NIGERIA Macro-economic OUTLOOK FOR 2022
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 2022.

KEY THEMES / TRENDS FOR 2022 INCLUDE:

• Fiscal Policy, 2022 FG Budget and Finance Act 2021
• Total Debt Profile
• Monetary Policy - Interest Rate and Inflation
• Exchange Rate Policy, External Reserves and Capital Flows
• Oil Prices, Oil Production and Insecurity
2021 REVIEW AND HIGHLIGHTS OF 2022

In his 2016 podcast; My Little Hundred Million, Malcolm Gladwell talks about the concept of Strong-Link vs. Weak-Link approach to problem-solving, illustrated using basketball and football. He argues that the strength of a basketball team can revolve around its strongest player, a typical feature of a strong-link sport, as that player can single-handedly dominate the game and win it for the team. In a weak-link sports like football, however, the best player will still require the input of the other teammates to be able to receive the ball and make an impact on the game; the performance of the team therefore depending on the relative strength of the weak link. Football is said to be a weak-link sport as the team is only as good as its weakest link.

Drawing a line to how the pandemic has been managed, the relative success of global efforts to tackle the impact of the covid-19 pandemic would be dependent on how much resources are committed to achieving a high level of global vaccinations through widespread availability of vaccines, and adoption of protective hygiene – across both high-income and low-income countries. According to World Health Organization (WHO), of the 61.7% of the world’s population that have received at least a dose of the vaccine, 77% are from high and upper-middle income countries compared to low-income countries where the vaccination rate lags at 10% as of January 13, 2022. In a recent publication on its website, the WHO insists that there are enough vaccines to go around and drive transmission and mutation down, but vaccine hoarding created a staggering vaccination gap between big powerful countries and their low-income counterparts.

The fight against climate change achieved some wins in the course of the year. In addition to retaining the 1.5C ambition, participating nations at the 26th UN Climate Change Conference of the Parties (COP 26) held in Glasgow, committed to renewed awareness in cutting emission, climate finance and adaptation. The true measure of the COP’s success is no longer in the formal agreements but rather in the level of compliance of countries to agreed terms.

As a beacon of modern democracy, the attempted Insurrection of January 6th, 2021 did not only portray the United States of America (US) in a bad light, it also depicted it as a nation at war with itself; an act repugnant to the very idea of modern-day democracy. This is further reinforced by the hasty and unexpected withdrawal of US and NATO forces from Afghanistan which, while long overdue, has resulted in the return
of the Taliban and precipitated a major humanitarian crisis in the country with over 20 million Afghans on the brink of famine.

In Africa, following the exacerbation of local economic challenges in the wake of the covid-19 pandemic, cases of hostile power take-overs by the military have been on the rise, with 5 successful and 1 attempted coup recorded in the last 24 months. In almost all cases, Coup Plotters have cited rising poverty and endemic corruption as reasons for their actions.

Speaking of hostilities, Russia’s military ordered a full-scale invasion of Ukraine after earlier claiming its troops were in two Russian-backed rebel-held regions of eastern Ukraine; Donetsk People’s Republic and Luhansk People’s Republic on a ‘peacekeeping’ mission following its recognition of the sovereignty and independence of the self-declared republics. While Ukraine’s foreign minister has referred to the attacks as a Full-scale invasion with military infrastructure, border guards and civilians affected, his Russian counterpart insists that the strike targeted Ukraine’s military infrastructure and poses no threat to the population. NATO and other top European leaders have condemned Russia’s move, and Biden has warned of consequences for Russia’s unprovoked and unjustified attacks on Ukraine and insists that the world will hold Russia responsible. Experts have argued that aside from leading to Europe’s biggest war since 1940, the escalation of this invasion would bring about unprecedented economic shocks, avoidable human suffering and geopolitical realignment.

China’s clampdown on its tech giants including Ant, Meituan, Didi, etc. owing to antitrust concerns was a prelude to Xi Jinping’s scrutiny of big techs. This was closely followed by its ban on all cryptocurrency transactions as he sought to strike a balance between innovation and governance. In the Indo-Pacific region, the security agreement between Australia, the United States and the United Kingdom (AUKUS) as well as the strengthening of Japan-US relations amidst China’s incursion into Taiwan seem to have stepped-up Sino-American rivalry, with China referring to the alliance as ‘highly irresponsible’. Xi Jinping could be paying close attention to how the West reacts to the Russian invasion of Ukraine as it could be a ‘dry-run’ for his ambition in Taiwan.

