3%. Poor implementation of the naira redesign policy, negative pass-through of newly introduced fiscal measures (such as the 7.5% VAT on Diesel price), "partial" abrogation of PMS and exchange rate subsidies, and shortage of farm produce supply due to flood-induced harvest loss in 2022, topped the new risk factors driving inflation.

To holistically address the ugly narrative of surging price pressure, we posit that the monetary and fiscal authorities rethink their anti-inflation strategies which have mainly been fixated on the control of money supply and selective tax reliefs. In our view, an effective strategy for taming the high inflation rate would be one that addresses structural bottlenecks (notably, insecurity and infrastructural gaps), improves ease of doing business, and incentivizes large-scale local production of agriculture and manufactured goods alongside effective liquidity management and proper anchoring of market yields to the MPR. In all, we stress that failure to stem the surging inflation tide in the near term would result in a contagion financial sector crisis and by extension, derail other segments of the economy from the growth path, given banks' pivotal role as an economic bridge between the supply and demand segments of the economy.

Also, Nigeria's fiscal deterioration has continued unabated. After hitting the ₦70.0tn mark in 2022 due mainly to the ₦23.7tn addition from securitised Ways & Means liabilities, the total public debt profile nudged higher to ₦87.4tn in H1:2023. This, in addition to underwhelming revenue performance in H1:2023 (actual revenue, ₦4.1tn, underperforms pro-rata target by 26.5%, and 99.0% of it, ₦4.0tn, was used to servicing debt) has further put Nigeria on the cusp of insolvency. Against this backdrop, the new administration of President Bola Tinubu has introduced some policy measures to assuage the fiscal pressure, notable amongst which are (i) the "partial" removal of subsidy payment on PMS, (ii) the increase in education tax by 50bps to 3.0%, and (iii) the introduction of a 7.5% VAT on diesel. Despite these measures, we do not see a quick fix to the fiscal pressure in the near-term, given increasing internal and external pressure points on the economy and the time lag required for policy reforms to manifest gains.

MONETARY POLICY REVIEW & OUTLOOK

In what turned out to be an unprecedented move by a new President since returning to democratic settings in 1999, President Bola Tinubu on June 9 (barely 12 days after assuming office) announced the immediate suspension of Mr. Godwin Emefiele from office as the governor of the Apex Bank. This pronouncement brought to an abrupt end the second 5-year tenure of Mr. Emefiele, 11 months before his official tenure expiration. Although no formal pronouncement has been made by the FG for the unceremonial removal of the former CBN governor as of the time of this report, the jury is out on the impact of many of the unorthodox strategies of Mr. Emefiele over the last 9 years on the economy. We assess below, key developments in the monetary policy environment since our last BSR publication, highlight their near-term implication for the banking industry, and re-present our strategic agenda for the new CBN governor, Mr. Olayemi Cardoso, to drive a positive shift in paradigm.

- **Botched Naira Re-design Policy Implementation: Good Riddance to Bad Rubbish**

  Nigerians and the banking industry would not forget in a hurry the devastating impact of the ill-implemented naira redesigned policy of the CBN in Q1:2023. At a press briefing on October 26, 2022, Mr. Godwin Emefiele announced that newly redesigned banknotes for the ₦200, ₦500, and ₦1,000 denominations would gradually be circulated effective from December 15, 2022, to run concurrently with the "old notes" until January 31, 2023, when the old notes would cease as a legal tender. This decision, according to the CBN was hinged on the need to curb large-scale hoarding of banknotes by non-bank actors, worsening shortage of clean and fit banknotes, and the elevated risk of currency counterfeiting. Like other Apex Banks across the world, the CBN is constitutionally empowered to take measures that would ensure the preservation of the integrity of the fiat note, as part of its currency management functions. By convention, the global best practice for Central Banks is to redesign, produce, and circulate new banknotes every 5 to 8 years. For the CBN, the last of such actions was in 2007 when the ₦50 and other lower notes were redesigned and reissued.

