The New Exchange Rate Reforms and Internally Generated Revenue in Nigeria

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The new foreign exchange market reforms

On Wednesday, June 14, 2023, the Central Bank of Nigeria, introduced key operational changes to the foreign exchange market in Nigeria.

Some key changes highlighted in the press release include:

- Introduction of a willing buyer willing seller model.
- Cancellation of the Naira4dollar scheme and RT200 rebate scheme.
- Collapse of all the foreign exchange market segments into the Investors and Exporters (I&E) window (official market).
- More transparency in terms of FX orders in the market.

Data Source: CBN

How did we get here?

Naira firms to N157.25 on offshore investors' dollar flow

The Naira firmed against the US dollar on the interbank market on Wednesday, supported by dollar inflow from offshore investors buying local debt and waning … Continue reading

By Channels Television

Updated October 10, 2012

Subscriber Only

Nigeria's Inflation Rate Rises to 11.7% in October

By Maram Mazen

19 November 2012 at 08:00 GMT

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NEWS

Devaluation: Naira hits N186 in parallel market

Published on November 26, 2014

By Daily Post Staff

CBN warns Nigerian government on depletion of Excess Crude Account, foreign reserves

By Bassey Udo — January 22, 2014 Reading Time: 3 mins read 10

As at Dec 2013

External Reserves was – $42bn

Balance in the excess crude oil account – $11bn

How did we get here?

Nigerian economy slips into recession

31 August 2016

Nigeria "technically in recession" – Finance Minister

By Taiwo-Hassan Adebayo — July 21, 2016 **Reading Time: 2 mins read**

Nigeria is in technical recession, the finance minister, Kemi Adeosun, said Thursday.

ARTICLE / 19 DEC 2014

Global fall in oil prices affects Nigerian naira

By Staff Reporter

Nigeria + Add to myFT

Oil concerns drive slide in Nigerian naira

Stocks also suffer as currency drops to record low against the US dollar

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Robin Wigglesworth NOVEMBER 20 2014

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Naira plummets to all-time low of 472/dollar

29th September 2016

WORLD ECONOMY

Oil is not Nigeria's future: Finance Minister

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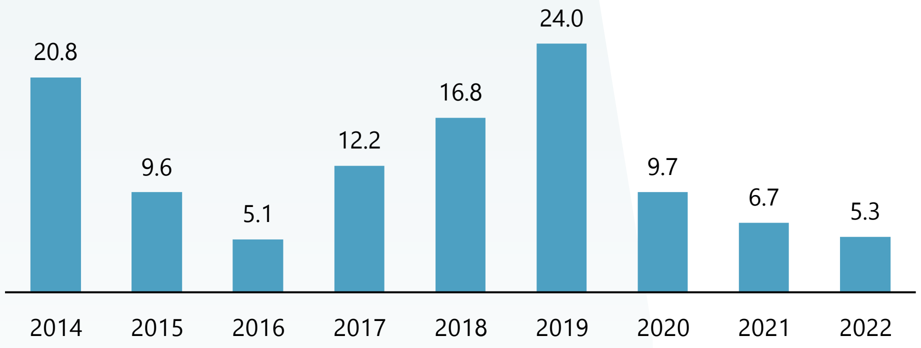
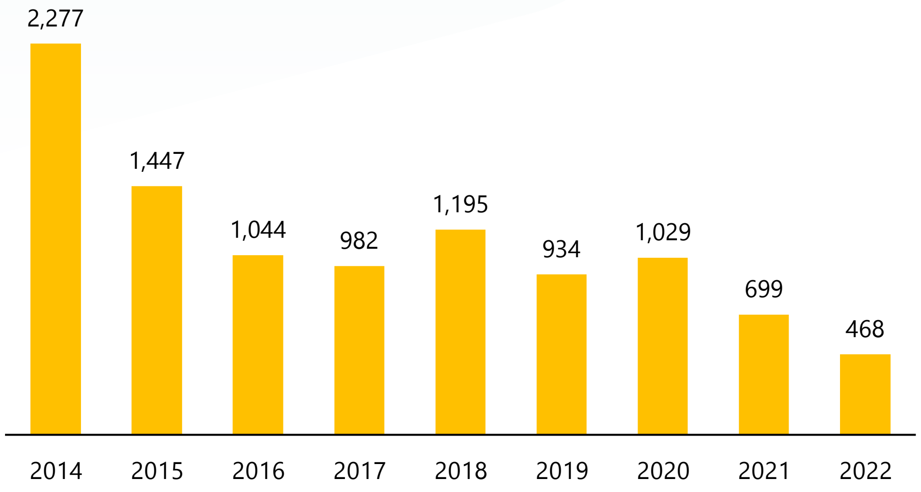
Investment inflows has declined since 2019