Available data by the World Bank suggests that the global economy is estimated to have grown by 5.5% in 2021, aided by a relaxation of pandemic-induced lockdowns & movement restrictions and improved economic activities boosted by increased vaccination rates in most countries. In 2022, the global economy is expected to decelerate and grow by 4.1% on the back of covid-19 resurgence, lingering supply chain challenges and easing of fiscal support from governments. Notwithstanding the projection of investments and output returning to pre-pandemic levels in Advanced Economies (AE), output in Emerging Markets and Developing Economies (EMDEs) is projected to remain depressed at 4.6% in 2022 from 6.3% estimated for 2021 as a result of weak investment and output which are inadequate to return growth to pre-pandemic levels, tighter monetary policies and lower vaccination rate stemming from inadequate vaccines.
The resurgence of highly transmittable covid-19 variants resulted in a surge in covid-19 cases. While fresh rounds of lockdowns were imposed in some economies, most governments refused to re-introduce any form of movement restrictions but instead opted for stiffer safety protocols and increased vaccination awareness. Thus, the impact on economic activities was not as severe as recorded in 2020. Sub-Saharan Africa (SSA) growth is estimated at 3.5% in 2021 aided by a rebound in commodity prices and easing of restrictions on social activities. The region is projected to grow by 3.6% in 2022 buoyed by strong commodity prices, gradual recovery of tourism and improved activities with the region’s main trading partner, China. Furthermore, the pace of recovery will also be constrained by increased policy uncertainty and slow implementation of structural reforms.

Most countries in the region witnessed a significant weakening of fiscal balances amidst the implementation of relief measures to households and businesses to improve debt sustainability. In addition to low covid-19 vaccination coverage stemming from poor supply and distribution of vaccines, other downside risks to the SSA growth projection for 2022 include a decline of commodity prices, increase in poverty occasioned by higher food prices and increasing insecurity within the region. The region’s three largest economies, Nigeria, South Africa and Angola, are projected to grow by 2.5%, 2.1% and 3.1% respectively in 2022 supported by higher oil prices, gradual easing of OPEC production cuts and improved management of the pandemic.

Nigeria

Following the expiration of the Economic Recovery and Growth Plan (ERGP) for 2017 - 2020 and Vision 2020 Plans, the federal government launched the National Development Plan 2021 – 2025 aimed primarily at significant infrastructural investment, macro-economic stability, a friendlier investing environment, better living standards, generate 21 million jobs and ultimately, lift 85 million Nigerians out of poverty. Economically, the plan aims to accelerate inclusive private sector-led growth as it seeks to unlock the potential in most sectors for sustainable, holistic and inclusive national development. Historically, Nigeria has struggled to drive the full implementation of most of its previous development plans, so it remains to be seen how well this plan will be executed.

The country recorded a feat in the course of 2021 following the enactment of the Petroleum Industry Act (PIA) after 14 years of legislative deliberations. The PIA seeks to address a host of challenges facing the country’s oil and gas sector as it provides a veritable framework to address governance, administrative and fiscal inefficiencies as well as host community relations. The Act transcends a mere legal and regulatory document for the oil and gas industry, it is also an economic law with far-reaching implications for the Nigerian economy. The inauguration of a Steering Committee and the Implementation Working Group by the federal government would suggest that the government is posturing to commence implementation of the Act in the course of 2022.
According to the Nigeria Centre for Disease Control (NCDC) data, Nigeria has reported about 254,010 infections and 3,141 covid-19 related deaths, which translates to a 1.2% fatality rate since the outbreak of the covid-19 pandemic. That said, the fully vaccination rate as at February 27, 2022 stood at 3.9% (8.1 million people) of the country’s population with 26.5 million doses administered. Fully vaccinated persons refer to those that have received two (2) doses.

Despite the growth of 6.1% y-o-y primarily driven by strong performances in the third and fourth quarters which more than offset the losses recorded in the first and second quarters of 2021, the Nigerian equity market had a roller-coaster year characterised by bargain hunting and profit-taking despite the resilient earnings posted across various sectors. Other factors that contributed to the rather difficult year of the equities market include rebalancing of portfolios from equities to fixed income, increased participation of alternative asset classes, reduced portfolio investments owing to FX illiquidity and lack of catalysts to boost activity. The volatile performance of the market earned it the 9th best performing exchange in Africa in 2021. Considering that 2022 is a pre-election year, we do not expect the equities market to perform significantly better than it did in 2021. Going into 2022, the positive outlook for macro-economic trends include positive GDP growth, healthy reserves, elevated oil prices coupled with increased spending and consumption owing to election campaigning suggests that the economy would post positive figures in 2022.

GDP growth

Source: NBS
Business and Regulatory Environment

In the light of the gradual improvement in vaccination rates, a better understanding and management of the pandemic, strong oil prices and positive GDP growth albeit on the back of a lower base, the business environment made an impressive recovery from the weak pandemic-induced performance of 2020. We expect significant improvements in the business environment going into 2022 supported by improved FX liquidity as a result of strong reserves, favourable oil prices, and strong production levels with minimal disruption challenges. Foreign investors have continued to reduce their exposure to Nigeria amidst difficulty in repatriating funds from the country which has seen the MSCI continue to apply the ‘Special Treatment’ on Nigerian securities. The Special Treatment status was placed on Nigeria in May 2020 after the MSCI decided not to implement index review changes for securities classified under the MSCI Nigerian indexes or composite indexes with Nigeria as a component. There are however, no indications of plans to remove Nigeria from the MSCI Frontier Market index.

Being a pre-election year, the CBN could be expected to intensify its excess liquidity mopping up activities to mitigate a heightening of inflationary pressures and further depreciation of the naira against the US dollars. The CBN faces a herculean task of keeping interest rate moderated to sustain the momentum of positive
growth and improve investments in the economy. We anticipate the introduction of a cocktail of monetary policies to sustain the drive for inclusive growth, curb inflation and achieve exchange rate stability.

