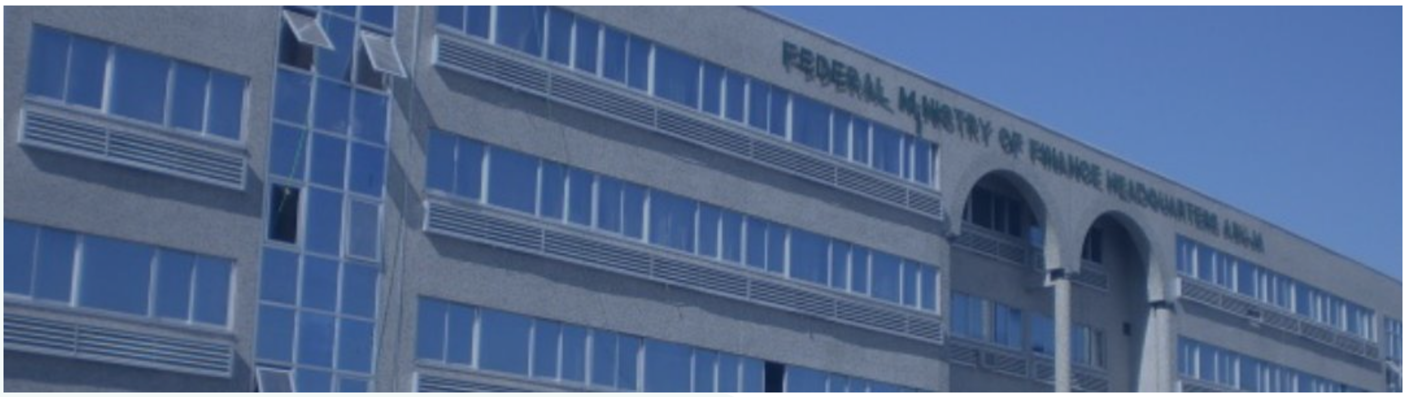
STREN & BLAN PARTNERS

FINANCIAL SECTOR OUTLOOK

H1 – August 2024

Introduction

Despite numerous global and domestic challenges, Nigeria's financial sector has demonstrated remarkable resilience throughout the first half of 2024. The country's economic landscape has been significantly shaped by fluctuating global trends and domestic events, which have collectively influenced financial policies and market trends. In the first half of 2024, Nigeria grappled with severe economic turbulence, characterised by insecurity, rapid depreciation of the Naira, high cost of living and soaring inflation rates.



These issues were exacerbated by the persistent gap between the supply and demand of foreign currency, frequent increase in the price of petroleum products due to removal of fuel subsidy and reduced agricultural output.

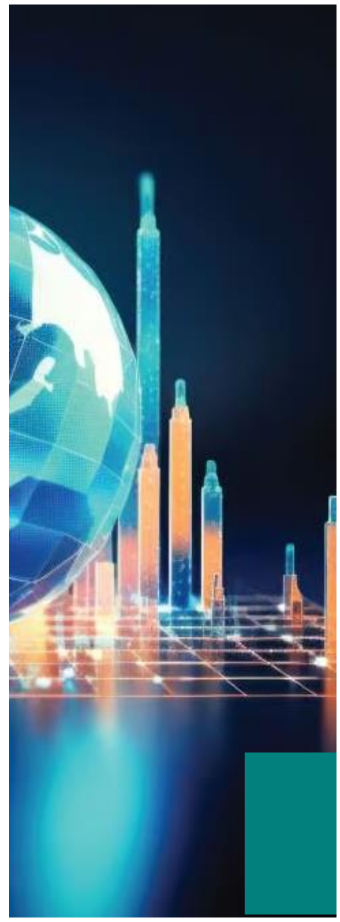
As Nigeria gears up to navigate and tackle the complex mix of economic dynamics in the latter half of 2024, stakeholders are eagerly looking forward to how the financial sector will shape up, drawing from the experiences of the past months. Key factors such as potential increases in minimum wages, commencement of oil refining at the Dangote refinery, ongoing fiscal challenges, and anticipated reforms will play critical roles in shaping the financial landscape. Economists project modest Gross Domestic Product (GDP) growth, supported by improved security in the oil and agriculture sectors, while inflation rates are expected to decline marginally.