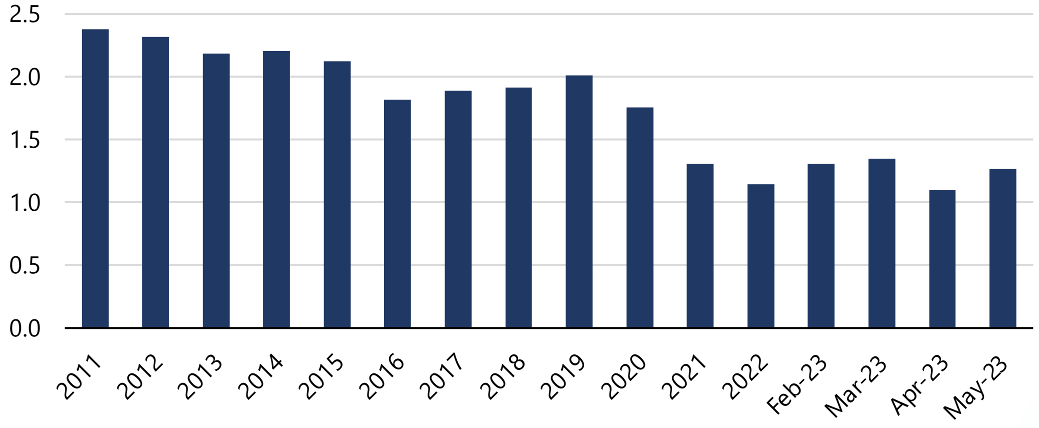
Nigeria's Foreign Investment Inflows (US$ Billion)



Nigeria's Foreign Direct Investment Inflows (US$ million)



Nigeria's Crude Oil Production (mbpd)

