



CBN's Financial Statements: Letting the Cat Out of the Bag

Sustained Profitability amid Numerous Interventions

Last week marked a significant development as the Central Bank of Nigeria (CBN) unveiled its financial statements spanning the period from 2016 to 2022. This disclosure comes on the heels of the suspension of Mr. Godwin Emefiele, the former governor of the bank. We believe that this move aligns with the new administration's commitment to fostering transparency within the operations of the apex bank. This commitment emerges after a series of years during which the bank had refrained from releasing its financial records, a practice incongruent with the provisions stipulated in the CBN Act of 2007.

According to the financial results, Interest Income grew at a CAGR¹ of 24.98% between 2016 and 2022 to reach NGN2.87trn. This is on the back of sustained increase across the years except in 2017 when Interest Income declined by 9.08% YoY to NGN685.61bn. Similarly, Interest Expense increased at a CAGR of 21.41% to NGN1.47trn between 2016 and 2022. Notably, interest expense on CBN instruments issued (NGN1.17trn) and Securities lending (NGN80.73bn) and Swap contracts (NGN223.98bn) contributed the most to Interest Expense.

Furthermore, Operating Expenses rose significantly by 121.96% from NGN548.88bn in 2016 to reach NGN1.22trn in 2022. We observed that Other Operating Expenses accounted for a whopping 72.92% of Total Operating Expenses incurred in 2022 (vs. 31.63% in 2016). In terms of profitability, both PBT² and PAT³ recorded declines at CAGRs of 2.90% and 2.97% each between 2016 and 2022. Consequently, PBT settled at NGN105.06bn in 2022 (vs. NGN125.36bn

¹ Compound Annual Growth Rate

² Profit Before Tax

³ Profit After Tax

in 2016), while PAT stood at NGN103.85bn in 2022 (vs. NGN124.47bn in 2016). However, the bank recorded sustained PAT and PBT from 2016 to 2022, despite persistent exchange rate fluctuations, extension of intervention funds and loans to government, as well as the implementation of developmental policies.

Surge in Ways and Means Contributes to Interest Income and Credit Loss Expenses

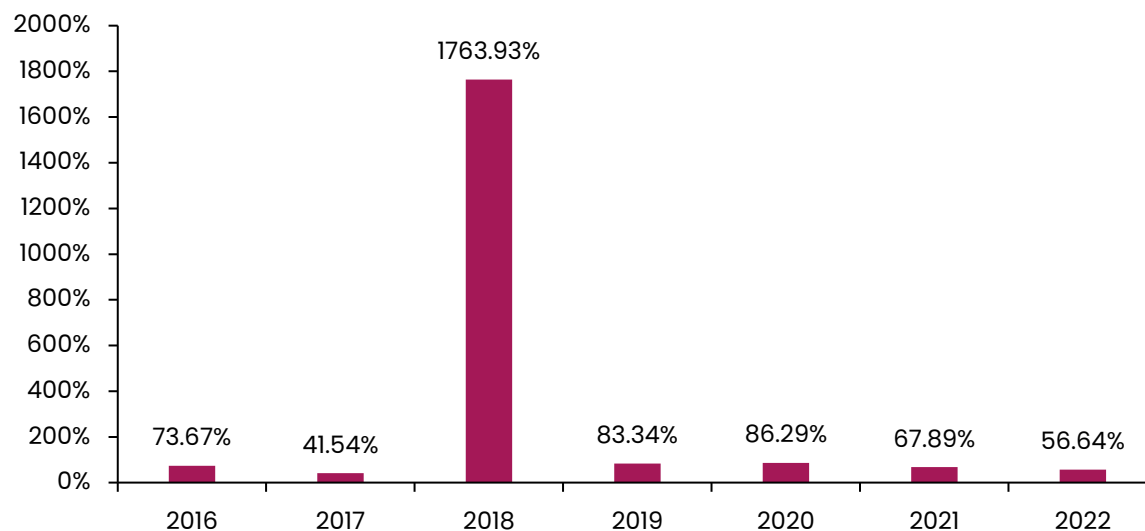
Interest Income recorded significant growth to NGN2.87trn in 2022 compared to NGN754.09bn in 2016. This remarkable growth was primarily driven by a notable increase in income derived from Loans and Receivables (+53.90% YoY) and Time Deposits and Money Placements (+161.95% YoY). The sharp growth in interest income from loans and receivables is linked to the receipt of NGN1.9trn interest income (calculated as MPR⁴ +3%) stemming from the overdraft loan extended to the government. Interestingly, Credit Loss Expense in 2022 grew to NGN875.21bn (from NGN72.93bn in 2016). The report underscores that the Central Bank of Nigeria (CBN) provided a significant NGN23.18trn in the form of Ways and Means to the Federal Government. This exceeded the established statutory limit of 5% of the previous year's government revenue, subsequently resulting in an overdraft of NGN22.9trn. A key development occurred in May 2023, wherein a substantial portion of this Ways and Means loan, specifically NGN22.7trn out of NGN23.18trn, received approval for securitization. This move entailed a 40-year tenor, coupled with a 3-year moratorium period, all at an annual interest rate of 9%. Furthermore, a notable adjustment emerged in the form of an increase in the Ways and Means ceiling, expanded from the initial 5% to 15% of the previous year's revenue. This change was implemented due to the consistent breach of the 5% limit. *However, it is our viewpoint that this elevation of the ceiling might potentially foster increased borrowing activities, thereby augmenting the government's debt servicing obligations.*