Fiscal Environment and the 2022 Appropriation Act

Following amendments by the National Assembly, President Muhammadu Buhari signed the 2022 Appropriation Bill and the accompanying Finance Bill into law on the last day of 2021 with implementation expected to commence in January for the 2022 fiscal year. The 2022 Appropriation Act was increased by N735.8 billion to N17.12 trillion by the National Assembly from the N16.39 trillion earlier proposed by the Presidency. The 2022 approved budget dubbed ‘Budget of Economic Growth and Sustainability’ is 26% higher than the 2021 budget and is predicated on a benchmark oil price of US$62 per barrel (pb), oil production of 1.88 million barrels per day (mbpd), an exchange rate of N410.15/US$1, projected GDP growth of 4.2% and inflation rate of 13%. As the last full-year budget to be implemented by the Buhari administration, the 2022 budget seeks to build on the achievements of its previous budgets and deliver on its goals and aspirations. With a targeted revenue of N10.74 trillion and projected expenditure of N17.12 trillion, the budget deficit is estimated at N6.26 trillion.

Of concern is the 34% increase in projected revenue to N10.74 trillion from N7.99 trillion in 2021. While we applaud the government’s decision to impose a cost-to-income ratio of 50% on Government Owned Enterprises (GOEs) to help stem the haemorrhaging expense profile of these GOEs and in turn, bump up the revenue base, we are of the option that an amicable resolution of the lingering issues between the federal and state government regarding VAT collection will positively impact the revenue profile of the federal government.

As is now customary with recent annual budgets, the 2022 Appropriation Act was accompanied by the 2021 Finance Act with various amendments spanning 12 different laws and became effective on January 1st, 2022. The Act provided for greater borrowing latitude in the Fiscal Responsibility Act, introduced tax regimes for foreign entities and e-commerce companies with activities in Nigeria, amongst others. Some notable changes in the Act include:

The budget deficit will be financed primarily by N5 trillion Borrowings, Privatization Proceeds of N0.9 trillion and Multi-lateral & Bi-lateral loans estimated at N1.2 trillion. On the expenditure side, N5.46 trillion and N6.9 trillion are earmarked for Capital Expenditure and Non-Debt Recurrent Expenditure as well as N3.8 trillion for Debt Servicing. The budget proposes to generate N5.52 trillion in oil revenue, N4.23 trillion from Non-Oil Revenue and N969.7 billion from Other Revenue sources.
1. Capital gains tax at 10% is chargeable on the disposal of shares worth N100m or above in any 12 consecutive months except to the extent that such proceeds are reinvested in the shares of any Nigerian company. Transfer of shares under the regulated Security Lending Transaction is exempted.

2. Imposition of a Cost-to-Income ratio of 50% on Government Owned Agencies (GOE) to significantly rationalize wasteful spending by GOEs.

3. Under the amended Companies Income Tax Act (CITA), Lottery and Gaming businesses including betting, promotional competition, gambling, gaming machines and the likes, are now specifically taxable.

4. FIRS to be empowered to assess Company Income Tax (CIT) on the turnover of a foreign digital company involved in transmitting, emitting, or receiving signals, sounds, messages, images or data of any kind including e-commerce, app stores, and online adverts.

5. Following the enactment of an Act in 2019 imposing a tax of 0.005% of the net profit of companies operating in Nigeria, the FIRS has now been appointed to assess, collect and enforce the payment of the Nigerian Police Trust Fund levy.

6. Mandatory payment of gross revenue collected by federal ministries, departments or agencies to the federation account or consolidated revenue fund except otherwise authorized by law.

7. The amendment of the Fiscal Responsibility Act will now enable the government to borrow for “critical reforms of significant national impact” in addition to Capital expenditure and Human development.

The imposition of a 50% Cost-to-Income ratio for GOEs is very commendable as we expect this singular provision to stem the wasteful orientation of most GOEs. Another laudable provision of the Act is the introduction of taxes for the lottery and gaming businesses in the country. The Nigerian Sport betting...
and Gaming industry has grown tremendously over the last decade as a result of the country’s teeming youth population, affordability of smartphones and increased access to internet-enabled devices. Available data from 2020 suggests that the country’s video game market was worth US$104 million. A separate report by the Research and Market’s 2019/2020 report on the Nigerian Sports Betting industry revealed that the market is estimated at US$2 billion and expected to accelerate further amidst the rapid spread of mobile phones. In a statement credited to the Minister for Special Duties and Intergovernmental Affairs, Sen. George Akume, he revealed that the industry posted over N250 billion in revenue in 2019, yet the government revenue hovered around N1billion. Global trends have shown that, if well regulated, the industry could be a major sector for the generation of tax revenue for the government.