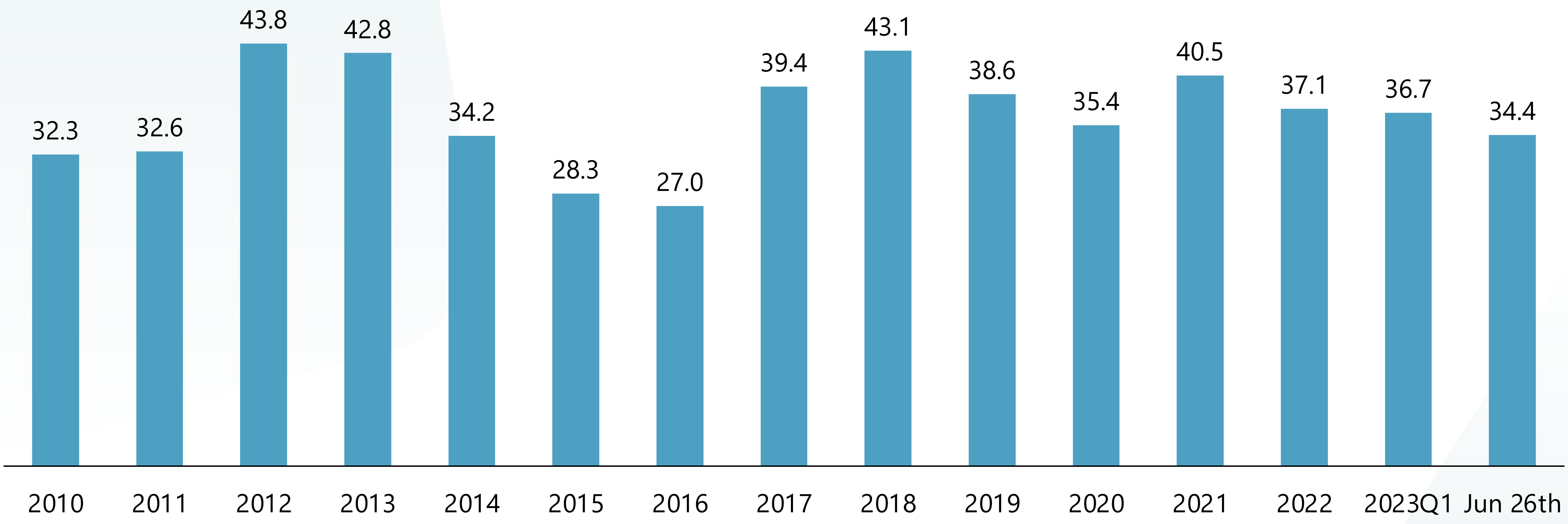


- Inflows from crude oil has dwindled.
- Poor FPI and FDI inflow signals weak investor confidence in the economy.
- FDI inflow into South Africa was US$37.6bn in 2021; Egypt +US$5 billion; US$31.1 in Indonesia.

Data Source: NBS, OPEC

Reserves yet to reach its year-end peak since 2012

Nigeria's External Reserves (Billion US$) (End-period)



- Reserves can finance about 5-7 months of imports

Data Source: CBN

What did we do?

- Address supply constraints? NO
- Provide clearer policies? NO
- Improve oil production and exports? NO
- Drive growth of non-oil export as a share of total exports? NO
- Created the I&E window ✓

We:

- Refused to accept the significance of the parallel market.
- Introduced RT200 rebate scheme: N65 for every $1 of repatriated to the I&E window.
- Banned anything that can be banned.
- Released frequent FX circulars – Over 15 in 2017- signals lack of clarity.
- “Fought” Aboki FX.

One of the many CBN circulars

CENTRAL BANK OF NIGERIA
Corporate Head Office
Central Business District
P.M.B. 0187, Garki, Abuja, FCT

TRADE AND EXCHANGE DEPARTMENT

09 462 37804
09 462 37802
e-mail: ted@cbn.gov.ng

TED/FEM/FPC/GEN/01/013 — October 26, 2017

TO: ALL AUTHORISED DEALERS
AND THE GENERAL PUBLIC

RE: REPATRIATION OF EXPORT PROCEEDS (OIL AND NON-OIL)

Further to the provisions of the circular Ref: TED/FEM/FPC/GEN/01/005 of February 19, 2015 on the above subject, exporters are hereby reminded that failure to repatriate their exports proceeds within the stipulated 90 days for Oil & Gas and 180 days for Non-Oil Exports constitute a breach of the extant regulation.