  However, the implementation approach of the 2022/23 currency redesign policy was largely flawed. Unlike previous currency withdrawal episodes in which a near commensurate size of the old currency to be withdrawn is re-injected as new currency, the CBN opted for a fractional injection (currency experts estimated the value of the new notes injected into the system to be around ₦500.0bn while over ₦1.8tn was withdrawn). Worse still, adequate reinforcement was not provided to support banks' infrastructure to seamlessly handle multiple cashless transactions at a time. This development led to a significant disruption of economic activities in Q1:2023, especially in the informal sector **which accounts for c.40.0% of the economy. Consequently, GDP growth tanked to 2.3% from 3.5% in Q4:2022 and 3.1% in Q1:2022).** Based on Afrinvest's estimation, the potential output loss for the economy in the period was in the region of ₦6.5tn. For the banking sector players, the attendant negative consequence of the botched Naira redesign policy implementation includes the running of full operations on weekends without direct compensation from the CBN, and the loss of sizeable infrastructure assets (ATMs, buildings, cars) to mob actions in several states.

- **Shift in FX Regime… A Tale of Two Sides to a Coin**

Since 2020, the gap between the official and parallel market rates has continued to widen astronomically. Even when global crude oil prices rallied to an 8-year high of an average of US$104.93/bbl. in 2022, Nigeria was unable to rebuild its FX reserves war chest, no thanks to the unabated industrial-scale oil theft in the Niger-Delta region. In addition, the inability of the fiscal and monetary authorities to implement policies that will boost local production of non-oil outputs for exports and local consumption over the years also created a fertile ground for FX speculation and racketeering.

Against this backdrop, the “post-Godwin Emefiele” CBN management team on June 14, 2023, shifted from a fixed-peg FX regime to a managed float. This move aligns with the overall economic reform agenda of President Bola Tinubu. The shift to a managed float regime which technically implies allowing the naira to trade at a rate that is more reflective of the forces of demand and supply drove the Naira/USD rate up by 38.7% in the official market to close for June at ₦769.25/$ (from ₦471.67/$ on June 13). Although the official rate has thereafter largely steadied between ₦755.00/$ and ₦790.00/$, the dynamics in the parallel market remain convulsive as critical imperatives – improvement in crude oil output, reversal of capital outflows, and increased non-oil exports – are yet to be achieved.

Based on the earnings performance of our coverage universe in H1:2023 (details contained in the banking sector performance section), the accompanied devaluation effect of the shift in the FX management regime would likely result in a net-positive performance for the banking sector in 2023, due to higher holding of FCY assets relative to liabilities. However, the negative effect of the naira devaluation impact on other sectors of the economy (notably, consumer goods, telecoms, and power) may impact negatively on the banking industry asset quality, in the coming years. In addition, we estimate that the record-high top and bottom-line numbers that banks are set to post in 2023 may be difficult to match in the near term, barring another major devaluation gain and significant pick-up in economic activities.

- **Isolated MPR Hikes and Price Stability Target… An Effort in Futility?**

Since our last BSR in October 2022, the CBN has further raised the MPR five times by a cumulative 325bps to 18.75% and tweaked the asymmetric corridor around the MPR to +100/-300bps (from +100/-700) in its quest to guide the inflation rate lower. Yet, NBS monthly inflation data have shown that price pressure surged in nine of the last ten months to reach a record high of 26.7% in September 2023. This indicates that the continued MPR hike since May 2022 has failed to achieve the CBN’s objectives.

Although the recent surges in the general price level can be largely linked to some fiscal policy reform of the current administration (such as the “partial” removal of PMS subsidy and change of FX management regime) and lingering structural challenges (insecurity and infrastructure gap), we spotted a counterproductive pattern in CBN’s liquidity management strategy that has undermined the potency of the MPR. Noteworthy, while the CBN has aggressively curtailed Currency in Circulation (CIC: down 14.5% y/y) and Currency Outside of Banks (COB: down 13.9%) to ₦2.8tn and ₦23.5tn respectively over the 12-month to September 2023 to check demand pull-inflation, it increased credit to the government by 50.0% (up ₦11.3tn) over the same period to ₦34.1tn. Interestingly, credit to the private sector which is more potent in boosting local productivity and reducing inflation rate only expanded by 44.6% to ₦58.2tn.

Consequently, the broadest measure of money supply, M3, expanded 36.2% over the reviewed period while real output in the economy grew only by 2.6% – implying that productivity growth in Nigeria remains short of liquidity-induced demand. This development affirms Milton Friedman's famous postulation that *“Inflation is always and everywhere a monetary phenomenon, in the sense that it is and can be produced only by a more rapid increase in the quantity of money than in output.”*

More so, the repeated hike in the MPR (ideally) is supposed to be accompanied by a commensurate tightening of the financial conditions for effective policy transmission. However, this was not the case over our reviewed period.

