
# MACROECONOMIC UPDATE | JUNE 2023

## A PARADIGM SHIFT IN THE FOREIGN EXCHANGE RATE POLICY

MERISTEM

# A Paradigm Shift in the Foreign Exchange Rate Policy

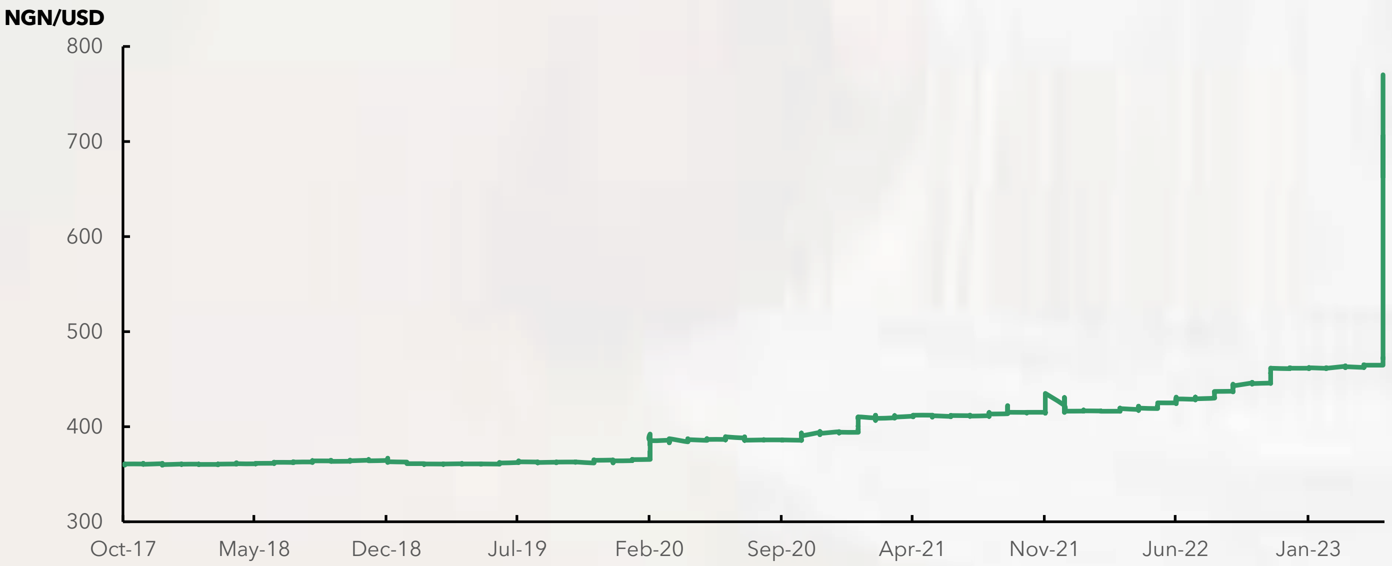
As anticipated in our report detailing our expectations for President Tinubu's administration, the CBN lifted the peg on the exchange rate effectively ending intervention (unless the need arises) at the Investors and Exporters (I&E) window. This resulted in a c.63% slump in the value of the Naira. In addition, all the existing official FX windows were collapsed into the I&E FX Window.

Other operational changes were also announced effective immediately including:

- Re-introduction of "willing buyer, willing seller" model at the I&E window;
- Operational rate for all government transactions now pegged at the weighted average rate of the preceding day's transactions;
- Proscription of trading limits on oversold FX positions and nil on overbought positions;
- Re-introduction of two-way quotes with bid-ask spread of NGN1.00;
- Cessation of the RT200 Rebate Scheme and the Naira4Dollar Remittance Scheme from 30th June 2023.

While the official exchange rate rose significantly, the parallel market largely remained within a band of NGN755.00/USD - NGN760.00/USD. This move represents a first and major step in the direction of unifying the exchange rate windows in the country and is largely welcome as it allows the currency to reflect market realities. However, we expect these policies to have an impact on key economic variables including prices, consumer purchasing power, the federal government's financial position, as well as firms and the capital market.

**Chart 1**: **NGN/USD Exchange rate on the I&E Window from inception till Date**




***Source:*** *FMDQ, Meristem Research*

## On Inflation

Based on our engagement with manufacturers and importers, we observe that the informal parallel market (which already had a c.40% premium over the erstwhile official rate of NGN464.42/USD), has been a major source of foreign exchange for these firms. Thus, we do not expect the official devaluation to have much impact on these importers. However, more of the brunt will be felt by government transactions settled at the official window (like PMS importation by the NNPC). According to the new CBN circular, all government transactions (including the NNPC) will be settled at the weighted average rate of the preceding two-days transaction on the I&E Window. This development should thereby lead energy prices higher. Additionally, import license has been granted to other firms who would be importing the PMS at the devalued rate.