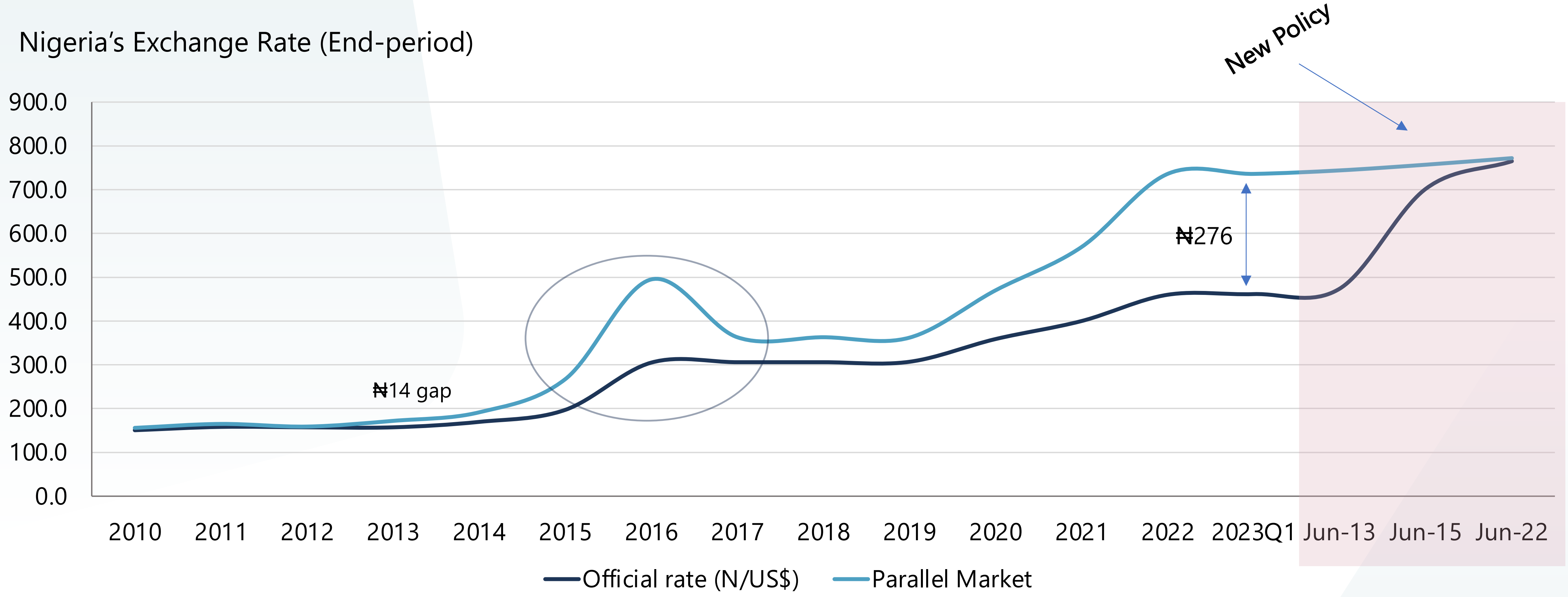
Consequently, any exporter that defaults in the repatriation of export proceeds within the stipulated period shall be barred from accessing all banking services including access to the foreign exchange market.

Please note and ensure compliance accordingly.