Noteworthy, while the MPR has risen by a cumulative 725bps to 18.75% since the tightening cycle commenced in May 2022, yield on the long-term T-bills, savings deposits, and average lending rates only nudged higher over the reviewed period by 300bps, 390bps, and 113bps to 5.1%, 3.9%, and 20.8%, respectively – suggesting systematic deployment of financial repression strategy. We hold that only concerted fiscal and monetary policy efforts targeted at resolving insecurity challenges, optimising exchange rate management, fixing structural loopholes, and curbing reckless fiscal spending would resolve the high inflation quagmire.

CBN in the New Era: Strategic Agenda for the New Governor

No doubt, the unorthodox strategy of the immediate past administration at the CBN failed to preserve the bank's core objectives - price and exchange rate stability – given the historical low ebb of key monetary indices. As the new CBN leadership takes over, Nigerians and the banking industry are on the lookout for a positive and timely turnaround of stifling banking regulations and major monetary indices - exchange rate, inflation rate, and FPI & FDI flows. Consequently, we present our 14-point strategic agenda (captured under five segments) for the new CBN governor, Mr. Olayemi Cardoso, to pursue as he commences his transformative journey at the Apex Bank.

- **Price Stability Segment:** (i) Prioritise credit expansion to critical real sectors to boost local outputs, (ii) Anchor market rate to the MPR, (iii) Restrain from quasi-fiscal interventions, and (iv) Encourage policy harmonization with the fiscal authority.
- **Exchange Rate Management Segment:** (i) Abrogate capital control measures, (ii) Improve communication of policy direction to the market, and (iii) Support the current crawling peg FX regime with regular adjustments that reflect changes in economic fundamentals.
- **Monetary Policy Anchor Segment:** (i) Return to an orthodox monetary policy regime where policy direction reflects the forces of demand and supply, (ii) Give explicit and synchronized focus to exchange rate and price stability, and (iii) Restore the CBN's independence and transparency.
- **Government's Banker Segment:** (i) End deficit financing outside of the legally permitted threshold and ensure previous intervention is fully recovered before new disbursement, and (ii) Maintain the independence of opinion in anchoring policy tools even when fiscal authority has a divergent target.
- **Banking Regulator:** (i) Improve financial system surveillance through proactive monitoring initiatives, and (ii) Revise income-stifling policies on banks while also ensuring prudence.

BANKING SECTOR REVIEW & OUTLOOK

In 2022, the world grappled with high inflation and central banks' responsed through interest rate hikes to tame consumer price increases. Notwithstanding, the global economy was resilient with a growth of 3.5%. However, Nigeria experienced a slight slowdown in GDP growth, reaching only 3.1% compared to 3.4% in 2021. Meanwhile, the financial services sector posted a more robust 17.2% GDP growth (10.5% in 2021). Profitability was impacted by rising operating expenses (OPEX), which squeezed profit margins. Consequently, the combined gross earnings of banks within Afrinvest's coverage universe saw a 24.6% growth in 2022, reaching ₦7.1tn. However, pre-tax profit (PBT) and profit after tax (PAT) increased by only 20.6% and 9.1%, respectively, a slower pace compared to the prior year's 25.6% and 22.0% growth.

In terms of asset creation, the loan books of our coverage banks expanded 6.3% to ₦30.0tn in 2022, reflecting CBN's efforts to increase credit accessibility. This expansion was supported by an 18.8% growth in deposit bases, reaching ₦63.2tn, as banks competed fiercely to attract deposits. Furthermore, aggregate credit extended to the private sector increased by 9.7% in 2022, a decrease from the 19.7% growth in the previous year. Notably, the industry's average non-performing loan (NPL) ratio improved to 4.2% in 2022 from 4.9%, thanks to more robust credit risk management practices by banks. However, impairment charges rose by 61.5% in 2022, partly due to Nigerian banks' exposure to Ghana's sovereign debt default. Meanwhile, industry Capital Adequacy Ratio (CAR) experienced a slight decrease of 64bps to 20.8% (ex. ETI & Unity Bank) due to a faster increase in the risk-weighted assets by 9.7%. Although CAR remains above the regulatory threshold, we recommend industry recapitalisation to mitigate the impact

of inflation and currency devaluation on capital to enhance global competitiveness.