The recent Nigeria Economic Outlook by PwC Nigeria[1] highlights four key trends influencing the country's economic path this year, the trends include sectoral reforms, monetary policy, inflation and exchange rate dynamics, and fiscal reforms. The Economic outlook further stressed the importance of balanced fiscal reforms and coordinated monetary policies as the key indicators needed for sustainable growth.

This work provides a comprehensive exploration of the Nigeria's financial sector performance in the first half of 2024, along with a detailed outlook of the anticipated trends and regulatory developments expected to influence the second half of the year. Also, an initial foray into the key global outlook will be undertaken to provide clarity and direction to this work. Through this work, we aim to provide an understanding of the complexities and opportunities within Nigeria's financial ecosystem in 2024.

[1] Strategy & Part of the PWC Network, 'Nigeria Economic Outlook 2024: Navigating Economic Reforms'. Accessed on 1st July, 2024.

Overview of the Global Economy in the First Half of 2024 and Outlook for the Second Half of 2024



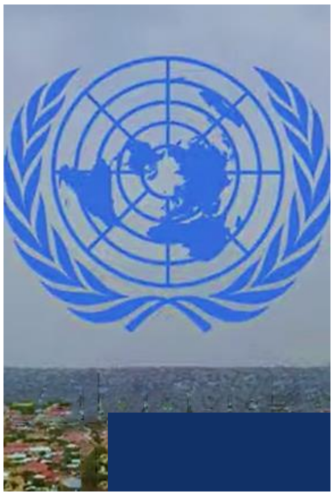
In the first half of 2024, the global economy showed resilience despite challenges mainly related to geopolitical issues and monetary policies. According to the "World Economic Situation and Prospects report[2]: June 2024 Briefing", a collaborative report by the United Nations Department of Economic and Social Affairs (UNDESA), in partnership with the United Nations Conference on Trade and Development (UNCTAD) and the five United Nations regional commissions, offers a thorough analysis of global economic trends. Accordingly, the global economic outlook has improved since January 2024, with the world economy now projected to grow by 2.7 percent in 2024, up from the earlier forecast of 2.4 percent in 2023. The reason for this growth is associated with improved prospects in major economies like the United States, supported by strong labour markets, real income growth, declining inflation, and anticipated monetary policy easing by central banks.

Notably, the US economy continued to surpass expectations in its growth, even amidst high interest rates, and challenges in other major economies. Although real GDP growth dipped in the first quarter of this year due to decelerations in consumer spending, exports, state and local government spending, and a downturn in federal government spending. Remarkably, policymakers successfully steered the economy away from recession and made progress in curbing inflation towards the 2 percent target. The November 2024 election contest between former President Donald Trump and Vice President Kamala Harris will also play a key role in the economic direction of the US, thus, consideration is paid towards the economic policies of the next President of the US in further determining the economic direction of the US.

The European Union and the United Kingdom (UK) have also shown slight improvement this year, compared to their performance in 2023 due to tight financing and reduced fiscal aid in some EU countries. However, factors like decreasing inflation, strong wage growth, and planned rate cuts by the European Central Bank and the Bank of England are set to drive regional growth in the short term. The EU economy is set to make a modest comeback in 2024, with GDP growth expected to reach around 1 percent for the EU and slightly lower for the eurozone. This marks an improvement from the stagnation seen in 2023, although it still lags behind pre-crisis levels.

China's economic growth is forecasted to slow down to 4.8 percent in 2024 from 5.2 percent in 2023 mainly due to the subsiding surge in consumer demand post-pandemic. While there's anticipation of increased policy support for infrastructure and strategic sector investments, the property sector remains a significant concern for China's economy.

[2] United Nations (2024), 'World Economic Situation and Prospects: June 2024 Briefing, No 181'. Accessed on 1st July, 2024. 24.