W. D. Gotring
Director
Trade and Exchange Department

Source: Central Bank of Nigeria

Exchange rate gap widened overtime

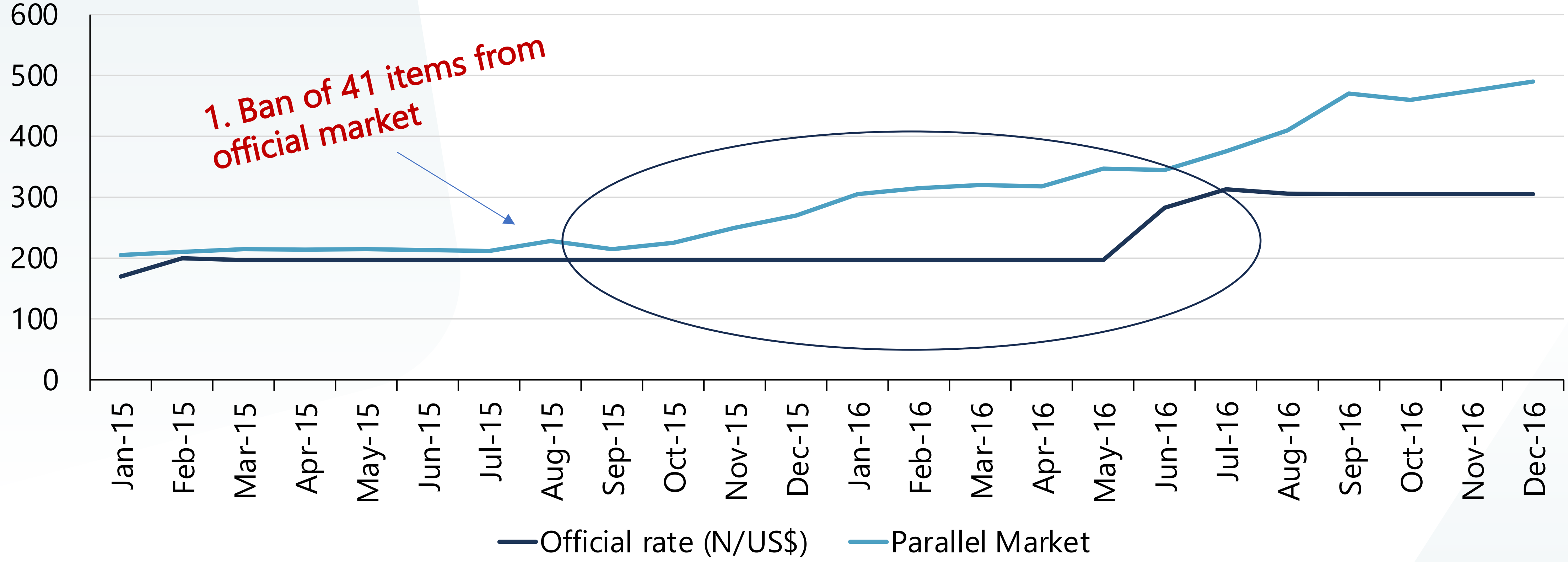


- Limited reserve accretion, unstable exchange rate policies, economic recessions, tough business environment are some factors that have led to significant depreciation of the Naira vis-à-vis other currencies.

Data Source: Central Bank of Nigeria, Aboki FX and other sources

Three key factors were responsible for the FX problems

Nigeria's Exchange Rate (End-period)



2. FX Restrictions
3. Low net foreign exchange inflows into the market – fall in oil price, oil production, capital outflows, rising import bills etc.

"the moment you ban anything from the official market, you have indirectly legalised the black market" ~ Wilson Erumebor

WRE
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Data Source: Central Bank of Nigeria, Aboki FX and other sources

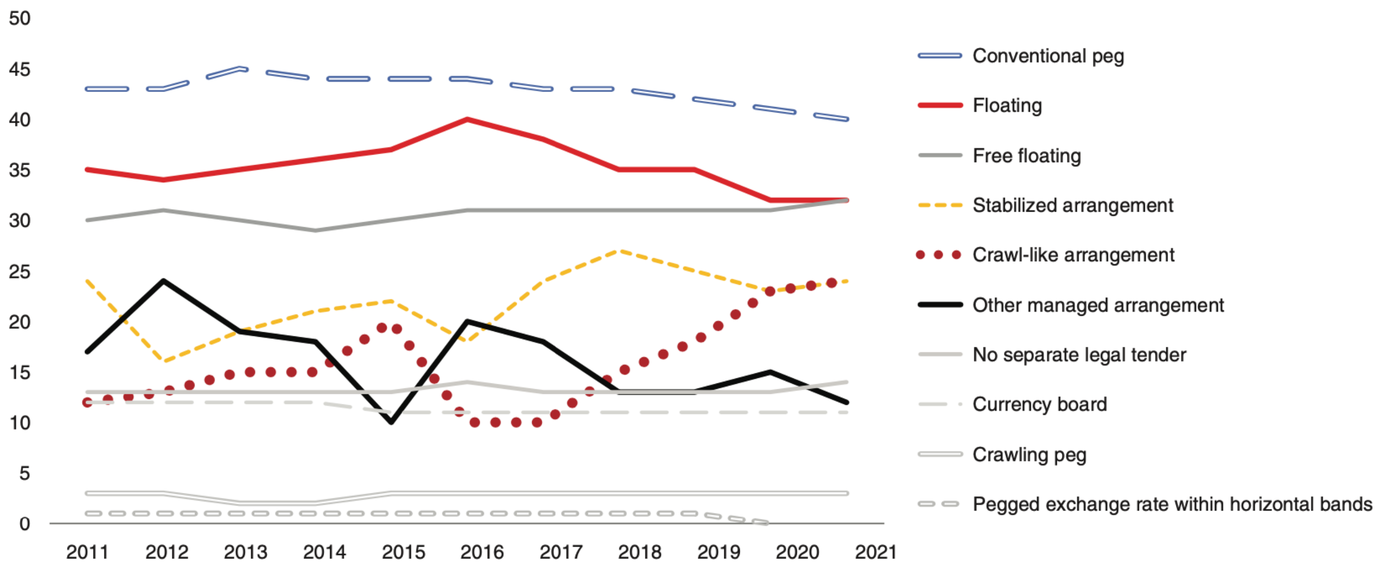
Exchange Rate regimes and their features

