KPMG

Flashnotes

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Precipitous Decline in foreign capital in a Transition Period

- **Capital importation figures has now shown a persistent decline from $23.9 billion in 2019, $9.65 billion in 2020, $6.70 billion in 2021, and $5.32 billion in 2022.**

- **The persistent decline in capital importation may be attributed to the rounds of global economies' monetary tightening, since the COVID 19 Pandemic and into the Russia/Ukraine war, low investor confidence due to the ambiguous foreign exchange regime, challenges in accessing foreign exchange, high foreign exchange volatility, unflattering ratings by Moody's and Standards and Poors', continuous security challenges, high cost of doing business, weak growth and high inflation and interest rates, fiscal and monetary constraints and all in a period of tense political transition.**

- **While substantial reforms may yet be done to reverse the trend of declining foreign capital in the long term, we believe that in the meantime, the country will struggle to attract increasing foreign capital for most of 2023 and struggle to keep the exchange rate from depreciating further, unless it is able to boost its crude oil and non-oil exports, especially now that oil prices are once again rising.**

Event

The National Bureau of Statistics (NBS) reported that the total capital importation into Nigeria in Q4 2022 stood at $1,060.73 million, representing a 51.51% decrease from $2,187.63 million recorded in the same quarter, last year. The report also shows 8.53% decrease from the preceding quarter, where capital importation was $1,159.67 million in Q3 2022. The largest contributor in 2022 was portfolio investment which amounted to $2,442.24 million, representing 45.8% of total capital importation, lesser than 50.53% contributed in 2021. Other Investments such as trade credits, loans, and currency deposits came second amounting to $2,418.56 million and a 45.39% increase from 39.04% in 2021. Foreign Direct Investments totaled $468.08 trillion, signifying 8.71% contribution in 2022 from 10.43% in 2021. On a sector basis, the top three sectors with the highest inflows in 2022 were the Banking sector with 39.21% ($2,089.60 million) of the total capital importation, the Production sector accounting for 17.80% ($948.43 million) and the Financing sector which accounted for 14.85% ($791.16 million). The sector with least contribution was the transport sector with a 0.02% ($1.32million) in 2022.

Analysis/Opinion

Capital importation figures has now shown a persistent decline from $23.9 billion in 2019, $9.65 billion in 2020, $6.70 billion in 2021, and $5.32 billion in 2022. The importance of capital inflows in a country where foreign exchange is in high demand to stimulate economic activity is very clear. Accordingly, the continuous decline in foreign capital inflows in the presence of dwindling crude oil sales and generally poor and unstable export earnings has slowed down foreign reserves accretion and widened the foreign exchange supply gap thereby putting pressure on the exchange rate which has depreciated for the most part since 2022. Additionally inadequate access to foreign exchange has constrained inputs for production leading to higher production costs, lower revenues and slower economic growth.

The recent decline in capital importation may be attributed to several factors. Firstly, the rounds of monetary tightening since the COVID 19 Pandemic and into the Russia/

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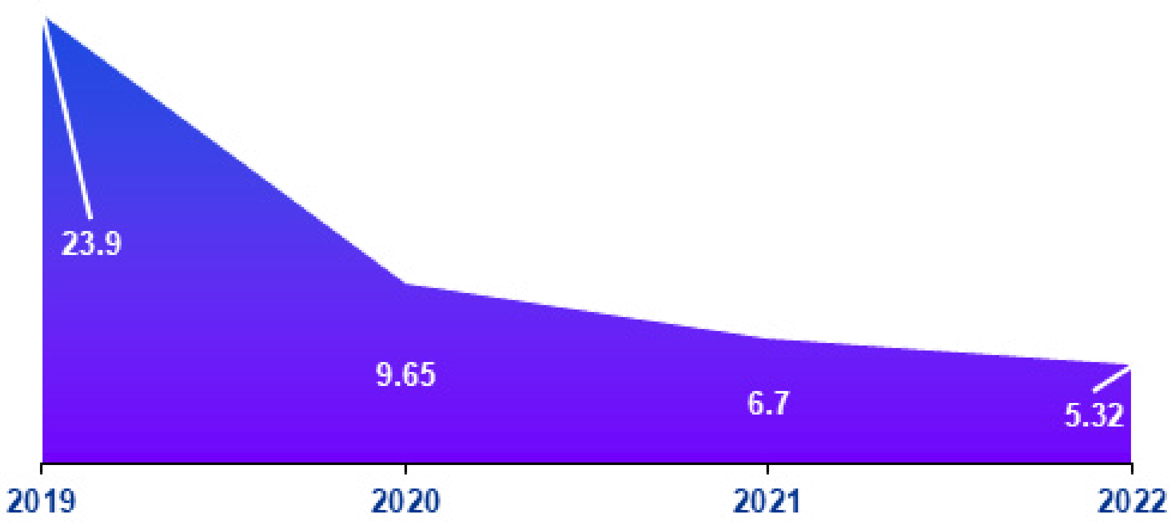
Ukraine war has shifted interest away from emerging and developing economies and this is not expected to change anytime soon. Additionally, with respect to Nigeria, investor confidence, especially portfolio investors, has weakened in the presence of what foreign investors consider an ambiguous foreign exchange regime characterized by multiple exchange rates, inadequate access to foreign exchange, and high foreign exchange volatility. Moreover, two renowned rating Agencies, Moodys and Standards and Poor's recently released unflattering ratings reports about Nigeria's fiscal position and cited concerns about the exchange rate regime further weakening investors' confidence.

