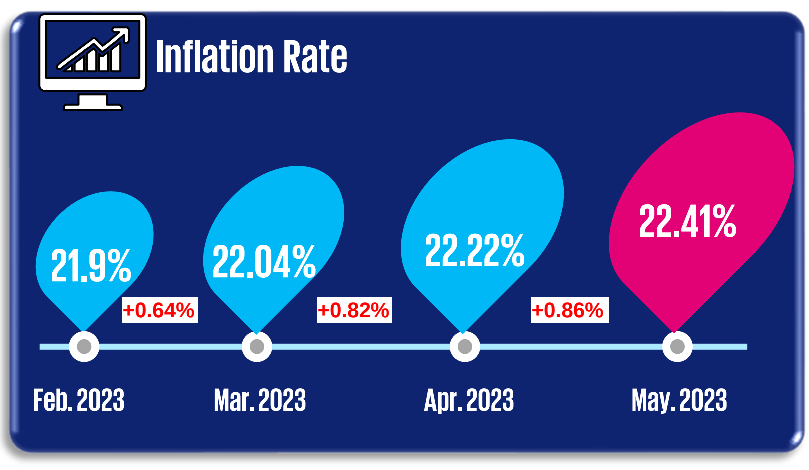
Friday 16th June, 2023

Crude Oil Price

$76.28 0.09%

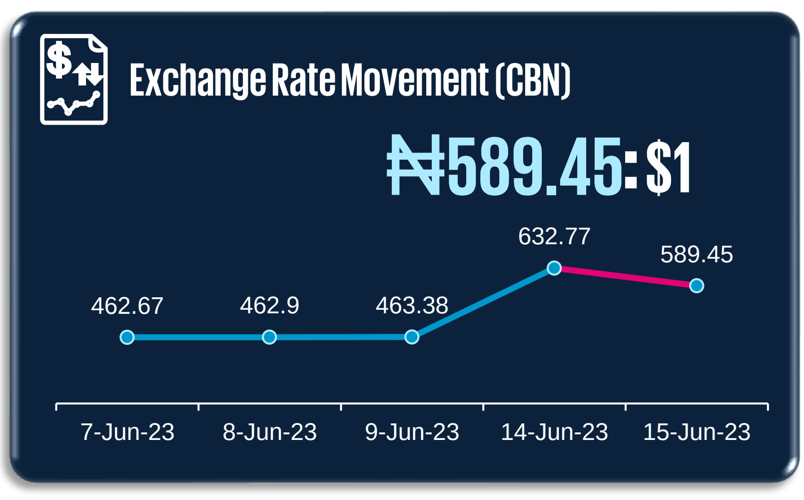
$76.21 Previous



FX Reserve

$34.656b 0.11%

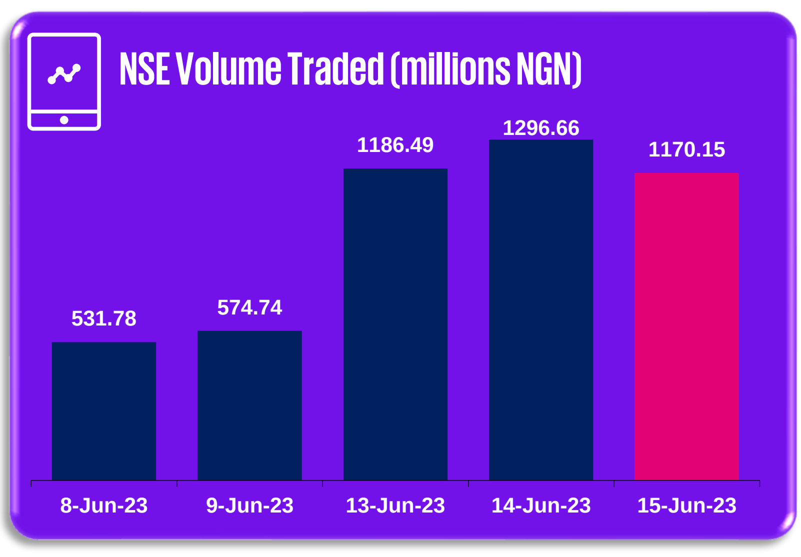
$34.693b Previous



Market Capitalization

N30.46tr 0.20%

N30.40tr Previous



18.5% Monetary Policy Rate

18% Previous

KPMG Analysis: FX Rate Convergence

This week, we highlight the Central Bank of Nigeria's (CBN) operational changes to the foreign exchange (FX) market on Wednesday, June 14, 2023, unifying the official FX rates into the Investors and Exporters (I&E) window and reintroducing the "willing buyer, willing seller" model where the exchange rates will be determined by the market forces.

Though, details about broader changes to the FX policy regime or monetary policy in general especially as regards the restrictions placed on import of 41 items, clearing FX demand backlogs etc are still in unclear, this move, together with the earlier one on PMS subsidy removal will most likely support a sovereign ratings upgrade and increase confidence in the Nigerian economic environment.

Following this announcement, the exchange rate in official I & E window rose to N664/$ from N473/$ the day before and closed at N702/$ as of 15th June 2023. At the same time, activities in the Nigerian capital market surged higher with investors taking position in anticipation of a likely surge in foreign portfolio investor's participation.

We anticipate that the following positive implications of these developments over time will include:

- Boost in FX supply from FDI, PFI, home remittances, GOE and export-oriented companies who will now have the incentive to bring in their FX via official channels.
- Reduction in round tripping and speculative FX demand.
- Increased government revenue for expenditure on much needed physical and social infrastructure and associated less pressure on debt service payments

However, the following risks and unintended consequences of this move may include:

- A reduction in VAT and CIT if household expenditure should reduce as a result of the potential inflationary effects of a weaker official exchange rate as well as tighter margins for businesses due to higher costs and lower demand for their products and services
- Increased costs to businesses from FX losses due to higher FX rate in between the financial year which they have not budgeted.
- Government debt in naira terms, debt to GDP and debt servicing ratios may worsen if measures are not taken to boost government revenue.
- Nigeria's status as the largest economy in Africa and any advantages that it presents may be lost as it will slip to the 3rd largest after Egypt and South Africa.

In conclusion we believe the overall long term net benefit of this policy will be positive and a move in the right direction. We estimate that the FX rate will range within N650-750/$ in the near term and relative equilibrium will depend on how quickly supporting policies are introduced that also encourage and guaranty FX supply. This will also require amongst other things, proper decentralisation of the FX supply environment where the CBN still act as the primary supplier of FX.

Sources: CBN, NBS, NGX & KPMG Research

Other Stories

- Inflation higher before Impact of Subsidy Removal and FX rate Convergence
- Naira weakens to 702/$, CBN fresh FX supply likely
- CBN announces unification of FX windows, abolishes Naira4Dollar scheme
- OPEC projects Nigeria's economy recovery in coming months
- Nigeria's Debt Profile To Hit N81 Trillion Following Fx Rates Unification
- Nigeria's inflation rate climbs for 5th straight month in May
- Nigeria records N710bn VAT in Q1 2023

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