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Global Markets

Naira On The Edge?

The announcement this morning that Nigeria's Central Bank will no longer sell hard currency to the Bureaux de Change firms and allow commercial banks to resume accepting US dollar deposits, following a 6 month embargo, underlines the relentless pressure the country's FX reserves are under as the oil price continues to plunge. The CB Governor, Godwin Emefiele said that the decision to stop providing hard currency to the BDCs' was taken due to concerns that many transactions undertaken through these entities were "illegal" as well as a drain on Nigeria's precious reserves. The "kerb" rate immediately jumped above 280.00 against the US dollar on the back of this news compared to last week's level of 265.00 and the official rate of 199.00. Meanwhile the Oil Minister, Emmanuel Ibe Kachikwu, was also quoted today claiming that a "couple" of OPEC members have called for an emergency meeting of the organization.

At the end of last year President Buhari publically repeated his belief that Nigeria cannot afford a devaluation at this stage, and that he would not support such a move. His view was echoed by Emefiele and so the authorities have instead implemented a number of restrictions on imported goods and access to official sources of foreign exchange over the past few months in an attempt to protect reserves, which stood at US$29.1 bio at the end of December 2015. However its becoming clear that this policy is becoming unsustainable and seriously impacting the ability of businesses to operate, which in turn affects economic growth, job creation and the ability to diversify the country away from its extremely heavy reliance on oil revenues. Their reluctance to allow the currency to float or initiate another one-off devaluation is understandable as it would have a direct effect on inflation and thus sharply raise the cost of living in a country where an estimated 33% of the population still live below the poverty line (World Bank Data 2014), especially in the north where Boko Haram is active. Conversely the longer this situation continues the risk grows that a devaluation will become self-fulfilling and the consequent market upheaval more pronounced and far more difficult to manage compared to a carefully planned and communicated event.

The options open to the authorities are: 1) To devalue the currency in a gradual manner until the official and unofficial rates are much closer together, 2) To do another one-off move as was last done in November 2014 when the Naira was weakened by 8% or 3) To allow a free-float. The problems with options 2 and 3 are that a one-off move might not be large enough and thus encourage further speculation, while a free-float in the current environment could result in a free-fall. So bearing that in mind we think option 1 would be the least painful of the three for the government to digest. Of course it would increase the burden on the average Nigerian, but at the same time it would provide some oxygen to the business community, and increase the Central Bank's credibility with investors and market participants, while at the same time boost the value of the country's exports in Naira, which in turn would provide more funds for government spending on infrastructure projects and job creation. This is especially relevant when you consider that 75% of the government's revenues are generated via oil exports, and that hard currency earnings from this source have dropped from a high of US$3 bio per month to around US$1 bio per month currently, in line with the fall in oil prices.

In conclusion we believe that a downward adjustment in the value of the Naira is not a question of if but when.

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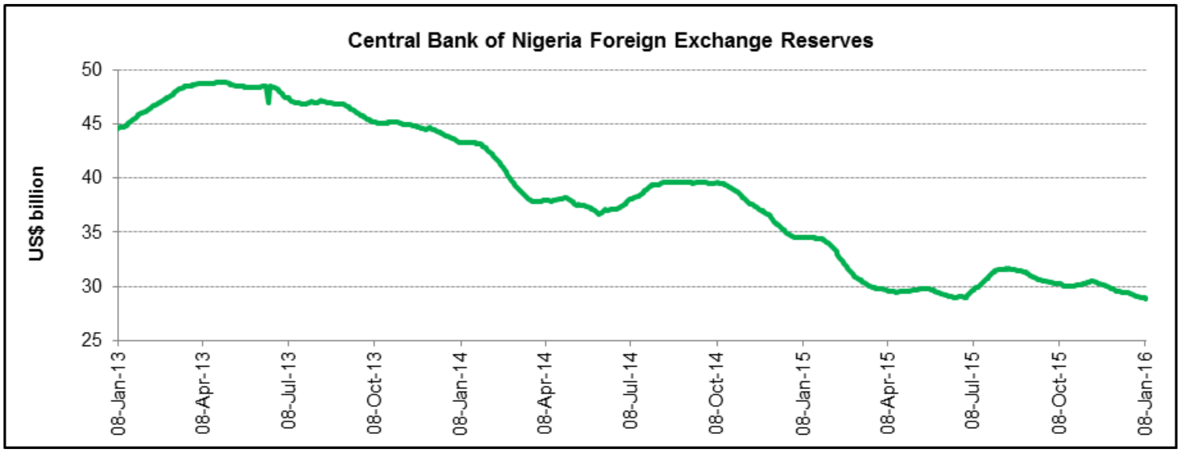

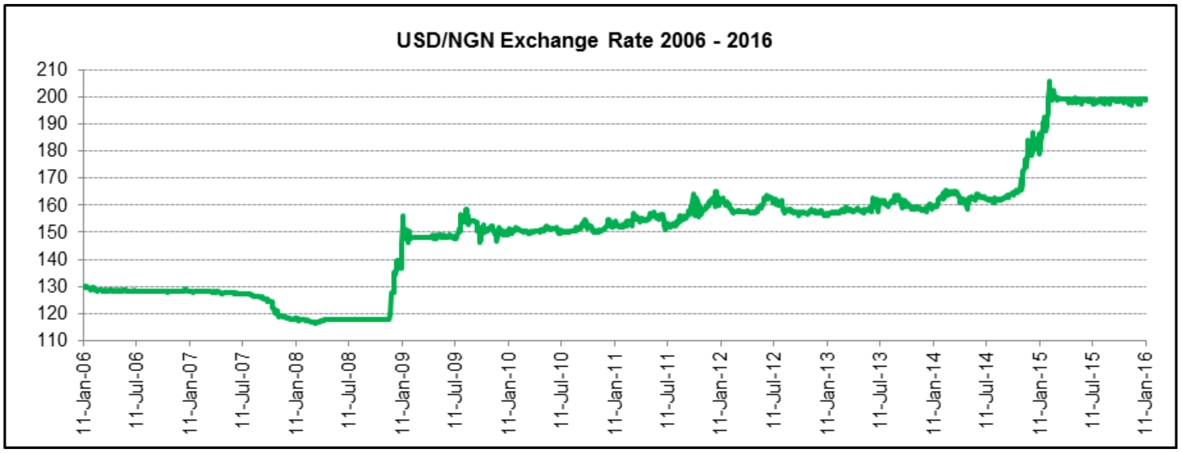

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