The growth outlook for the Least Developed Countries (LDCs) is expected to improve slightly from 4.2 percent in 2023 to 4.8 percent in 2024. However, debt sustainability remains a concern in many LDCs, with some countries facing debt distress. Landlocked developing countries, such as Afghanistan, Burundi, and Uganda etc. (LLDCs) are projected to maintain a growth rate of 4.7 percent in 2024, with geopolitical tensions impacting their economic prospects due to reliance on transit countries for trade routes. Small Island Developing States (SIDS) are anticipated to experience GDP growth rising from 2.4% in 2023 to 3.3% in 2024, driven by tourism recovery. Yet, challenges like natural disasters, geopolitical tensions, inflation, and high public debt pose risks to this optimistic outlook.

Developing countries like Angola, Argentina, Democratic Republic of Congo, Egypt, Ethiopia, Gambia, Ghana, Lebanon, Nigeria, Sierra Leone, Türkiye, and Zimbabwe, are grappling with high inflation due to ongoing balance of payments issues, currency devaluation, and pass-through effects. Additionally, inflation surged in the State of Palestine in early 2024, mirroring the challenging economic conditions in the Gaza Strip.

Most central banks of the world kept policy rates steady in the first quarter of 2024, monitoring actions by the US Federal Reserve and the European Central Bank. While some central banks, including those in Armenia, Brazil, and Hungary, executed rate cuts, others, such as those in Nigeria, Egypt, and Türkiye, continued with monetary tightening. However, high public debt levels and increasing interest expenses pose challenges for many governments. In Africa, governments are predicted to use over a quarter of their total public revenues to service debt in 2024. Fiscal consolidation efforts are underway in many regions to manage debt burdens more effectively.

As we move into the second half of 2024, the global economic outlook remains cautiously optimistic. Investors should be aware of several key factors including continued policy adjustments, sector-specific opportunities, geopolitical risks and debt and inflation concerns. Central banks' monetary policies and government fiscal measures will continue to play crucial roles in shaping economic stability and growth prospects. Investors are encouraged to closely monitor policy changes that may impact market conditions and investment returns.

Growth in sectors like technology, renewable energy, and infrastructure, particularly in emerging markets, presents investment opportunities. China's policy support for strategic sector investments and the recovery of tourism in Small Island Developing States are notable trends. Ongoing geopolitical tensions in the world such as the Russia – Ukraine, and Israeli-Palestine wars impact global trade routes, commodity prices, and investment flows. Thus, Investors should consider diversifying portfolios to mitigate risks associated with geopolitical uncertainties. High inflation and debt levels in many developing countries pose risks to economic stability. Investors need to assess the credit risk and economic policies of countries where they have exposure.

In summary, while challenges persist, the improved global economic outlook and strategic policy adjustments offer a mix of risks and opportunities for investors in the second half of 2024. Careful analysis and strategic positioning will be key to navigating the evolving economic landscape.

Overview of Key Events Shaping Nigerian's Economic Performance for 2024

In the first half of 2024, Nigeria faced significant economic challenges and policy shifts, that impacted various sectors of the economy. The year began with the rapid depreciation of the Naira to an all-time low of 1$(one Dollar) to N1650 naira (one thousand, six hundred and fifty Naira). The decline in the value of the Naira was driven by the widening gap between dollar supply and demand, exacerbated by low foreign direct investment (FDI) flows valued at US$183.97 million (one hundred and eighty-three million, nine hundred and seventy thousand dollars), which made up 16.9 percent of the total capital importation in the fourth quarter of 2023. The Central Bank of Nigeria (CBN), in a bid to reduce the depreciation rate, adopted the willing buyer, willing seller forex transactions model. The implementation of willing-buyer, willing-seller temporarily eased the pressure on the Naira. By March 28, 2024, the Nigeria Autonomous Foreign Exchange Market (NAFEM) closing rate was N1309.4 (one thousand three hundred and nine Naira, forty Kobo) - a significant appreciation from a peak of N1,650 (one thousand six hundred and fifty Naira) of February 26, 2024. However, this measure proved unsustainable as the naira has now depreciated to the rate of N1600 (one thousand six hundred Naira) per dollar as the date of this publication. Temporary intervention mechanisms by the CBN will remain subdued in the absence of improved capital flows and export proceeds to the foreign reserves.