⁴ Monetary Policy Rate

Admin Expenses, Naira Depreciation, National Security and Rebate Expenses Fuel Operating Expenses

Total Operating Expenses surged from NGN548.88bn in 2016 to NGN1.22trn in 2022, at an average growth rate of 15.65%. As stated earlier, Other operating expenses took a large chunk of total expenses (72.92%) and was driven by increases in administration expenses, FX losses, intervention expenses and rebate expenses. For context, administration expenses surged by 178.16% to NGN127.06bn from NGN45.68bn in 2016. Following the persistent depreciation of the Naira against the US dollar, the CBN disclosed an FX loss amounting to NGN346.21bn in 2022, marking a decrease from the NGN572.87bn reported in 2021. Moreover, the CBN took on a role in intervention efforts related to national security, acting on behalf of the Federal Government with an involvement totaling NGN125.37bn. It is pertinent to note that this loan is subject to a write off if not repaid within a 12-month period by the Federal Government. Additionally, noteworthy expenses in the form of rebate expenditures were incurred as part of the execution of the RT200 and Naira 4 Dollar schemes. These initiatives contributed NGN155.59bn to the aggregate operating expenses for the year 2022. These schemes were instituted to attract and maintain a steady influx of foreign exchange (FX). Notably, the CBN's Cost-to-income (CIR) ratio declined by 17.03% from 56.64% in 2022 from 73.67% in 2016. We observed an upsurge in the ratio in 2018 to 1763.93% following a 102.60% YoY plunge in operating income to -NGN20.50bn in 2018 (vs. NGN788.74bn in 2017). This was on the back of a large increase in interest expense (+41.49% YoY) to NGN1.90trn during the period.

