A Temporary Aid for the Naira While Uncertainty Clouds the Long-Term | August:2023

MERISTEM

Nigerian National Petroleum Corporation Limited (**NNPCL**) successfully secured an emergency crude repayment loan from African Export-Import Bank (AFREXIM Bank) amounting to USD3.00bn on August 16, 2023. The purpose of this funding, as disclosed by **NNPCL**, is twofold, albeit complementary: firstly, for upfront payment of taxes and royalties to the Federal Government of Nigeria (FGN); and secondly, to provide Dollar liquidity to the FGN to rescue the Naira which has been declining in value in the aftermath of the ongoing fiscal and monetary policy reforms. The disbursement of this fund is scheduled to occur in multiple tranches, in line with the FGN's needs. The facility would be repaid from fractions of the **NNPCL**'s proceeds from future oil production and is not expected to deny the FGN's future revenue from crude oil production. This development is aimed at achieving stability within the exchange rate market and saving the Naira from further depreciation against the greenback.

Recall that the Central Bank of Nigeria (CBN) recently released its financial statements for seven years dating to 2022FY. A major highlight from the apex bank's balance sheet is its limited ability to defend the Nigerian legal tender, as its liquid foreign exchange (FX) position could be as low as USD11.27bn in our estimation, after excluding key liabilities. Thus, there is a need for a strategic move to mitigate the negative impact of the FX rate harmonization policy earlier embarked on by the CBN. Thus, this AFREXIM loan is a positive development, although only a necessary short-term fix, but not sufficient.

Since the liberalization of the Naira, it has slumped by 57.03% against the Dollar in the I&E window. Also, the disparity between the I&E window rate and that of the parallel, which initially narrowed significantly, began to widen, leaving room for arbitrage. A major reason for this has been the limited supply of USD in the market, which the loan can help immediately.

One major upside of having a relatively stronger Naira is that it will reduce fuel prices, as the importation cost of refined petroleum products will reduce. This, in turn, is projected to alleviate the pressure on the prices of goods and services and tame the level of a projected rise in the inflation rate in the near term. Concurrently, a robust Naira will further enhance investors' confidence in Nigeria and might entice FX inflows into the country in the near-to-medium term.

Another burgeoning concern revolves around the repayment, which is intricately linked to proceeds from future crude oil production. While the exact details of the repayment structure have not been explicitly divulged, the fact that it is closely associated with oil production introduces a certain degree of flexibility in the repayment process. Nonetheless, this arrangement faces a significant challenge due to the unstable trajectory of the country's oil production.

In our view, the AFREXIM loan is a welcome short-term fix; however, Nigeria's inherent FX market issues need permanent respite. Clearing the existing FX backlog and meeting new legitimate FX demands would require an additional inflow of FX into the reserve balance. Fortunately, the ongoing reforms are key amongst the demands of the International Monetary Fund (IMF) for financing to be provided to the country. Thus, the ongoing reforms pave the way for Nigeria to attract an IMF facility which could go a long way in contributing to the country's leverage in defending its legal tender from further deterioration.