For the non-interest Banking segment, its growth potential remains enormous and underpinned by factors, such as a large population with an interest in non-interest products and favourable regulatory support for the industry. However, the negative pass-through of elevated operating costs amidst high inflation has seen the industry's net profit margin moderate to 27.1% in Q4:2022. All in all, the performance of the banking sector failed to inspire a solid outing on the domestic bourse in 2022, owing to regulatory policies and the global trend of rising benchmark interest rates. Resultantly, the NGX Banking-10 index rose 2.8% in 2022 underperforming the broader market's 20.0% appreciation for the year.

BANKING THEMATIC SECTION

Getting Nigeria to Work Again... It is Time

More than six decades after gaining independence, Nigeria faces ongoing challenges in establishing a viable economic model to fully harness its potential. The initial crude oil boom of the 1970s and '80s which gave Nigeria a head start compared to non-oil-producing peers, lacked the necessary institutional mechanisms, governance checks and balances, and policy framework to drive sustained and inclusive growth. Quite the opposite happened as Nigeria's per capita GDP has since dropped far below levels attained in 1981. Countries such as Benin, India, and Kenya with similar per capita GDP sizes in 1960 have steadily grown same by 298.0%, 780.0%, and 414.0%, respectively according to World Bank data. Not surprisingly, broader measures of well-being such as the Human Development Index (HDI), Corruption Perception Index (CPI), and Good Governance Index (GGI) followed suit, falling behind most peers.

The magnitude of this shift becomes more overwhelming considering Nigeria's crowning as "The poverty capital of the world (World Poverty Clock)" and "The country with the highest number of out-of-school children (UNICEF)." In fact, between 2010 and 2022, the World Bank estimated that more than 20.0m more Nigerians fell into extreme poverty due to sub-optimal economic growth (CAGR: 2.6%) relative to population (CAGR: 2.8%), elevated inflation rate (13.8% annual average in 2010 vs 23.3% in 2023 Jan-Sept), debt overhang (₦5.2tn as of 2010 vs ₦87.4tn as of Sept-2023), steep currency devaluation (₦150.48/$ as of the 2010 year-end vs ₦815.31/$ as of 31st Oct-2023), and widespread insecurity (98,906 lives lost to various insecurity incidences since Council on Foreign Relations began tracking the data in Nigeria in 2012).

As President Tinubu's administration embarks on bold reforms to reset the economy, it is critical to ensure that policies target underlying causes rather than symptoms. It is instructive to highlight that the ongoing reforms are not the first for Nigeria given the history of the Structural Adjustment Program (SAP) of the 1980s and 1990s, National Economic Empowerment and Development Strategy (NEEDS) of 2004, Vision 20:2020 of 2009, Economic Recovery and Growth Plan (ERGP) of 2017, amongst others – all of which have largely been unsuccessful in driving lasting change. Therefore, failure to unmask the root challenges plaguing the country would be akin to "pouring new wine into old wineskin". The consequence would be policy fatigue and the perpetuation of a vicious cycle of ambitious development plans and underwhelming outcomes. On this basis, we lean on the New Institutional Economics (NIE) school of thought to gauge what real structural reform should look like for the Nigerian economy.

Understanding Old Problems in New Light... The NIE Perspective

The NIE postulates that the quality of social contract that exists between people is critical for the successful formation of institutions and reformation. This idea could stem from the fact that unity and shared vision are sine qua non in driving compelling visions as was the case with the US (The American Dream of post WWI & II era) and South Korea (1950s Miracle on the Han River) during key transformation periods. In Nigeria, a younger nation of 63 years with 371 ethnic groups, this sense of strong national orientation is often lacking, mostly due to deliberate fomenting of divisions amongst the populace by the political elite. The 2022 Nigerian Social Cohesion Survey Report by Africa Polling Institute (API) pointed out that the Nigeria Social Cohesion Index (NSCI) printed at 39.6% against 44.2% in 2021. The index below the 50.0% means that Nigeria is not as socially cohesive as it should be, due to higher proclivity towards ethnicity (50.0%) than nationalism (14.0%).

In an environment like this, common visions are difficult to realize as economics and politics are heavily regionalized to the detriment of all. In addition, sentiments of perceived partialities and marginalization would devolve into security challenges and outright hostilities by the fringes. Beyond this, the basic institutional environment (laws and institutions) to uphold trust, fairness, and cohesion has deteriorated owing to elitism, nepotism, and corruption. Transparency International ranked Nigeria (scoring 20 out of 100 points) as 154/180 on the list gauging perceived levels of public sector corruption across countries. In 2010, the country ranked 143/178. This corruption perception does not exist in a vacuum; the Brookings Institute citing the International Centre for Investigative Reporting estimates that Nigeria loses $18.0bn or 3.8% of GDP annually to corruption and financial crimes.

