Market Insights & Strategy
Global Markets

Nigerian Naira - Pressure Building

Talk of an impending official devaluation of the Naira began doing the rounds earlier this week and you'd be right in asking "haven't we been here before?" In June last year markets were initially buoyed by the news that the government had decided to allow the local currency to 'float', however in practice what actually happened was a sharp devaluation of the official rate from NGN 199.00 against the US dollar to just above 280.00, followed by a further dip in August 2016 to around 345.00 before the currency pair 'settled' and has hovered in a 300.00 – 320.00 range since September last year. This tight range is not market driven. It is the range that the CB has clearly indicated it wants local banks to quote within and thus essentially is the new 'pegged' level.

Unfortunately because of this and apart from sporadic injections of liquidity by the Central Bank, the interbank market essentially came to a relative standstill, while an already chronic hard currency shortage worsened driving USD/NGN to record highs in the unofficial 'kerb' market. The authorities have over the past few months made a number of attempts to resolve this issue, first by banning the exchange houses (whom many importers have had to turn to in order to access enough foreign currency to pay their overseas suppliers), from selling US dollars at a rate higher than 400.00 and then by using the state security services to investigate any breaches by the BDCs, actions which instead of improving the situation have actually made it worse.

The latest devaluation rumours surfaced following an announcement by the Central Bank that it would begin selling US$ 1 mio on a weekly basis to each local commercial bank at an exchange rate of 370.00-380.00 in an attempt to clear the hard currency backlog for retail clients, it also made dollars available via a special auction for those Nigerians needing to pay for overseas school fees and medical expenses. It appears the bank believes that if it can improve liquidity for the retail sector, then demand for US dollars via the exchange houses and the kerb market would dampen, leading the exchange rate differential between the official and unofficial markets to narrow. USD/NGN had hit a new high of 520.00 in the 'kerb' market prior to Monday's announcement compared to an official rate of 305.00/315.00, but has since dipped back to around 502.00 yesterday. This policy action also created the impression amongst some that the bank may be 'testing the water' ahead of a possible aggressive devaluation of the official interbank rate, which in turn sent the offshore USD/NGN NDF curve higher. Adding fuel to this issue was the news that President Buhari has been forced by doctors to extend his stay in London, where he has been based since the middle of January receiving treatment for an unspecified illness. While the President has made it clear a number of times in the past that a float or further devaluation of the Naira would in his opinion not benefit the country, his Vice President, Yemi Osinbajo, who is in charge of the government during Buhari's absence seems to have a more nuanced view towards the exchange rate. It's worth noting too that Osinbajo was the one who publically extolled the benefits of a more "flexible" exchange rate system in May last year just prior to the official devaluation move discussed in our introductory paragraph above, and which more interestingly came at the same that President Buhari was previously out of the country receiving medical treatment.

It is of course questionable, that the Vice President would at this stage authorize a major adjustment to the country's FX policy such as the introduction of a full-float, which runs counter not just his boss's view but also that of the current Central Bank Governor, Godwin Emefiele. However the CB's most recent measures, together with a promise to intervene more often in the interbank market and, partially lift a restriction that limited the type of client to whom the banks could on-sell their FX allocations will provide some relief, and indications are that more flexibility is being considered. But these steps alone are also not enough to significantly improve the ongoing shortage of hard currency and nor will they greatly tighten the differential between the official and unofficial exchange rates. What they have done this week is to create a 'third tier' within the current exchange rate regime and this will doubtless prove to make it even more confusing for banks and businesses.