Classification of Exchange Rate Arrangements

Hard pegs	Soft pegs	Floating regimes (market-determined rates)	Residual
Exchange arrangement with no separate legal tender	Conventional pegged arrangement	Floating	Other managed arrangement
Currency board arrangement	Pegged exchange rate within horizontal bands	Free floating	
	Stabilized arrangement		
	Crawling peg		
	Crawl-like arrangement		

Exchange Rate Arrangements

(Number of countries as at April 30)



Data Source: IMF

Possible currency regime options for Nigeria

Select exchange rate regimes and countries as at 2021

		Key feature	Countries
	Free floating	Influenced by demand and supply.	Australia, Canada, Japan, Norway, Russia, United Kingdom, United States, EMU, Finland, France, Germany, Greece, Ireland, Italy, The Netherlands, Spain.
	Managed Floating	Allowed to fluctuate. Occasional Central Bank intervention to moderate the rate of change and prevent undue fluctuations in the exchange rate.	Angola, Brazil, India, Indonesia, Korea, Sri Lanka, South Africa, Thailand, Turkey, Malaysia, Pakistan.
Strong Reserves/ control of imports	Crawl-like arrangement	ER must remain within a margin of 2% relative to a statistically identified trend for six months or more	Vietnam, China, Democratic Rep. of the Congo, Ethiopia, Rwanda, Ghana, Philippines, Romania, Uzbekistan, Argentina, Malawi, Zambia.
	Conventional Peg	Formally pegs its currency at a fixed rate to another currency. Heavy central bank intervention to maintain a particular exchange rate -+1%.	Iraq, Qatar, Saudi Arabia, United Arab Emirates, Denmark, WAEMU, Senegal, Rep. of Congo, Equatorial Guinea, Gabon.
	Currency Board	Extreme form of fixed exchange rate	Djibouti, Hong Kong, Antigua and Barbuda, Brunei.

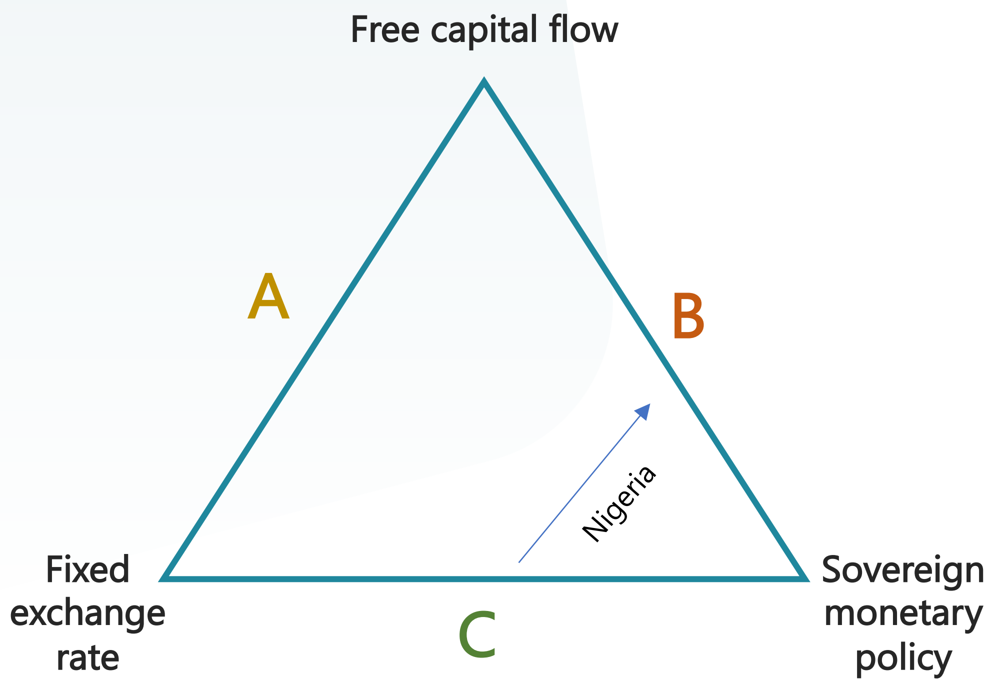
Nigeria was classified under *stabilized arrangement:* entails a spot market exchange rate that remains within a margin of 2% for six months or more and is not floating.

