

## Explanation of the Directive

On the 31<sup>st</sup> of January, the Central Bank of Nigeria (CBN) issued a circular titled "**Harmonization of Reporting Requirements on Foreign Currency Exposures of Banks.**" This regulatory directive, effective from February 1, 2024, imposes stringent limits on the Net Open Position (NOP) of Nigerian banks regarding their foreign currency exposures, both on and off the balance sheet. This directive mirrors a 2015 circular (BSD/DIR/GEN/LAB/08/006) titled "Daily Rendition of Net Open Position" which mandated that banks' NOP should not exceed 20% of its shareholders' funds unimpaired by losses.

As an explainer, the NOP is the difference between a bank's foreign-currency denominated assets and its foreign-currency denominated liabilities. When a bank has higher FCY assets than FCY liabilities, it is said to be in a long position while it is in a short position when its FCY assets are less than its FCY liabilities. For banks in long position, a devaluation of Naira should typically result in FX revaluation gains and vice versa. Thus, the CBN posits that banks in long position are incentivized to hold higher FCY assets, which could pose a threat to FX liquidity.

Hence, the CBN has mandated the banks to adhere to a strict cap on the NOP, restricting it to a maximum of 20% short position or 0% long position of shareholder's funds unimpaired by losses, determined by the Gross Aggregate Method. In simpler terms, banks can either be in a position where  $FCY\ assets = FCY\ liabilities$  or  $FCY\ assets < FCY\ liabilities$  (with a maximum limit of 20% of the banks' shareholders fund).

Click [here](#) to access the circular.

## Implication to Economy

If effectively implemented, this directive may prove to be a short-term balm for the struggling exchange rate, which fell to a historic-low of NGN1,482.56 on January 30, 2024. We recognize this development as another strategy from the CBN to combat speculative activities in the FX market. This was evident in the slight appreciation of the Naira (+1.80%) on the official FX market.

As banks race to offset the mismatch between their FCY assets and FCY liabilities coupled with the removal of exchange rate cap for international money transfer operators, we envisage an increase in FX into the market, which could potentially lead to an appreciation of the Naira in the immediate term.

Notwithstanding, we highlight that the reaction in the FX market may be temporary as more persisting challenges including the low supply of FX and FX illiquidity still largely exist.

## Implication to Banks

Taking this into consideration, we posit that the following are likely implications of this regulation to the banks:

- Could provide better risk management strategies regarding the banks' exposure to currency and other risks. It also ensures that their capital remains sufficient to cover potential losses, thereby improving their capital adequacy ratio.
- Should be a relevant tool in supporting better asset quality for the banks.
- Banks (like **UBA**, **FBNH**, **GTCO**, and **ZENITHBANK**) that benefitted significantly in 2023 through robust FX revaluation gains are not expected to record the high gains in 2024. Thus, our 2024FY expected earnings per share for these banks are lower relative to 2023FY.
- We highlight the potential time constraint on banks to meet the imposed limit and adjust their foreign currency positions.

## Recommendation

Given the established implications to the economy and particularly to the banks, we recommend that:

- Investors particular about capital gains should take profit on banking tickers in bid to reposition .
- Long-term investors with objective to benefit from dividend payments should hold their positions. Also, investors that took long position at higher-than-current price can accumulate to lower their average cost.
- Interested and potential investors can consider taking long position on the banking tickers with attractive upside potential as shown in the table below:

Ticker	Current Price	Target Price	Upside Potential
<b>ACCESSCORP</b>	22.70	27.60	21.57%
<b>ETI</b>	26.60	23.26	-12.57%
<b>FBNH</b>	21.70	20.11	-7.30%
<b>FCMB</b>	8.95	8.50	-5.02%
<b>FIDELITYBK</b>	10.65	11.46	7.58%
<b>GTCO</b>	37.00	44.53	20.36%
<b>STANBIC</b>	65.00	66.05	1.61%
<b>STERLINGNG</b>	5.67	6.27	10.53%
<b>UBA</b>	24.40	29.25	19.87%
<b>WEMABANK</b>	10.00	6.38	-36.22%
<b>ZENITHBANK</b>	35.10	46.09	31.31%

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