Beyond the rigidity and lack of clarity in the FX management system, other factors have discouraged Foreign Direct Investment and capital inflow in general such as security challenges, ease of doing business issues particularly as it relates to the infrastructure deficit, overly stringent policies and bureaucratic bottlenecks for securing permits and a perceived weak legal framework, which make it expensive to do business in Nigeria are contributing to the reasons foreign investors are avoiding bringing their capital into the country. Finally, investors may also be finding it difficult to make certain investment decisions in a year of political transition which has remained tense and typically will adopt a wait and see approach to investing into the country until new administrations have settled in and they can understand the direction and priorities of the new government. This is amid slower economic growth suggesting weakened consumer demand, hyperinflation, high interest rates and more volatile fiscal and monetary conditions.

Against this backdrop we expect the country will struggle to attract increasing foreign capital for most of 2023 and unless it is able to boost its crude oil and non-oil exports, it may struggle to keep the exchange rate from depreciating further.

Annual Total Capital Imported (billions USD)



Source: ***Central Bank of Nigeria (CBN)***

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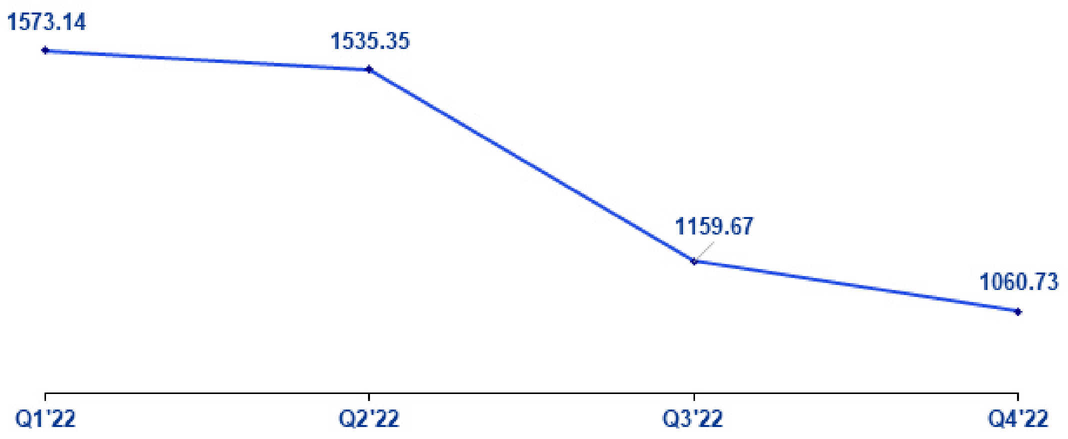
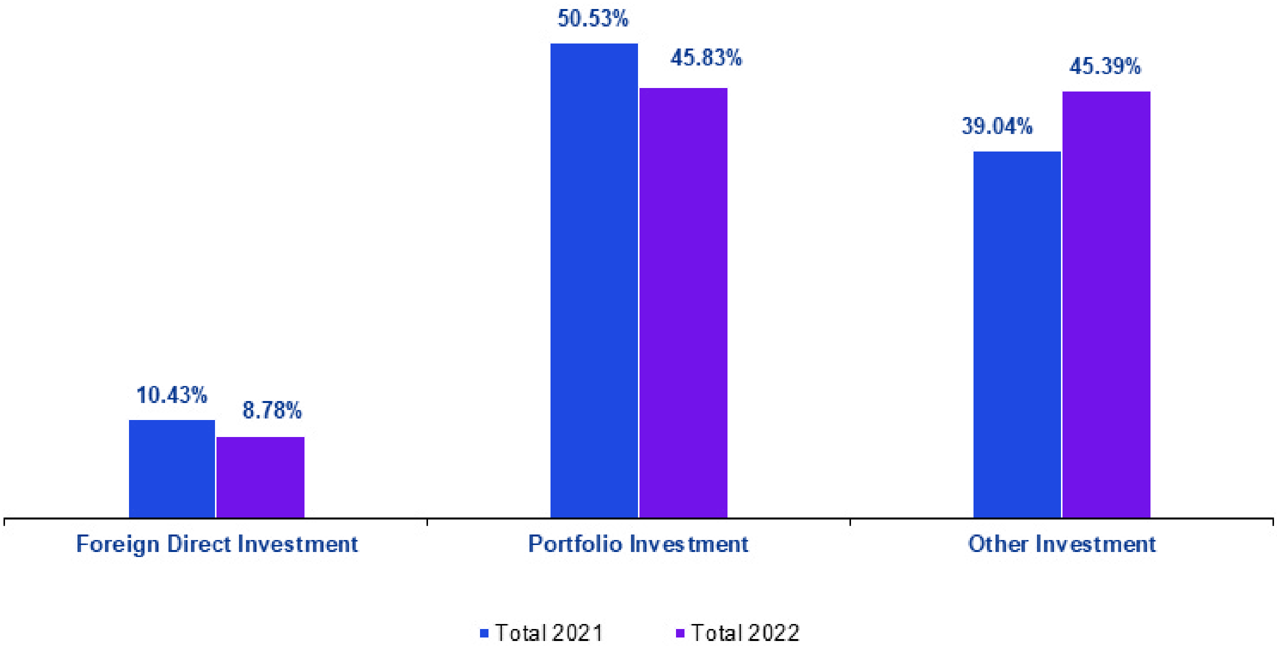
Total Capital Imported per Quarter



Source: ***National Bureau of Statistics (NBS)***

Annual Contribution by Types



Source: ***National Bureau of Statistics (NBS)***

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