The first half of the year has also seen an increase in inflation in the country. Nigeria's inflation rate shot up to 34.19 percent in July 2024, as per the latest Consumer Price Index (CPI) report from the National Bureau of Statistics (NBS). The main drivers and key contributors of inflation included Food & Non-Alcoholic Beverages (contributing 17.59 percent), Housing, Water, Electricity, Gas & Other Fuel (contributing 5.68 percent), and Clothing & Footwear (contributing 2.60 percent). This significant increase in food prices is linked to various factors affecting different food categories. Food inflation hit 40.0 percent in March, driven by factors such as reduced agricultural output, high transportation costs, rising energy prices, and instability in crucial food-producing regions.

The policy interest rates went up in line with the inflation-targeting strategy of the CBN. However, the rate hikes have not kept up with the pace of inflation. The Monetary Policy Rate (MPR) increased from 18.75 percent in December 2023 to 22.75 percent in February, 24.75 percent in March, and 26.75 percent in July. The Nigeria 10-year Government Bond Yield also rose, from 14.55 percent in May 2023 to 19.30 percent in May 2024, due to attractive rates on Open Market Operations (OMO) and treasury bills driven by the higher MPR. While rate hikes address monetary inflation, fiscal authorities must implement reforms to tackle non-monetary issues like infrastructure deficits, insecurity, and low productivity.

Overview of Key Events Shaping Nigerian's Economic Performance for 2024

According to the NBS, Nigeria's GDP grew by 2.98 percent (year-on-year) in real terms in the first quarter of 2024. This growth rate is higher than the 2.31 percent recorded in the first quarter of 2023 and lower than the fourth quarter of 2023 growth of 3.46 percent. While the NBS attributes the performance of the GDP in the first quarter of 2024 to the Services sector, which recorded a growth of 4.32 percent and contributed 58.04 percent to the aggregate GDP, PWC attributes the growth in Q1 2024 to the performance in the financial, insurance, mining and quarrying sectors.

The country's total public debt surged by a whopping 144.1 percent to N121.67 trillion (one hundred and twenty-one trillion, six hundred and seventy billion Naira) in the first quarter of 2024 from N49.85 trillion (forty-nine trillion eighty hundred and fifty billion Naira) in 2023, primarily due to naira devaluation. The fiscal deficit to GDP ratio of 6.1 percent in 2023 remained higher than the Fiscal Responsibility Act (FRA) threshold of 3 percent, resulting in an elevated debt burden.

The first half of the year also saw an increase in capital requirements for banks. In March 2024, the CBN announced new minimum capital requirements for commercial banks in Nigeria. Commercial Banks with national authorization must now meet a minimum capital of N200 billion (Two Hundred Billion Naira), those with regional authorization being N50 billion (Fifty Billion Naira), and those with international authorization being N500 billion (Five Hundred Billion Naira) by 31st March, 2026. This increased capital requirement is set to make banks more resilient and solvent and help them continue to support Nigeria's economic growth. The new rules also allow banks to downgrade their authorization if they are struggling to meet the capital requirements. This allows them to develop long-term strategies for a sustainable capital base.

Overall, the first half of 2024 was marked by economic turbulence and policy adjustments as Nigeria navigated domestic and global headwinds. As the country moves into the second half of the year, the focus will be on stabilizing the economy, addressing inflation, and implementing structural reforms to foster sustainable growth and attract investment.

Key Regulations Made by CBN in the First Half of 2024

The CBN in the first half of the year in order to ensure price stability, inflow of foreign exchange and economic development embarked on several regulations, such as;

1. Regulatory and Supervisory Guidelines for Bureau de Change Operations in Nigeria

In a move to strengthen the Bureau De Change (BDC) sector in Nigeria, the CBN issued new regulatory Guidelines on May 22, 2024. These Guidelines aim to enhance BDC operations by introducing stricter regulations and incorporating advanced technology and corporate governance standards. The Guidelines outline new licensing requirements, different categories for BDCs, revised financial and corporate governance standards, as well as provisions for combating money laundering and terrorism financing. Additionally, the Guidelines prohibit certain entities from operating as BDCs and emphasize the digitalization of BDC operations.

