Agusto&Co.

Research, Credit Ratings, Credit Risk Management

2021 Outlook for the

NIGERIAN BANKING INDUSTRY

Asset Quality | Earnings | Liquidity | Capital

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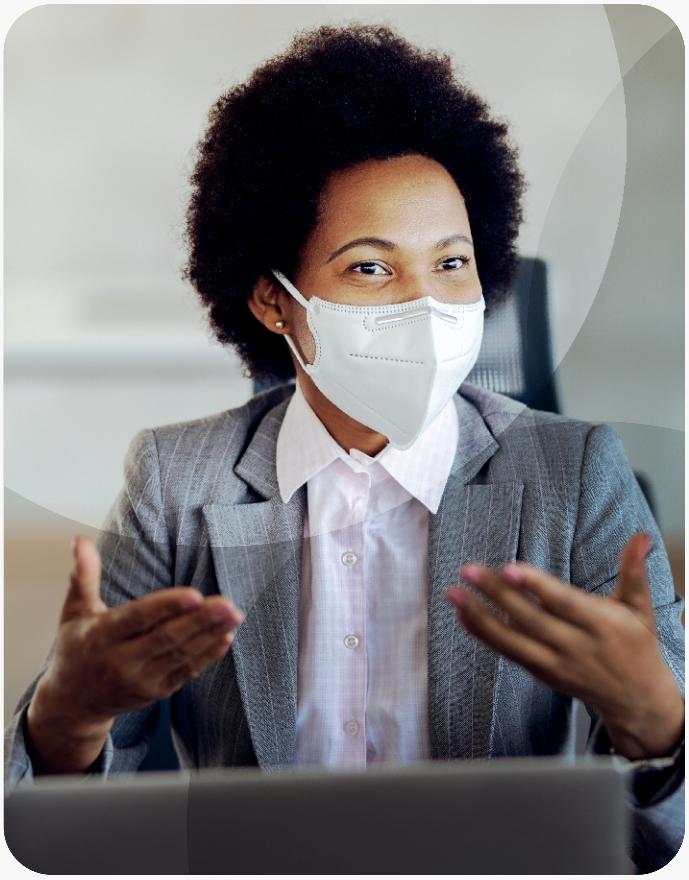
The 2020 financial year was a challenging one for the Nigerian Banking Industry (the Industry). The coronavirus pandemic and some heterodox policies of the Central Bank of Nigeria (CBN) impacted the Industry's performance negatively. Conversely, the regulatory forbearance, the extension of the moratorium on intervention loans and other measures introduced by the apex bank (to moderate the impact of the pandemic) supported the Industry. The issuance of securities as a refund of the excess cash reserve requirements (CRR) debits in December 2020 relieved the liquidity pressure on banks, albeit to an extent.

Agusto & Co. posits that the year 2021 will be a year of two halves for the Nigerian Banking Industry and the economy at large. The lingering adverse impact of the pandemic, exacerbated by the second wave, is expected to dominate the first half of the year. However, mass vaccination, clarity on OPEC's pricing strategy and a better understanding of the coronavirus are expected to moderate the headwinds in the second half of the year. In our view, the year will be a mixed bag for the Industry and this will be reflected in its asset quality, earnings, liquidity and capital position.



12%-15%

GROWTH IN THE INDUSTRY'S LOAN BOOK

9.6%

We do not expect the Industry's impaired loan ratio to exceed

Asset Quality

Agusto & Co. anticipates a 12%-15% growth in the Industry's loan book in 2021, buoyed by naira devaluation and the CBN intervention funds. The pressure to meet up with the minimum loan-todeposit ratio (LDR) and risk assets creation by the relatively new banks (those licensed in the last six years) will further support loan growth in the year. However, we anticipate more pressure on the Industry's asset quality based on the expiration of the regulatory forbearance and the moratorium on intervention loans by March 2021. Notwithstanding, we believe the forbearance induced loan restructuring, implemented in 2020, will moderate the impaired credit portfolio. We do not expect the Industry's impaired loan ratio to exceed 9.6% as at 31 December 2021.

Earnings

Agusto & Co. expects a gradual increase in interest rates, particularly in the second half of the year. Thus, we anticipate a 56% net interest spread, higher than the 50.1% estimated for FY 2020, given that loan pricing is more sensitive to upward movements than funding costs. Net earnings will also benefit from debt instruments (bonds and commercial papers) issued by banks at record low-interest rates in 2020, coupled with the expected 400 basis points increase in the pricing for intervention loans by March 2021. In our view, investments in electronic banking platforms, growing adoption of the digital banking channels and the expanding online community will continue to drive non-interest income. The Industry is expected to consolidate on cost-efficiencies elicited by the pandemic, although we foresee additional technology costs, which are largely USD dominated, as most banks scaled up on electronic tools and platforms. Overall, we anticipate a 21.8% average return on equity in the Industry for the 2021 financial year.

56%
NET INTEREST SPREAD

21.8%
AVERAGE RETURN ON EQUITY

Liquidity

We expect a significant improvement in the Industry's foreign currency liquidity position in 2021. In our view, full resumption of economic activities in the second half of the year on the back of mass vaccination in most developed economies will support crude oil prices and Nigeria's foreign exchange earnings. We anticipate the settlement of most pent up foreign currency demand before December 2021.

Capital

The banking industry's capital was pressured in 2020 by additional provisions elicited by the deterioration in most macroeconomic variables. However, long term bonds issued by some banks provided a capital buffer. In 2021, we expect this trend to continue to support capital, provide liquidity and reduce the asset-liability mismatches on the balance sheet. We foresee the initiation of capital raising exercise by some tier II and III banks in anticipation of the CBN planned increase in the minimum capital of banks. The asset growth plans of the banks will also propel the capital raising exercise. However, successful implementation of the capital raising exercises will be challenging based on the general apathy (although reducing) to equity by the investing public. Some banks in the Industry are in dire need of capital while some need additional equity to strengthen their capitalisation ratios. Nonetheless, we anticipate that collectively, the capital of the Industry will continue to provide a buffer for the increased business risk.

Overall, we anticipate a better year for the Industry compared to the prior one on the back of a more supportive regulatory environment, a better understanding of the macroeconomic environment, a positive (albeit muted) economic growth and cost efficiencies elicited by the pandemic.
Notwithstanding, we believe some of the challenges in the Industry will still linger.

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