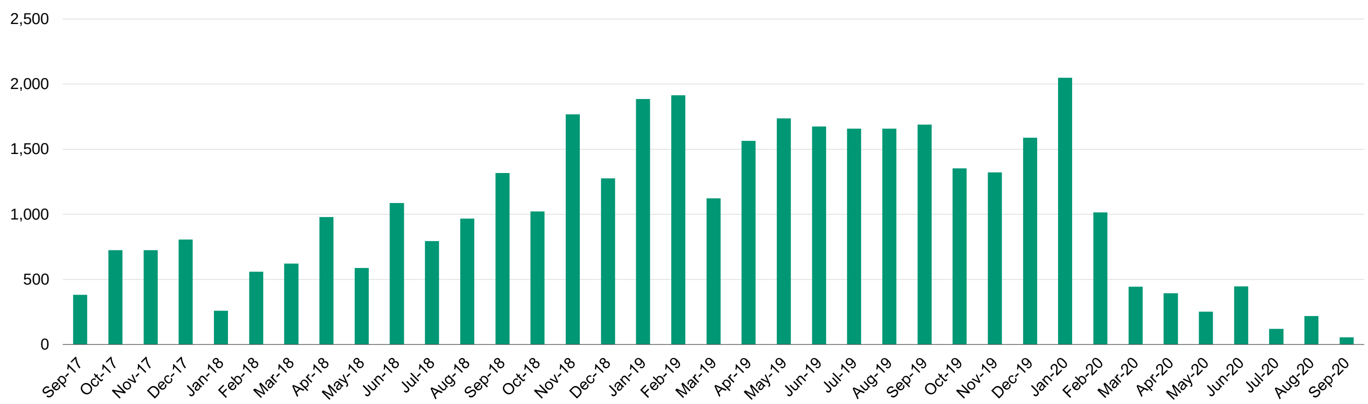
Nigeria's reduced remittances will worsen foreign-currency shortages

On 6 January, Central Bank of Nigeria (CBN) data indicated that monthly total direct remittances from Nigerians based abroad fell to their lowest level in three years in September 2020. The decline is credit negative for Nigerian banks because it reduces their already limited foreign currency, strains their foreign-currency liquidity buffers and raises funding costs.

Remittances fell by 88% between June and September 2020 to $54.4 million from $446.2 million (see exhibit). The decline brings total remittances for the first nine months of 2020 to $5 billion, significantly below the $19.2 billion for all of 2019 and $11.2 billion for 2018. Although the official data is likely to overstate the extent of the reduction, given that some of the inflows are likely to have used alternative channels that official statistics do not capture, they nevertheless point to a general contraction in foreign-currency liquidity in the banking system.

Nigeria's monthly remittances fell to a three-year low in September
Total direct monthly remittances ($ millions)



Sources: Central Bank of Nigeria and Moody's Investors Service

Remittances of $19.2 billion in 2019 equated to 4%-5% of GDP and were more than the $17.3 billion of foreign direct investment and portfolio investment combined. We expect remittances to recover in 2021[1], although slowly. A resurgence in coronavirus infections and new lockdowns in countries such as UK, one of the major sources of remittances for Nigeria, will likely delay a strong recovery this year. A recent directive by the Central Bank of Nigeria requiring remittance companies to pay remittance recipients in foreign currency rather than local naira will likely support inflows this year.

Reduced remittances strain banks' foreign-currency liquidity buffers. While the ratio of foreign-currency liquid assets to foreign-currency total assets for the largest Nigerian banks improved to 42% in 2019 from 34% in 2016, we do not expect this trend continued in 2020 or that it will in 2021, based on Access Bank Plc, (B2 negative, b3[2]), First Bank of Nigeria Limited (B2 negative, b3), Zenith Bank Plc (B2 negative, b2), Guaranty Trust Bank Plc (B2 negative, b2), United Bank for Africa Plc (B2 negative, b2), Union Bank of Nigeria Plc (B2 negative, b3), Fidelity Bank Plc (B2 negative, b3), Sterling Bank Plc (B2 negative, b3) and FCMB (First City Monument Bank) Limited (B2 negative, b3).

Furthermore, dollar inflows from loan repayments will likely slow as foreign-currency borrowers struggle with repayments, limiting the amount of foreign-currency cash flow banks can deploy in liquid assets. In addition, some of the remittances that could be entering the country through alternative channels are unlikely to benefit banks given their current tighter anti-money laundering controls and requirements. More positively, the large banks are likely to attract deposits from large exporters because of their strong corporate banking franchises.

Lower remittance inflows will also slow the improvements in banks' foreign-currency funding gaps, the difference between foreign-currency loans and foreign-currency deposits,[3] as foreign-currency deposits decline. As a result, banks will have to increase their reliance on market funds, which tend to be more expensive and confidence-sensitive than deposits, to support their large foreign-currency loans, which accounted for around 42% of total loans in June 2020. Banks are also losing cheaper deposits because foreign-currency deposits are exempt from Nigeria's high cash reserve requirement of 27.5%. All these factors will put upward pressure on banks' funding costs, weakening their interest margins.

More generally, we expect lower remittances to have a negative effect on households' disposable income and debt repayment capacity because some households rely on external remittances to help meet debt obligations or other living expenses. Lower household disposable income will compromise consumer borrowers' debt affordability, constraining lending opportunities for banks, and financial inclusion. As of the end of 2019, household or consumer loans accounted for 10.2% of Guaranty's loan book, 7.7% of First Bank of Nigeria's, 7.0% of Access Bank's and 6.0% of United Bank for Africa's.

Endnotes

1 The World Bank expects remittances in Sub-Saharan Africa to increase by 4.0% in 2021, lagging the expected 5.6% in middle- and low-income countries.

2 The ratings shown in this report are the banks' deposit rating and Baseline Credit Assessment.

3 See Renewed foreign-currency shortages highlight vulnerability for banks, 1 July 2020.

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