Debt Profile

In view of the devastating impact of Covid-19 on the world’s poorest countries and the likelihood of pushing over 100 million people into extreme poverty, the World Bank and the IMF urged G20 countries to establish the Debt Service Suspension Initiative (DSSI) to help low-income countries focus their resources on safeguarding lives and livelihood of the most vulnerable people. The DSSI which became effective in May 2020 has delivered more than US$10.3 billion in temporary suspension of debt service payment to over 40 eligible countries. Surprisingly, Nigeria turned down the opportunity to participate in this initiative despite its heightened debt service obligations, citing concerns of future access to debt and possible credit-rating downgrades. According to the World Bank, Nigeria could have saved about US$324.7 million (N133.3 bn) between January and December 2021 through the DSSI. The DSSI would have seen the government channel a portion of the said funds into supporting struggling SMEs and other businesses which could generate taxable profit to enhance the government’s tax revenue in the foreseeable future.

![Graph showing Nigeria's Oil Production Volume (mbpd)](image-url)

**Source:** OPEC
The latest data from the Debt Management Office (DMO) revealed that the country’s total debt stock as of September 30, 2021 stood at N38 trillion (US$92.6 billion) which represents an 18% y-o-y increase from N32.2 trillion reported in September 2020 primarily driven by US$4 billion Eurobond issued by the government in September 2021. Consequently, total debt service-to-revenue ratio was estimated at 73% as of October 2021 amidst the country’s poor revenue generation challenge and inability to reduce its overheads and recurrent expenditure. While the Debt-to-GDP ratio estimated at 35% is significantly below the DMO’s newly increased limit of 40% (increased from 25% in the 2020-2023 Debt Management Strategy and Target to accommodate new borrowings, ways and means, etc.), the government’s interest payment gulps a huge chunk of its declining revenue. Hence, making the seemingly low debt-to-GDP ratio increasingly prone to unfavourable shocks.

Despite the rising debt profile, the National Assembly’s lower chamber approved an external borrowing request of US$5.8 billion and another US$10 million grant to the federal government. Asides the widespread concerns around the utilization of these loans, we note that the rising debt profile and the unsustainably high servicing cost is becoming a source of concern for many Economists and private sector practitioners. We hope to see concerted efforts directed at reducing government overheads and enhancing revenue generation.

**Oil Price and Production**

Brent crude prices recorded a progressive decline in November 2021, reaching a low of US$68.87 per barrel (pb) as of December 1, 2021. However, the decision by the OPEC and non-OPEC Ministerial Meeting (ONOMM) in December 2021 to maintain a gradual upward adjustment of overall monthly production of 400,000 barrels per day (bpd) till February 2022 drove prices northward with Brent Crude trading at US$78.98 pb on the first trading day of 2022, and accelerating furthering to US$97.63 pb as at February 22, 2022.

In view of the positive performance of participating countries in the Declaration of Cooperation (DOC) with overall conformity to production agreement estimated at over 100% and world oil demand forecasted to grow by 4.2 mbpd, we believe that oil prices will, on average, hold above US$70 pb in 2022.

Due to covid-19 and OPEC’s decision of gradual production increases, coupled with the cumulative output loss from terminal shutdowns in the course of 2021, Nigeria’s crude oil production is estimated to have averaged 1.69 mbpd (including Condensates) in 2021. This is 9% lower than the benchmark production estimate of 1.86 mbpd for the 2021 approved budget framework. Improved vaccination rates should mute the possible impact of Omicron and other variants of the virus. This coupled with OPEC’s decision to gradually increase oil production output should be net positive for Nigeria’s crude production in 2022.

Another factor that is expected to change the fortunes of the nation’s oil and gas industry for good is the passage of the long-awaited Petroleum Industry Act in
2021. The PIA is expected to address some challenges that have rocked the country’s petroleum industry as it seeks to bring a cohesive legal framework, particularly in the midstream and downstream sub-sectors. We are optimistic that the enactment of the Act would attract significant investment into the sector. Overall, we do not see a risk to the budget benchmark production output of 1.88 mbpd as we believe that production levels will average 1.75 mbpd in 2022. The downside risks remain an escalation of the covid-19 pandemic on global oil demand, the impact of the Russia-Ukraine war on oil prices and disruptive activities of illegal bunkering and vandals.

We are however less optimistic that higher oil prices could translate to a significant build-up in external reserves as the huge fuel subsidy bill is expected to dampen most of the benefits arising from an increase in oil prices.

Insecurity

The security situation in the country has continued to deteriorate over the last decade as Nigeria battles unabated security challenges on several fronts - the activities of militant Boko Haram insurgents in the north, violent clashes amongst ethnic groups (sometimes with religious undertone) as well as farmers-herders clashes in the Middle Belt, separatists’ activities in the South East and indiscriminate kidnapping and banditry activities at almost every corner of the country. The trend of widespread kidnapping especially of school children, commuters and other soft targets has become a scary threat to Nigerian families. Most of the more than 1,000 students/pupils abducted from their schools between Dec. 2020 and July 2021 only regained freedom after ransoms were paid to their captors. For context, the displacement of over 2 million people by Boko haram insurgency and banditry activities alone has led to the emergence of armed civilian vigilante groups and invariably, the proliferation of arms and ammunition as more people resort to defending themselves and their communities.