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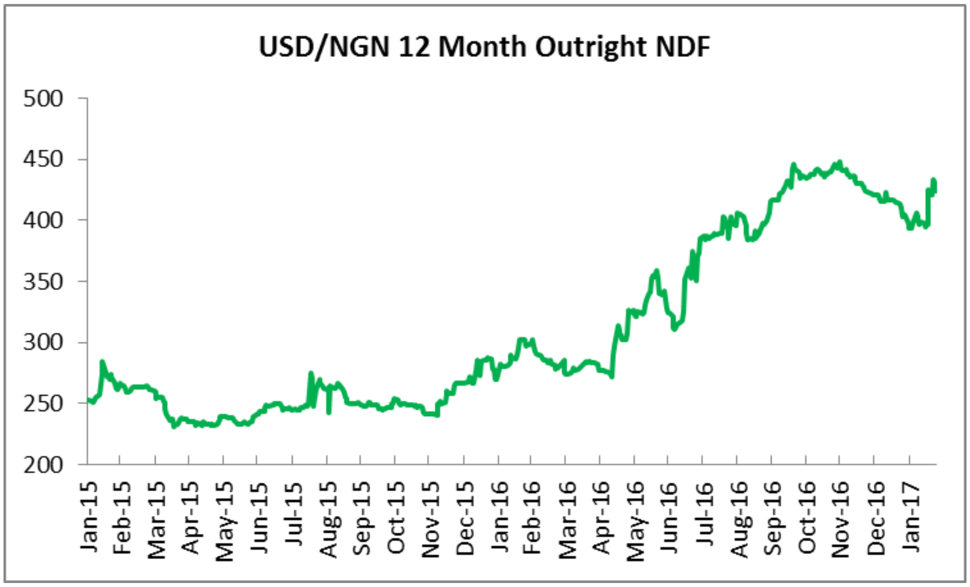
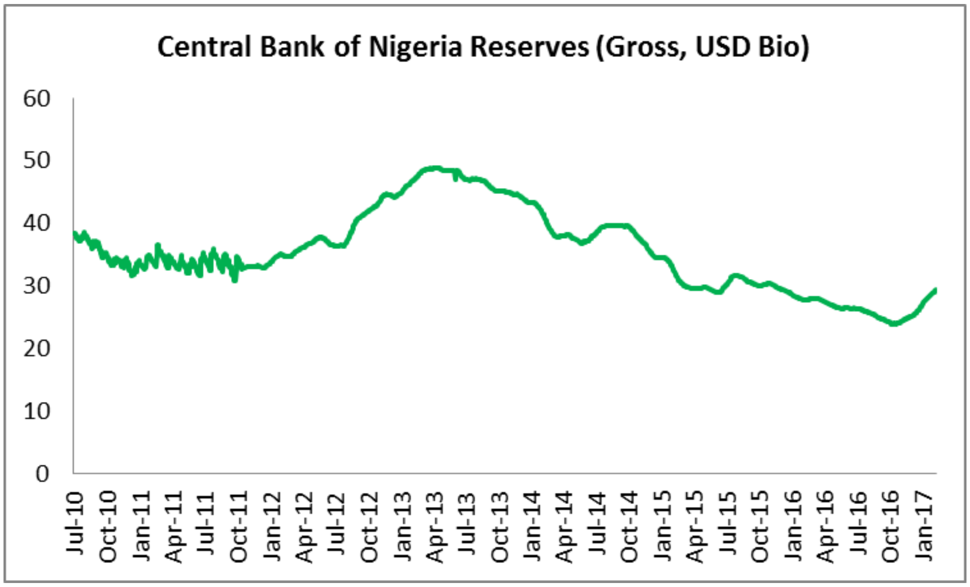
Glenn Wepener
Executive Director & Geopolitical Analyst, Middle East & Africa

As we have suggested in our previous commentaries Nigeria needs to urgently initiate significant economic reforms such as the removal of red-tape to help boost local SME activity, and introduce a fully transparent and more streamlined exchange rate system, this in turn would help to draw both short and long term investors back into a country which has enormous potential but that in our view, is sometimes restrained by occasional knee-jerk and ineffective policy decisions.

In conclusion whilst we anticipate some further near-term tinkering of Nigeria's exchange rate regime, and the chance of another devaluation of the official interbank rate within the next 3 months or so, an Egyptian style float despite its strong merits seems unlikely for now. Thus despite the recent rise in FX reserves, which now stand at around US$29 bio against US$23 bio in November, they are still far below their 2008 peak of US$64 bio and unless we see a significantly higher oil prices, and/or major economic policy changes the country's general hard currency shortage looks set to continue, which in turn could see fundamental market pressures build to an extent where it eventually forces the government's hand.



Source: Bloomberg.



Source: Central Bank of Nigeria; Bloomberg.

Glenn Wepener
Executive Director & Geopolitical Analyst
Middle East & Africa
Market Insight & Strategy
NBAD Global Markets
Tel: +971-2-6110141
Mobile: +971-50-6415937
Email: GlennMaurice.Wepener@nbad.com
Website: www.nbad.com