According to a 2019 joint report from the NBS in partnership with the United Nations Office on Drugs and Crime (UNODC), 30.2% of surveyed respondents either paid a bribe to, or were asked to pay a bribe by a public official. To provide context, two-thirds of bribes were paid to access services provided by public officials. In other words, public officials required undue incentives to provide the services for which they were either employed or appointed.

The complications and cost of doing business in such an environment are apparent. Seeking redress is also arguably an uphill task due to the weakness of the rule of law (118/140 on the 2022 World Justice Project Rule of Law Index). Meanwhile, many public institutions lack raison d'etre (2011 Steve Oronsaye Committee) only serving to bolster low-impact fiscal spending and complicate governance.

Perhaps one of the apparent evidence of flaws in the governance sphere is in the pages of the national budget where the 469 federal lawmakers (about 0.0002% of the population) account for ₦228.1bn of the budget (1.0%), a ratio of ₦486.3m per lawmaker vs ₦95,781 per head for the rest of Nigerians. This sharp divergence in the realities of “the representatives of the people” and “the people” is a major flaw that highlights the disconnect between society and institutions. Based on the NIE, these outcomes are not conducive to the intended economic reforms and create loud noise in the Nigerian economic model.

Repairing the Foundation… Our View

Some of the recent steps taken towards reviving the Nigerian economy by the new administration are commendable, as brave stances have been taken on critical issues that previous leaderships have dragged. We hold the view that the implementation of these reforms would be important for the success of the new administration. But beyond these, there are structural changes that must happen to provide the fertile ground for seeds to be sown…

Contacts

Investment Research & Consulting

Abiodun Keripe	akeripe@afrinvest.com	+234 1 270 1680 ext. 1034
Aminat Tolani	atolani@afrinvest.com	+234 1 270 1680 ext. 1027
Benedict Egwuchukwu	begwuchukwu@afrinvest.com	+234 1 270 1680 ext. 1023
Damilare Asimiyu	dasimiyu@afrinvest.com	+234 1 270 1680 ext. 1054
David Ogidan	dogidan@afrinvest.com	+234 1 270 1680 ext. 1104
Mary-Stella Nkwocha	mnkwocha@afrinvest.com	+234 1 270 1680 ext. 1139
Mobifoluwa Adesina	madesina@afrinvest.com	+234 1 270 1680 ext. 1051
Nathaniel Disu	ndisu@afrinvest.com	+234 1 270 1680 ext. 1114
Nelson Abudah	nabudah@afrinvest.com	+234 1 270 1680 ext. 1107
Precious Oluwafaka	poluwafaka@afrinvest.com	+234 1 270 1680 ext. 1150
Segun Adams	sadams@afrinvest.com	+234 1 270 1680 ext. 1073

Securities Trading & Brokerage

Adedoyin Allen	aallen@afrinvest.com	+234 1 270 1680 ext. 1016
Taiwo Ogundipe	togundipe@afrinvest.com	+234 1 270 1680 ext. 1601

Investment Banking

Suru Daniels	sdaniels@afrinvest.com	+234 1 270 1680 ext. 1098
Kate Isabota	kisabota@afrinvest.com	+234 1 270 1680 ext. 1017

Asset Management

Christopher Omoh	comoh@afrinvest.com	+234 1 270 1680 ext. 1505
Robert Omotunde	romotunde@afrinvest.com	+234 1 270 1680 ext. 1039

Trustees

Rita Abengowe	rabengowe@afrinvest.com	+234 1 270 1680 ext. 1005
Chisom Nwogbo	cnwogbo@afrinvest.com	+234 1 270 1680 ext. 1048

For further information, please contact:

Afrinvest West Africa Limited (AWA)