Despite several changes in the leadership of the country’s law enforcement agencies, the much-needed improvement of the country’s security situation remains elusive. We note and commend the pressure mounted on the federal government to continuously change the hierarchy within the Army, Navy, Airforce and Police until there are meaningful improvements in the country’s security situation. We would also expect the same treatment for the Nigerian Immigration Service (NIS) and Nigerian Customs Service (NCS). These agencies are responsible for border policing, migration management and championing the anti-smuggling strategy of the country. With over 1,400 identified illegal entry routes in addition to the 84 legal entry routes into the country, according to the country’s Minister of Interior in 2018; Mr. Abba Moro, Nigeria is said to be home to over 70% of the illegal small arms proliferation in the region.

The influx of weapon-wielding herdsmen and bandits from neighbouring African countries also suggests that the migration management strategy is lax. We believe that an accountability-cautious NIS and NCS could champion the renovation of the country’s borders, curtail the proliferation of arms and ammunition through the borders and enhance proper migration management. The relevance of these agencies cannot
be over-emphasized thus, it is only fair that they are subjected to as much scrutiny (if not more) as the other law enforcement agencies not only on revenue generation, but also in ensuring internal security.

With a security allocation of N2.51 trillion, representing 14.8% of the planned 2022 expenditure budget, expectations of a well-implemented security strategy able to combat the menace of insecurity within the country are not misplaced.

The reporting of the country’s security challenges has adversely affected its reputation and economic growth prospects. For context, Nigeria is ranked No. 3 in the 2020 Global Terrorism Index (GTI) report, behind Afghanistan and Iraq. The report which measures the impact of terrorism in the world, further reveals that of the 13,826 terrorism-related deaths in 2019, Nigeria accounts for 9% of those deaths earning it second place behind Afghanistan which accounted for 41% of terrorism-related deaths.

Monetary Policy – Inflation and Interest Rates

In a bid to boost economic activities, most central banks implemented several stimulus injection policies and relief packages to increase spending, consumption and ultimately, spur growth. On the fiscal side, the government also resorted to heavy spending to improve economic activities and revive struggling sectors. This has resulted in global inflationary pressures amidst positive GDP growth. Thus, monetary authorities are now faced with the challenge of balancing positive growth with inflationary concerns. Conversely, Nigeria recorded an 8-month stint of decelerating inflation which started in April 2021 after it peaked at a 4-year high of 18.17% in March 2021, continued through November 2021 at 15.40% and inched up to 15.63% in December 2021. This increase was attributed to the yuletide-induced spike in demand and associated price increases.

### Inflation (y-o-y%)

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<td>Value</td>
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*Source: NBS*
The decline in inflation has been attributed to base effect and early harvest coupled with relative easing of movement restrictions. There are, however, concerns that lingering insecurity, violent communal clashes in the food-producing regions, supply chain challenges and depreciation of the Naira against the US dollars could drive inflation northwards in 2022. The enactment of the PIA in August 2021 supports the removal of subsidy and the full deregulation of the downstream oil and gas sector, coupled with a possible escalation of domestic gas prices and unfavourable weather conditions restricting planting and harvest seasons present downside risks to the continued moderation of inflation.

The Minister of Finance, Budget and National Planning, Mrs. Zainab Ahmed hinted during one of the Eurobond roadshow meetings that PMS subsidy was only factored for the first half of the year in the 2022 budget. While we agree that the deregulation of the downstream oil sector is long overdue and inevitable, we note that the removal of subsidy now will see Nigerians spend as much as N340/litre on PMS from N167 levels which will worsen already depressed household income and significantly increase the general price of goods and services. Furthermore, considering that 2022 is a pre-election year, it would seem unlikely that the ruling All Progressive Congress (APC) would consider such a move in a bid to moderate negative public sentiments.
ahead of the elections. Overall, the huge spending and cash distribution that typifies campaigns and electioneering in the country pose downside risks to headline inflation. Consequently, we expect inflation to average 16.3% in 2022.

In view of positive GDP growth figures and declining inflation numbers, the monetary authorities rode on this to gradually increase primary market rates in the bonds and T-bills space in the fourth quarter. Turnover at the NTB market also recorded improved turnover growing over 80% from 2020 levels. The recorded increase of external reserves buoyed by the Eurobond Issuance and IMF’s SDR allocation, spurred the increase in daily turnover at the I&E FX window in the second half of the year. The need for positive real returns amidst a possible upward trend in inflation might see the apex bank increase yields on fixed-income securities.

At the other end of the continuum, however, the need to fund the budget deficit of N6.26 trillion would very likely see the government resort to domestic borrowing by the Debt Management Office (DMO). We might see rates trend upwards to attract flows into the market. We expect the Monetary Policy Committee (MPC) to leave MPR unchanged in the first half of the year and increase it by about 100 bps as the market becomes awash with campaign-related spending.

Exchange Rate, External Reserves and Capital Flows

The CBN’s decision to discontinue the sale of FX to Bureau De Change (BDC) operators for allegedly mishandling FX was widely applauded as it was seen as a move in the right direction. The apex bank also clamped down on websites that hosted daily real-time exchange rates for the official and parallel markets. Notwithstanding these actions, the pressure on the naira continues to mount. As at the time of filing this report, the naira exchanged for N415.33 to a dollar at the official market (NAFEX).