- Given the low level of external reserves, high demand for import and weak inflow from exports, Nigeria cannot afford to have a free-floating or currency board exchange rate regime. A managed floating where the CBN occasionally intervenes in the market to manage excessive fluctuations is optimal for Nigeria.

Data Source: IMF

No more fixed rate? What next?

The impossible trilemma provides some useful context: only two of the three goals can be achieved at a time.



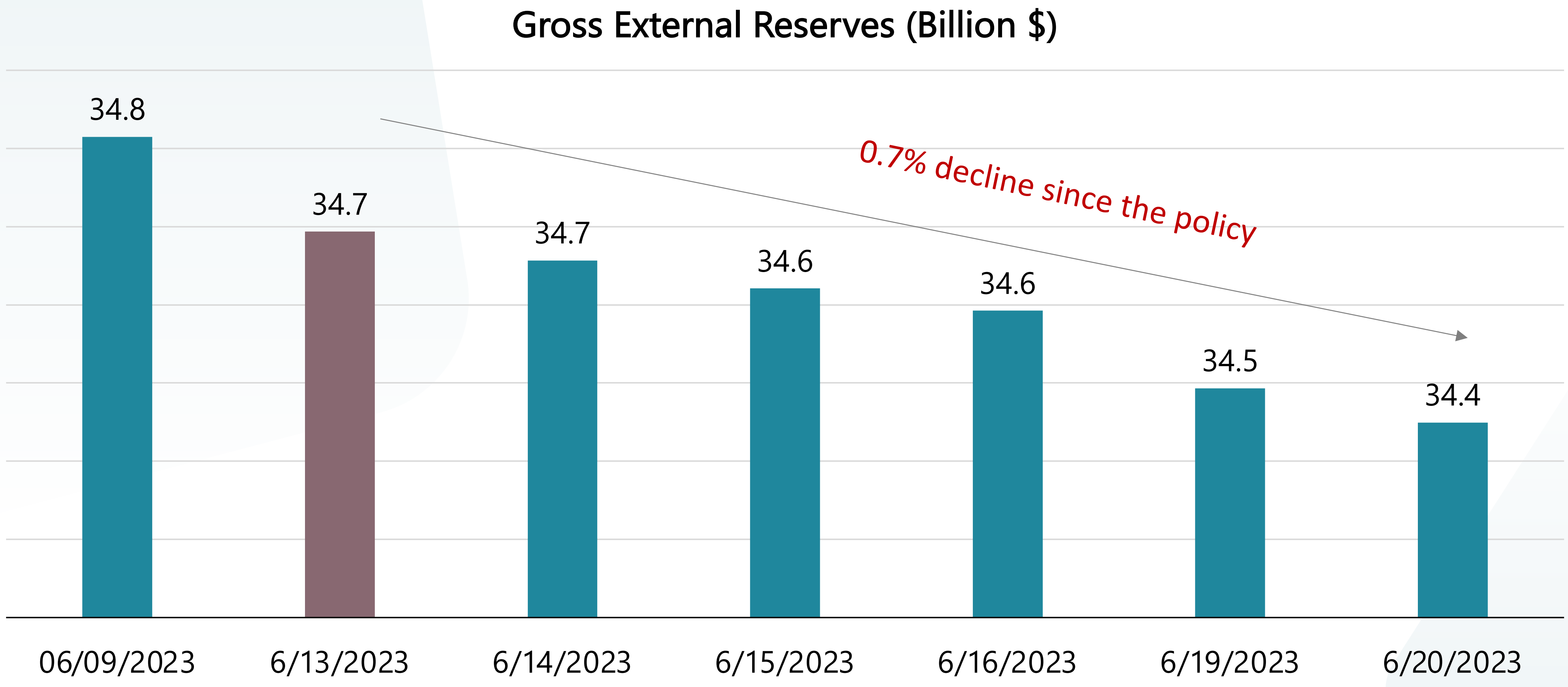
One key thing to watch: Will the CBN/FG raise interest rate on fixed income securities to attract foreign capital as recently argued by foreign fund managers?