2. The Guidance on National Security Levy

The CBN took a significant step on May 6, 2024, by instructing various financial entities to remit a 0.5% national cybersecurity levy from electronic transactions. This levy was part of the Cybercrimes (Prohibition, Prevention, etc) (Amendment) Act 2024. The CBN issued guidelines to ensure compliance across different banking sectors and payment service providers. This move was crucial in enhancing cybersecurity measures within Nigeria, aligning with the evolving landscape of cyber threats. However, it's noteworthy that the CBN reversed this decision by withdrawing the circular on 17th May, 2024, because of the public outcry and criticisms the new directive received.

3. Suspension of Processing Fees on Cash Deposits for Financial Institutions regulated by CBN until September 30, 2024:

Back in September 2019, the CBN directed banks to stop processing fees on cash deposits to push for more electronic transactions. These fees ranged from 2 percent for individual accounts with deposits exceeding N500,000 to 3 percent for corporate accounts with deposits surpassing N3 million (three million Naira). Fast forward to May 6, 2024, the CBN changed its decision by pausing these processing fees on cash deposits for CBN-regulated financial institutions until September 30, 2024. This move implies that financial institutions are now required to accept all cash deposits without any charges during this specified timeframe.

Key Regulations Made by CBN in the First Half of 2024

4. NDIC increases Maximum Deposit Insurance Coverage for Bank Depositors

The Nigeria Deposit Insurance Corporation (NDIC) made a significant announcement on May 2, 2024, regarding an upward revision of the maximum deposit insurance coverage for various categories of depositors in deposit-taking financial institutions licensed by the CBN. This adjustment entails an increase in the maximum deposit insurance coverage for Deposit Money Banks (DMBs) from N500,000 (five hundred thousand Naira) to N5,000,000 (Five million Naira), Microfinance Banks (MFBs) from N200,000 (two hundred thousand Naira to N2,000,000 (two million Naira), Primary Mortgage Banks (PMBs) from N500,000 (Five hundred thousand Naira) to N2,000,000 (Two million Naira), Payment Service Banks (PSBs) from N500,000 (Five hundred thousand Naira) to N2,000,000 (Two Million Naira) and Mobile Money Operators (MMOs) subscribers from N500,000(Five hundred thousand Naira) to N5,000,000 (Five million Naira) per subscriber, all in alignment with DMB coverage levels. This measure aims to fortify depositor protection and adapt to the evolving financial landscape in Nigeria.

5. The Monetary Policy Committee (MPC) of the CBN increases the Monetary Policy Rate (MPR) by 150 Basis Points to 26.75%

As earlier reported, the CBN's Monetary Policy Committee, as of July 2024, convened to assess recent economic and financial developments in Nigeria. Following the meeting, the MPC increased the MPR by 50 basis points to 26.75% from 26.25%. Additionally, the Committee opted to maintain the asymmetric corridor around the MPR at +100/-300 basis points, keep the cash reserve ratio (CRR) of deposit money banks at 45.00 percent, and retain the liquidity ratio at 30.0 percent.

6. The Central Bank of Nigeria Reduces the Loan-to-Deposit Ratio of Deposit Money Banks

The CBN in April 2024 via a letter addressed to all banks announced the reduction of the statutory loan-to-deposit ratio (LDR) by 15 percentage points from 65 percent to 50 percent. This reduction was part of the CBN's monetary tightening policy and was intended to align with the increase in the CRR rate for banks. In essence, the effect of this is to encourage DMBs not to loan more than the deposit they receive, in that way, liquidity is ensured, and DMBs' are not exposed to loan defaults that might erode their liquidity and customers 'deposits.

Key Regulations Made by CBN in the First Half of 2024

The CBN in the first half of the year in order to ensure price stability, inflow of Foreign exchange and economic development embarked on several regulations, such as;

7. CBN Guidelines Prohibiting the Use of Foreign Currency Collateral for Naira Loans

The CBN, in a circular directed to all banks, announced the prohibition of foreign currency as security for Naira loans, with specific exceptions. This decision aims to enhance the financial sector and ensure regulatory compliance. By shifting away from foreign currency collateral, the CBN anticipates stabilizing the economy and addressing currency liquidity issues. The focus is on utilizing alternative collateral such as Federal Government Eurobonds and foreign bank guarantees to ease pressure on foreign exchange reserves.