The external reserve was supported by proceeds from the US$4 billion Eurobond Issuance and receipt of US$2.3 billion, of the US$3.35 billion due to Nigeria, under the Special Drawing Rights (SDR) allocation of the IMF. Against the backdrop of widely held expectations, the country’s reserves did not benefit from the strong oil prices of 2021 as a result of lower oil production levels, spiking fuel subsidy receipts, maturing SWAP positions and FX shortages in the market. That said, the growth in reserves by 14% (US$4.9 billion) between the first and last trading days of 2021 was as a result of the receipt of these funds. In view of a strong outlook for oil prices supported by healthy reserves, we expect the CBN to sustain the momentum of its H2 2021 market intervention to ensure a relatively stable exchange rate.

The Q3 2021 National Bureau of Statistics (NBS) report on capital importation revealed that total capital inflows stood at US$1.73 billion in Q3 2021 representing an 18% y-o-y and 98% q-o-q growth from US$1.46 billion and US$876.6 million recorded in
Q3 2020 and Q2 2021 respectively. On a year-to-date (ytd) basis, however, capital inflows dropped by 9% from US$1.91 billion recorded in the first quarter of 2021. The growth recorded was driven by investment in money market instruments and bonds investments amidst a decline in equities.

A cursory look at the YTD capital inflows into the country revealed that the country attracted almost twice as much capital in 2020 than it did as of Q3 2021. Specifically, a total of US$8.61 billion was inflowed as capital as of Q3 2020, down from US$20.19 billion in 2019 compared to US$4.51 billion as of Q3 2021. While analysts have attributed this staggering drop to portfolio investors posturing for the campaign season ahead of the 2023 elections, it is not unlikely that the negative real yield, lingering insecurity and the uncertainty around the FX policy, etc. may have also contributed to this decline.

Across the capital inflow components, portfolio investment contributed US$1.22 bn (70.3%) of the total capital inflow for Q3 2021 which represents 121% q-o-q growth from US$551.4 million recorded in Q2 2021. Similarly, on a y-o-y basis, portfolio investment spiked by 199% from US$407.25 million. Other Investments and Foreign Direct Investments (FDIs) accounted for 23.5% (US$406.25 million) and
6.2% (US$107.8 million) of total capital inflows in the referenced quarter. Conversely, the Other Investments and FDI components recorded a q-o-q growth of 65% and 38% from US$246.27 million and US$77.97 million recorded in Q2 2021 respectively.

The CBN adopted the NAFEX rate as the official rate in Q2 2021 and eventually devalued the naira to N435/US$1 on the last business day of the year, representing a 6.12% y-o-y depreciation of the naira at the I&E window in 2021. Notably, 2021 witnessed the continued widening of the gap between the official and parallel market rates. While we expect FPI inflows to remain low as rates in developing economies normalise and the real return on government securities remain negative, remittance inflow is likely to improve on the back of improved economic activities in emigrants host countries and the continuation of the CBN’s Naira 4 Dollar initiative. The CBN recently introduced two (2) policies to improve FX liquidity in the market; Non-Oil FX rebate scheme and RT200 FX programme. While the former is a special local currency rebate scheme for non-oil exporters who sell export proceeds into the I&E window, the latter will entail the establishment of a dedicated non-oil export terminal anchored on reaching a goal of US$200 billion in non-oil exports. We applaud the CBN’s drive to significantly improve FX liquidity in the market to reduce dependency on oil revenue and foreign portfolio investments.

Overall, we expect that the CBN’s capacity to defend the naira will be buoyed by strong oil prices, healthy reserves, diaspora remittances, and the newly introduced non-oil export schemes.
Overview of 2021

Asides from launching the e-Naira - the digital currency project of the naira - the CBN commenced the implementation of Basel III, halted FX sale and license issuances to BDCs while directing banks to sell FX directly to customers as well as extented indefinitely the CBN’s Naira 4 Dollar scheme on the back of improved diaspora remittances. The CBN kept the rates on investment securities low for most parts of the year amidst increased government borrowings, the depressed yield on fixed income securities, increased regulatory cost and relatively lower FX revaluations gains.

The tension between banks and Telcos intensified in 2021 culminating in a stern disagreement regarding the USSD session charge, one that needed the intervention of the CBN and Nigerian Communications Commission (NCC) to mediate. The challenges surrounding repatriating funds by foreign portfolio investors continued in 2021.

Going into 2022, the CBN will need strong reserves and sustained high oil prices to improve the FX liquidity in the market in order to meet domestic demand as well as the demands of FPIs seeking to repatriate funds from the country.

Outlook for 2022

Discretionary CRR debits will continue in 2022 and would weigh negatively on asset yield for the sector. The relatively low yield on fixed income securities (FIS) will mount pressure on banks to intensify credit creations to the private sector which will in turn increase competition for quality loans amongst banks and cause funding cost to inch up slightly. The pressure on funding could also trigger a complimentary repricing on deposits in line with current market realities. The year could witness an intensified competition for deposits not only between banks and non-bank competitors but also with the federal government as a result of FGN Sukuk Bond issuances and possible pick up of the e-naira, effectively taking away deposits from banks.