Features of the new regime

- Movement towards convergence.
- High level of volatility (not good):
  - June 13 – ₦474/$
  - June 14 – ₦664/$
  - June 15 – ₦702.19
  - June 21 – ₦732.79
  - June 22 – ₦765.13
- Fragmented rates across outlets – banks, fintechs, etc.
- Depleting reserves? (see next slide)

Data Source: FMDQ

Reserves has trended downwards in the last few days. Where is the FX supply?



Data Source: CBN

The new exchange rate regime needs even more clarity!

- The new exchange rate regime aims to:
  - ?
- What role will the CBN play in the new arrangement?
- By how much will the CBN intervene?
- Can Nigeria manage a free-float regime, given the low FX supply?
- Will the new regime attract FX inflows into Nigeria?
- What are the complementary trade, fiscal and industrial measures to support the country's exchange rate policy?
- What is the CBN's next policy move?
- Who is in charge? SA on monetary policy?

How will the exchange rate dynamics affect state governments?

	Positive	Negative	Note
Increase in foreign currency debt		✕	Debt will be valued at the new rate. Inflows for many states are majorly in Naira.
Higher debt servicing costs		✕	Cost of servicing foreign debts will increase.
Higher FAAC allocations	✓		A weaker Naira means that FAAC allocations to state governments are likely to increase.
Remittances	✓		High consumer spending and increased VAT.
High VAT	✓		Higher prices means higher VAT inflows. However, this could be offset by lower demand.
Investment inflows	✓		Largely dependent on business environment reforms
High cost of doing business		✕	Companies could down-scale. Implications on PAYE.

Some implications of current exchange rate reforms

- Functional markets – play the role of allocation.

- Implication on foreign reserves are still unclear.

- Impact on inflation will be huge:
  - Prices of imported goods will trend upwards.
  - Petrol prices – No more subsidies.
  - Inflation expectation: Advance purchases, hoarding, high wage demand and speculation.

- Potential for Nigeria to improve exports.
  - Oil and non-oil exports.
  - Services exports.

- Diaspora remittances will increase.

- Nigeria will no longer likely be the largest economy in Africa by the end of 2023.

Some urgent actions to take

- **Provide clarity! Policy signalling is crucial.**

- **The goal must be to ensure stable rates.** Stability will provide confidence. Nigeria needs more (net) inflows to ensure stability.

- **The market must be decentralised.** Allow FX to be sold by licenced operators at airports, shopping malls, etc. Not every individual will fill form A or M to get FX in the I&E window, at a rate close to the parallel market rate.

- **There is need for complementary policies to attract inflows of foreign currency into Nigeria.** Fiscal and trade authorities must incentivize growth and productivity - production of goods and services for both the local and export market. FDI is key.

- **Reform the FG budget. Fix oil theft.**

Some urgent actions to take

- **Implement supply-side policies to cushion the effect of inflationary expectations.**

- **Raise interest rates on government securities.** We must differentiate between raising rates to tame inflation and raising rates to attract FX inflows. The latter focuses on government securities (rather than the MPR) but this must be managed in view of government's borrowing costs.

- **Engage with the IMF on SDR to boost the reserves and confidence. Here are some factors to consider**:
  - The FG has made two of the most significant reforms that the IMF has always advocated for – subsidy removal and FX.
  - A country does not have to be in deep crisis before it can get support from the IMF.
  - The FG must comply with the statutory borrowing limit from the CBN.
  - Transparency in the use of the fund is important.

- **Ease of doing business and welfare reforms are urgently needed.**

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Thank You!

The views in this report are those of the author and do not represent the views of the organizations he is affiliated to.

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