Figure 1: CBN's Cost-to-Income-Ratio from 2016-2022

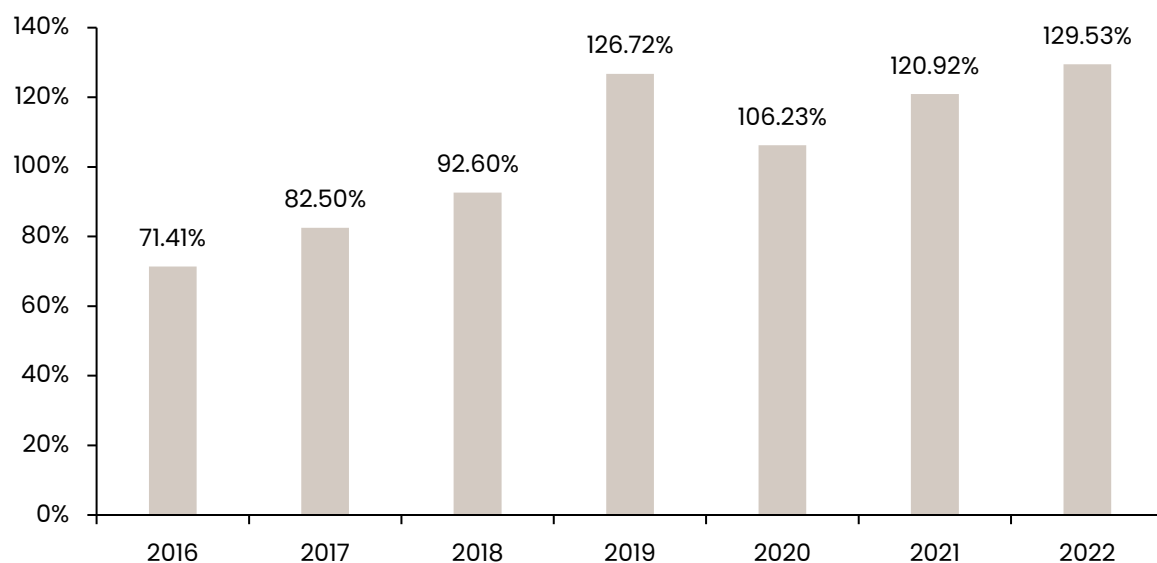


Source: CBN, ARM Research

Positive Net Assets Buoyed by Increased Lending to Government

In 2022, the bank's Total Assets soared by 164.63% to NGN57.99trn from NGN21.91trn in 2016. It is pertinent to acknowledge, however, that a substantial portion of the bank's assets is attributed to loans. To provide context, Loans and Receivables constituted 54.25% of Total Assets, which was the highest rate of contribution from 2016 to 2022. On the other hand, External Reserves played a relatively minor role, contributing 25.77% to Total Assets, the lowest contribution in the last seven (7) years. We believe that heightened lending activities to the government drove increased loans and receivables in 2022. Consequently, we observed sustained growth in the apex bank's Loan-to-Deposit (LDR) ratio, growing by 58.12% between 2016 and 2022 to reach 129.53% in 2022 from 71.41% in 2016. Similarly, Total Liabilities increased by 165.74% jumping to NGN56.39trn in 2022 from NGN21.22trn in 2016. Consequently, Net Assets recorded a significant growth of 30.78% YoY to GNI.60trn compared to NGN1.23trn in 2021.

Figure 2: CBN's Loan-to-Deposit Ratio from 2016-2022



Source: CBN, ARM Research

External Reserves: Just a Mirage

From the CBN financial statements, external reserves grew at a CAGR of 10.18% to NGN14.94trn (USD37.08bn) from NGN8.35trn in 2016. As per the report's details, the components of the country's external reserves for 2022 encompassed Convertible currencies (-3.16% YoY to NGN14.36bn), IMF⁵ tranche (NGN23mn) and Gold bullion (+5.79% YoY to NGN578.65bn). However, the CBN undertook securities lending agreements with both JP Morgan (NGN0.23trn or USD500mn) and Goldman Sachs (NGN3.23trn or USD7bn) pledging securities in exchange for cash. Hence, the total securities lending obligations of the CBN amounted to NGN3.46trn (USD7.5bn) in 2022. Furthermore, the bank reports foreign currency forward contract payables worth NGN3.16trn (USD6.84bn). Consequently, this brings the country's net external reserves to approximately NGN8.33trn (USD18.04bn).

⁵ International Monetary Fund

However, it is important to note that the exact status of these financial obligations remains uncertain, as the interim financial statements from the bank are pending release.

The CBN's current FX liquidity situation suggests that the apex bank might face challenges in propping up the Naira unless there is a substantial influx of foreign exchange to bolster the FX reserves. This calls attention to the need for strategies to enhance FX inflows to strengthen the overall liquidity position.

Looking Ahead: Fingers Crossed for FX Reserves

As stated earlier, given the significant depletion of the FX reserves presents a considerable challenge for the Central Bank of Nigeria (CBN) in sustaining the Naira against depreciation pressures. This predicament is likely to lead to a continued decline in the exchange rate, potentially discouraging foreign investors from engaging in domestic investments. Consequently, we foresee a need for substantial FX inflow, driven by enhanced crude oil production, economic diversification efforts, and a push for domestic goods and services production. This collective effort could foster increased demand for the local currency.

It is however noteworthy that the CBN has recognized the urgent need to build up FX reserves and as such on August 10th, 2023, carried out the first OMO⁶ auction since December 2022, Offering NGN50bn worth of OMO bills across three instruments (96-day bill, 187-day bill and 362-day bill). The auction was characterized by high demand, evident by an oversubscription of NGN52.48bn. This was despite the 396bps surge in average stop rate to 12.49% (vs. 8.53% at the last auction). Specifically, stop rates for the 96-day bill, 187-day bill and 362-day bill were 10%, 12.98% and 14.49% respectively. We believe that this auction and the high rates it offered, is a short-term fix for the CBN to attract FPI⁷ into the economy and boost FX reserves, considering the low yields currently dominating the Nigerian Treasury Bills market.

⁶ Open Market Operation

⁷ Foreign Portfolio Inflow

Furthermore, the USD3bn loan obtained by the NNPC⁸ from the African Export-Import (AFREXIM) bank is also a step in aiding the CBN boost FX reserves. We expect the loan to boost FX liquidity in the short run and repay FX obligations such as the USD812.2mn owed to foreign airlines. However, the extent to which the USD3bn loan can cover FX demand and sustain the Naira is uncertain. Following the receipt of the loan, Naira at the parallel market has appreciated to NGN810/USD1 as of August 18th, 2023, from NGN940/USD1 on August 15th, 2023, indicating gradual reduction in the gap between parallel and official exchange rates. Overall, we posit that the benefits of the FX liberalization policy and removal of PMS subsidy may not be fully realized until there is a significant bolstering of the FX reserves.

⁸ Nigerian National Petroleum Company Limited