Following the success recorded in the digital banking space post-pandemic and the massive investments made by banks to contain the pressure from fintechs, Banks will continue to look for innovative ways to grow non-interest revenue as well as consumer and retail loans. In view of an expected increase in government borrowing on the back of a higher budget deficit and dwindling revenue, a low-interest rate regime might not hold for much longer.
We expect the CBN to continue to defend the naira with more frequent interventions in the I&E window. Overall, the regulatory authorities will maintain its hold on the market as it continues to monitor activities in the market and will be quick to implement policies to mitigate the developments that might negatively affect its plan for a stable naira.

**Asset Quality**

In view of the forbearances granted by the CBN to banks on certain exposures, the apex bank has continued to assist banks in dealing with the issues of bad loans. In 2021, the CBN introduced a sinking fund for loans enjoying forbearance. The sinking fund will require banks to set aside 15% of Retained Earnings every half year for 3-5 years. In effect, the regulators have given the banks the option of taking provisions for delinquent loans through Retained Earnings instead of hitting the P&L. We note that this is a positive for the industry as sterilised funds will help to douse the impact of delinquent loans on capital in the event they crystalize.

The relatively lower yield on fixed-income securities prompted most banks to aggressively grow their loan book. Recent money and credit statistics by the CBN revealed that loans by banks to the private sector increased by 13.8% from N29.7 trillion in Sept. 2020 to N33.8 trillion as of Sept. 2021. The report also revealed that loans to the government grew by 35% to N13 trillion as of Sept. 2021 from N9.7 trillion in Sept. 2020. Although there are concerns that the CBN’s interventions as a percentage of total system liquidity is quite sizeable, and competes with and in some other cases, crowds out loans from banks, most of the intervention funds are for new businesses and to select sectors with a longer tenure.

Going into 2022, we expect the CBN to maintain its accommodative stance, further strengthened by strong oil prices, positive GDP numbers and tapering inflation. Thus, provisioning would return to somewhere around pre-pandemic levels in view of Basel III impact while NPL and Cost of Risk (COR) are also expected to remain depressed as the uptick in economic activity and strong oil prices could translate into improved performance of certain struggling or restructured exposures. An upside to low NPLs and COR could arise if the apex bank decides to further extend its forbearance on certain exposures.

**Basel III Implementation**

After a 12-months delay due to the covid-19 pandemic, the CBN successfully implemented the third set of regulations of the Basel Accord - Basel III - in November 2021. The new framework seeks to achieve stronger capital and liquidity positions for banks for improved stability of the global financial sector. In other words, the new framework is expected to strengthen capital levels & quality as well as enhance the liquidity position of banks. Specifically, Basel III introduced some changes to the existing Basel II framework, including a non-risk-based Leverage Ratio (LeR). According to the guidelines for Basel III issued by the CBN, banks are
now required to maintain a minimum LeR of 4% at all
times, with banks designated as Domestic Systematic
Important Banks (DSIB) required to maintain an
additional 1% buffer above the minimum rate of 4% (i.e. 5%).

Under the guidelines for Basel III issued by the apex
bank, the breakdown of total capital has evolved as
it further divides Tier 1 Capital into Common Equity
Tier 1 (CET1) and Additional Tier 1 (AT1) Capital with
minimum ratios of 10.5% and 0.75% respectively. This is against the backdrop of Basel II where capital
was only split into Tier 1 and Tier 2. The new standard
also introduces Liquidity Coverage Ratio (LCR) to the
existing performance ratios of banks. The LCR will
require banks to hold sufficient high liquid assets,
strong enough to survive a specified period of stressed
funding scenario.

A minimum capital requirement of 15% is required
for DMBs and an additional 1% for Banks designated
as DSIB (16%). An additional 1% capital buffer for
Capital Conservation Buffer (CCB1) will be required
under Basel III which takes the total minimum capital
requirement to 16% for Banks and 17% for DSIBs. The new guidelines also introduced a Countercyclical
Capital Buffer (CCB2) which has been set within a
range of 0-2.5% and shall be determined by CBN
from time to time. The CCB2 is currently set at 0% by
the CBN.

Generally, the capital requirements under Basel III are
more stringent to prevent banks from taking undue
risks that can impact the financial system. Although
the new framework has taken off since November
2021, the CBN noted that it will run concurrently with
the Basel II framework for an initial period of six (6)
months, extendable by an additional three (3) months
subject to satisfactory industry performance.

While some analysts and investors have argued that
the new framework will negatively affect dividend pay-
outs of these banks considering that they will need to
hold more liquid assets, regulators have insisted that
the goals of a healthy financial system characterised by
strong capital positions and leverage are in the interest
of all banking stakeholders and as such, outweighs
the immediate reduction in dividend pay-out.

**Capitalization**

In view of the introduction of Basel III which provides
for a more stringent capital regime where the strength
and sufficiency of a bank’s Tier 1 capital will determine
how much risk it can take, most banks will look to
shore up their Tier 1 capital position. For context, the
new framework allows for banks to raise Tier 1 capital
through the issuance of Perpetual Bonds. We expect
to see more banks tap into this mode of capital raising
just like some Tier 1 banks did in 2021.