8. Cash Reserve Requirement Framework Implementation Guidelines

The CBN, on February 2, 2024, informed banks about changes in the CRR implementation guidelines. The new framework aims to enhance banks' planning and monitoring capabilities to address liquidity challenges. The CBN will no longer conduct daily debits for CRR but will implement a revised mechanism. This new approach involves two phases: Phase 1 applies existing ratios as banks' deposits increase and Phase 2 enforces a CRR levy for banks not meeting the minimum LDR. The CBN's directive seeks to improve liquidity management in the financial system and ensure regulatory compliance.

9. Banking Sector Recapitalization Programme

As earlier stated above, commercial banks were mandated to recapitalize amidst tough economic times. Accordingly, the CBN has mandated banks to boost their financial strength through a recapitalization program to support the country's economic growth goals. This initiative aims to fortify banks' asset bases to align with the government's ambition of achieving a $1 trillion economy by 2030. The capital market will play a crucial role in helping banks raise necessary funds through various means. The new capital requirements set by the CBN apply to different categories of banks and are expected to be met by 31st March, 2026. This directive has spurred all affected banks to take action to comply with the new standards. The CBN's move is anticipated to bolster the banking sector's stability, increase its capacity, and attract more investments, ultimately benefiting the industry and the economy as a whole.

Key Regulations Made by CBN in the First Half of 2024

10. SEC Guidelines on Recapitization

In line with the CBN's directive for banking sector recapitalization, the Securities and Exchange Commission (SEC) also released the Framework on Banking Sector Recapitalisation Programme on June 21, 2024, to streamline the process. Given that many Nigerian banks are publicly quoted, any recapitalization efforts will be regulated by the SEC, CBN, and the Nigerian Exchange Limited (NGX). This Framework provides comprehensive guidelines for banks on raising capital through approved methods such as rights issuances, private placements, and public offerings, including detailed documentation requirements, application fees, and checklists for each capital-raising option. Banks and holding companies are mandatorily required to update their corporate information at the Corporate Affairs Commission (CAC) before applying to the SEC. Incomplete applications will be rejected and penalized with a fine of N1,000,000 (One million Naira) and a re-filing fee of N100,000 (One hundred thousand Naira) payable by the Issuing House. Bank Verification Numbers (BVNs) are mandatory for all applicants, and all applications and documents must be filed electronically via the specified SEC email address. The full documentation checklist and SEC filing/processing fees are available at the Securities and Exchange Commission, Nigeria.

11. CBN Guidelines on International Money Transfer Services in Nigeria

The CBN introduced new policies on foreign exchange remittances to tackle volatility issues. These policies include the International Money Transfer Operator's (IMTO) Guidelines and the Allowable Limit Circular. Businesses with IMTO licenses help transfer funds from abroad to Nigeria efficiently. The new IMTO Guidelines update the regulations, specifying permissible activities and governance standards. Previously, IMTOs had limits on exchange rate quotes for remittance payouts, but the recent directive allows payouts at prevailing market rates. These changes impact IMTO operations, especially for fintech companies in the financial services sector.

Overview of Nigeria's Economic Prospects for the Second Half of 2024

Economists have expressed cautious optimism about Nigeria's economic outlook in the second half of the year, though they do not anticipate a complete transformation of the economy. Several factors are expected to influence economic performance during this period.

One of the key factors is the review of minimum wages which had been pegged at N70,000 (Seventy Thousand Niara) which is to be reviewed every three (3) years. This increase in the minimum wage could set off inflationary pressures against a backdrop of sluggish economic productivity. The surge in worker wages in Nigeria is expected to make a significant impact on both the economy and society, boosting consumer spending, improving living standards, driving economic progress, and potentially fueling more inflationary pressures. However, the effects of the wage hike may go beyond just higher labour costs for businesses in Nigeria. It will have a ripple effect on profitability, competitiveness, employment, and the broader economy. With rising labour expenses in Nigeria, business growth may be constrained, operational costs could soar, and profit margins might shrink.

Also, the full commencement of the Dangote refinery for oil refinery and production will also affect the economy. It is expected that refining the petroleum products will not only enable the retention of foreign exchange in Nigeria but will also lead to the reduction of petrol pump price, which hovers from N700 to N1000 per liter and consequently drive down the cost of goods and service in Nigeria. The refinery is also projected to finally put a stop to the incessant fuel scarcity experienced in the oil rich country despite the removal of fuel subsidy.