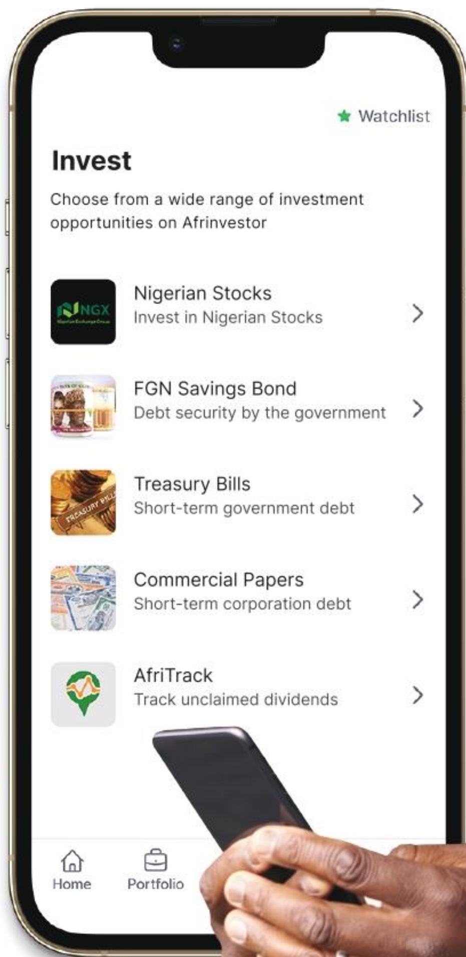
27, Gerrard
Road, Ikoyi,
Lagos, Nigeria.

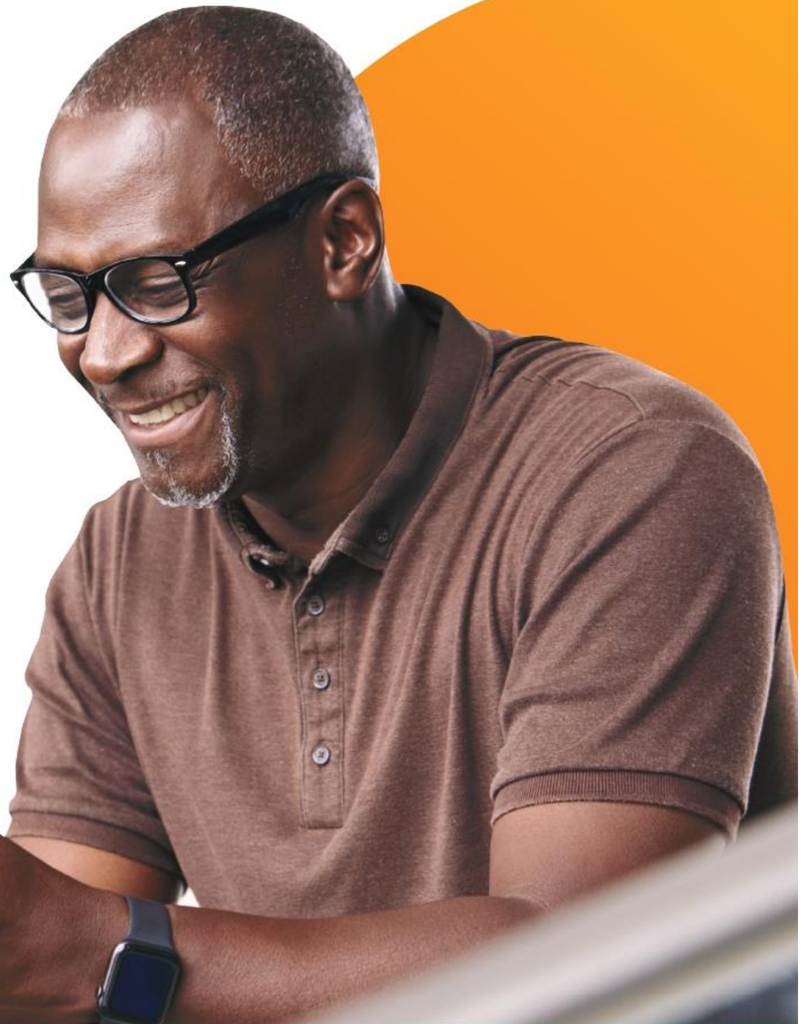
Tel: +234 1 270 1680

www.afrinvest.com

Buy & Sell Stocks with Ease.

Afrinvestor gives you access to stocks listed on the Nigerian Exchange.
You can also invest in Treasury Bills and Commercial Papers with just a few taps.





For more details,
Call: **+234 1 270 1680** or email: **connect@afrinvest.com**

Afrinvestor is brought to you by **Afrinvest Securities Limited** (A Dealing Member of the Nigerian Exchange Group)

optimus
by Afrinvest

Save & Invest in Naira & in Dollars with Optimus by Afrinvest

With Optimus by Afrinvest, you can grow your money in Naira or in Dollars, create investment plans and diversify your investment portfolio.

Visit www.optimus.ng to start investing

For more enquiries, send an email to **support@optimus.ng**

Powered by