Of concern, however, is the view of some analysts that
the new capital guideline could knock off as much
as 200 bps from the full impact Capital Adequacy
Ratio (CAR) of some banks. This could erase the
capital buffers of these banks. We expect the apex
bank to encourage banks with capital shortfalls to
retain a sizeable position of their earnings. The apex bank could work out transitional arrangements that will assist banks whose capital position is below the regulatory minimum to gradually build capital over a 3 – 5-year period.

**Liquidity**

The CBN’s mop-up stance in 2021 was less aggressive compared to 2020 and 2019. Specifically, total OMO bills, mostly longer-tenured bills of 180 – 361 days maturity, amounting to over N2 trillion had been issued as of December 2021 compared to N7.1 trillion issued in the same comparative period in 2020. While this might give a false sense of a relatively liquid market, the reality is that the maturing OMO bills in the year were less than that of the previous year. A cursory look at the market trend over the last three years suggests that the apex bank has sustained its trend of reissuing only a portion of maturing securities thereby resulting in a progressively illiquid market. Another reason for the tight system liquidity is the CBN’s discretionary CRR debits which posed a huge challenge to credit growth for most banks. A rough estimate of the industry’s effective CRR position suggests that about 50% of total naira deposits are sterilised with the CBN as CRR and Special Bills.

Going into 2022, the general build-up to the 2023 Elections will very likely result in a system awash with liquidity. We believe that the apex bank will tighten the system from the second half of the year just as political campaigns start, to mop-up excess liquidity from the system. Although it is unlikely that the CBN will slow down on its discretionary CRR debits, we expect more banks to approach the apex bank for the release of a portion of their ‘excess’ CRR to assist them in funding their transactions, payment of regulatory levies/fees, etc.

**Competitive Landscape**

The competitive environment is constantly changing primarily driven by regulation, non-bank competitors, law enactment and responses to macro-economic developments. Non-bank competitors sustained their pressure on the earnings of banks in 2021 as more fintechs secured requisite approvals and entered the space offering a range of financial services & products to banked customers using asset-light technology. The competition between Banks and Telcos is expected to go up a notch following the Approval-in-Principle (AIP) granted to MTN and Airtel to commence Payment Service Bank (PSB) operations. There are concerns about licensing the country’s two (2) largest mobile services providers who together account for over 65% of total mobile subscribers in Nigeria to perform financial service operations could see more traditional banks struggle. While these concerns might be valid, it is important to note that the banks pre-empted the possibility of having Telcos become licensed financial services providers and consequently, established the Shared Agency Network Expansion Facilities (SANEF) in a bid to minimize its impact on industry earnings.
and their market share. That said, bank’s ability to run a wallet account system in addition to the traditional accounts, the need for PSBs to be subjected to the same rigorous KYC procedures in place for banks and the payment of similar regulatory charges/levies (AMCON, NDIC, etc.) will go a long way to level the playing field.

**e-Naira**

The launch of the country’s Central Bank Digital Currency (CBDC); the e-Naira, effectively set the motion for the evolution of the naira. It seeks to advance the boundaries of payment systems in a bid to make financial transactions seamless and easier, thereby promoting financial inclusion in the country. The e-naira operates via an app wallet-system that leverages existing infrastructures to act as both a medium of exchange and store of value. Analysts have argued that the free wallet-to-wallet transfer feature and the movement of deposits from banks to the CBN’s balance sheet could pose marked risks to the industry’s earnings profile. Despite the initial operational issues, onboarding problems and low app user interface/ratings of the e-naira, we believe it has the potential to unlock new opportunities for the industry. We note that the success of the e-naira is largely dependent on the number of active users, rate of merchant adoption and the value-added services available on the app. With over 900,000 downloads reported for the app after 95 days of its launch, a lot more work needs to be done to drive increased adoption and usage by the relevant stakeholders.

**Restructuring and Transitions**

In response to changing competitive environment and regulatory constraints, some banks have initiated restructuring exercises that will see them diversify their earnings base into other non-banking operations while consolidating market share and operations in the banking industry. Macro-economic challenges and regulatory headwinds have gradually wiped out and/or constrained a significant portion of the revenue of banks thus, banks are looking at ways to augment earnings, venturing into uncharted territories, preserve their relevance and maintain a decent competitive edge. Some of the banks seeking to restructure are in the process of finalizing regulatory requirements for the requisite approval to restructure and join the likes of FBN, Stanbic, FCMB and most recently, GTCO to operate as holding companies. These banks will seek to replicate their success stories in banking in other financial services space as they fight for market share from established industry players, improve product & service offerings and enhance service delivery.

The recent acquisition of 89.4% majority stakes in Union Bank of Nigeria by Titan Bank in Dec. 2021 came as a surprise to most industry players. Although still subject to requisite regulatory approvals, the latter has demonstrated its deep pockets and determination to become a force to be reckoned with in the Nigerian banking sector. It is not unlikely that we might witness some more mergers and acquisitions in the course of the year with the potential to strengthen the industry.