Further, the total debt stock might see a further increase in 2024 due to the proposed worker salary review, heightened pension obligations, and increased debt servicing costs. As such, fiscal sustainability worries could linger somewhat due to the costs of servicing debt, with 89 percent of the planned fiscal deficit set to be covered by fresh borrowings.

On the other hand, it is predicted that the country's GDP will grow by the end of the year. Economic reports such as, the PWC report projects that the GDP may grow marginally by 2.9 percent on the back of sustained policy reforms although growth prospects may be limited by elevated economic pressures and a marginal decline in inflation to 29.5 percent by year-end, balancing the effects of reforms, policy actions, external pressures, and food price[4]. The International Monetary Fund (IMF) projects GDP growth at 3.3 percent for 2024 as both oil and agriculture outputs are expected to improve with better security. However, this optimism may not be fully realized if active steps are being taken to improve food security.

Practically there will be investment movement in the debt market through commercial papers, bonds and loans and the debt stock continues to soar in this period. Investors are likely to position themselves in this line of investment as the equity market may not be bullish and as aggressive as the debt market.

Thus, the second half of 2024 presents a mixed economic outlook for Nigeria. While cautious optimism exists, challenges such as inflation, fiscal deficits, and currency volatility remain. Investors should expect a volatile investment climate and consider strategies to mitigate risks associated with inflation and currency depreciation. All eyes will be on the Monetary policy Committee meeting of September 2024 to further dictate the direction of the Economy.

Conclusion

As Nigeria enters the second half of 2024, the economic outlook is mixed with both challenges and cautious optimism. Key factors influencing the financial sector include potential wage increases, ongoing fiscal challenges, anticipated reforms, rise cost of lending and improved security in the oil and agriculture sectors. Economists project modest GDP growth, with the IMF estimating 3.3 percent for the year, while inflation is expected to decline to 29.5 percent by year-end. However, the country's debt stock may rise due to increased pension obligations and debt servicing costs, raising fiscal sustainability concerns.

Investors face a volatile climate, with risks from inflationary pressures, currency depreciation, and broader economic uncertainties. Monitoring policy reforms and government actions will be crucial, as successful implementation could improve the investment environment and create new opportunities. A balanced investment approach, considering both risks and opportunities, is essential for navigating Nigeria's economic landscape in the latter half of 2024.

[4] Strategy & Part of the PWC Network, 'Nigeria Economic Outlook 2024: Navigating Economic Reforms'. Accessed on 1st July, 2024.

ABOUT STREN & BLAN PARTNERS

Stren & Blan Partners is an innovative and dynamic Law Firm with a compelling blend of experienced lawyers and energetic talents. We are focused on providing solutions to our client's business problems and adding value to their businesses and commercial endeavours. This underpins our ethos as everything we do flows from these underlying principles.

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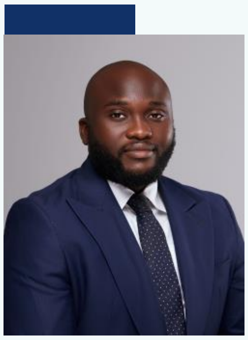

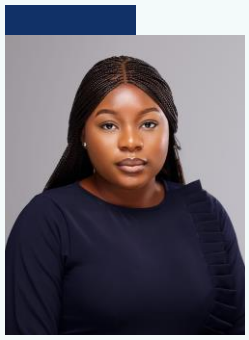

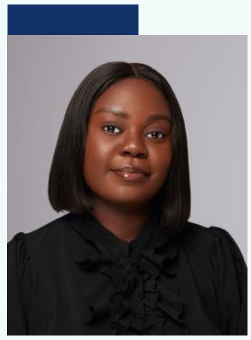

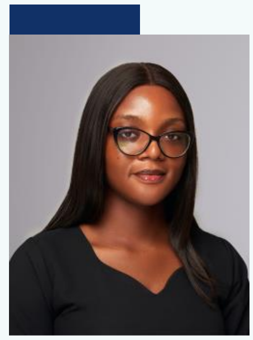

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