## On Capital Importation Prospects

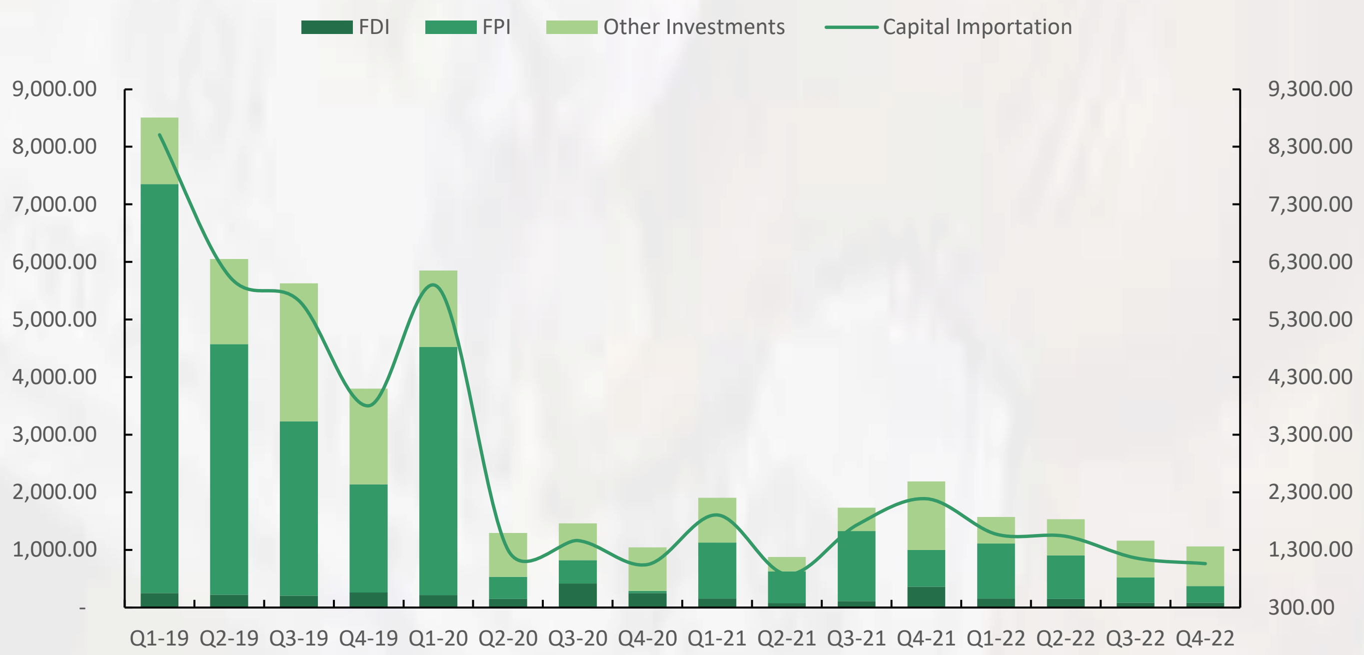
The recent policy moves by the government seems to be a signalling effect for foreign capital influx into the country. However, a couple of other factors (like weak macroeconomic environment and inability to repatriate capital) have also been responsible for the Nigeria's inability to attract foreign capital. Foreign Portfolio Investments have made up an average of c.50% of capital inflows into the country over the past 3 years, lower than the pre-pandemic contribution of 68.22%. For these investors to fully return, major reforms to ensure policy consistency needs to be carried out at the fixed income money market (which accounts for c.74% of the FPI inflows). These consistencies in policy reforms and implementations should also improve Foreign Direct Investment in the long run.

**The unification of all official FX windows alone is not likely to be sufficient to unify all FX rates in the economy and reduce/eliminate participation in the parallel market especially if the FX supply remains low, existing backlogs are not cleared and existing restrictions on importation of some items remained enforced.**

## On Federal Government Financial Position

Given that the exchange rate assumption used in formulating the budget stood at NGN435.57/USD, the increase in this exchange rate by c.77% should boost crude oil receipts for the year leading to an increase in the FG's actual revenue received. External debt in Naira terms has however increased by c. 67%, leading to higher debt to GDP ratio ( 27.26% vs 20.80% in 2022) and higher external debt service.

Chart 2: Capital Importation (USD'mn)




***Source:*** *NBS, Meristem Research*

## On Equities Market

We expect firms to implement price increases across various products to cushion the impact higher costs and protect margins. However, the elasticity of discretionary products should limit the possibility of this price transmission to consumers. For the equities market, selected sectors should report improved performance in 2023 despite this increase in costs. Tickers in the oil and gas, agriculture, consumer goods and financial services are our top sectors to watch.

## On Fixed Income Market

We expect the Federal Government to concentrate its borrowings on the domestic debt market to finance its deficit, given that external debt has become significantly more expensive. We also do not see the possibility of another Eurobonds raise during the year.

## 2023 Exchange rate expectation

We have reviewed our end-of-year forecast of the NGN/USD exchange rate to reflect these expectations. Particularly, our expectation is for the NGN/USD to trade within a band of **NGN724.41/USD** to **NGN765.31/USD.**

| Sector | Pros | Cons | Impact |
|---|---|---|---|
| **Telecommunication companies** | Majority of shareholders will be able to repatriate funds. | Increase capital expenditure borne in USD that was previously sourced at official rate.<br>Reduce revenue and profitability of companies that report in USD<br>Increase foreign denominated finance obligations and lease expenses | Net negative in the near term |
| **Agriculture** | Increased export earnings in Naira terms.<br>Demand for palm oil exports might increase as its exports become cheaper in the global market. | Marginal increase in capital expenditure.<br>Technology and raw materials from related parties should become more expensive. | *Net positive* |
| **Financial services** | Banks like **FBNH** with more financial assets than financial liabilities should record revaluation gains.<br>Increase in trading income. | Increased risk weighted assets in Naira terms and Capital Adequacy Ratio will reduce.<br>Higher operating expenses. | Net Positive |
| **Consumer goods/Industrials goods** | Increased export earnings<br>Converting financials back to Naira will increase the value of the financial position | Firm's typically have FX obligations<br>Increased import cost of raw materials | Net negative |
| **Oil and Gas** | Increased financial performance for **SEPLAT** after conversion of USD gains to Naira | External USD debt for firms like **TOTAL** and **ARDOVA** would be revalued higher | Mixed |

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