BREAKFAST SESSION ON

BUSINESS DYNAMICS UNDER A FLEXIBLE EXCHANGE RATE REGIME

HELD ON FRIDAY, JULY 15, 2016 AT THE BANKERS HOUSE, VICTORIA ISLAND, LAGOS

COMMUNIQUE

The Chartered Institute of Bankers of Nigeria Centre for Financial Studies (CIBNCFS), a subsidiary of The Chartered Institute of Bankers of Nigeria, organized a Breakfast Session on **Business Dynamics Under a Flexible Exchange Rate Regime.** The Session was held on Friday, July 15, 2016 at the Bankers House, Victoria Island, Lagos. A total of 37 (Thirty-Seven) participants drawn from the Central Bank of Nigeria (CBN), Deposit Money Banks (DMBs) and the Telecommunications industry were in attendance.

The objective of the Session was to x-ray the newly introduced flexible exchange rate regime by the Central Bank of Nigeria on the country's business environment and peculiarities vis-à-vis other successful countries' examples under a similar regime. This was done with a view to leveraging on their experiences for improved business performance and growth of the nation.

The following are the highlights of the Session:

Reasons for the Introduction of the Flexible Exchange Rate

- In mid-2014 the price of crude oil declined from $110 to $27 per barrel. This caused a decline in foreign reserves leading to restrictions and rationing. The Government through the CBN introduced policies to address the resulting negative effects on the economy.
- There were higher likelihoods of abuse and corruption in the last exchange rate regime
- The floating exchange rate system would be more transparent because it is determined by market forces
- The reduction in the major source of reserves derived from the downstream sector among other things led to the widespread uncertainties in the country. The Government needed to tackle the uncertainties and therefore introduced the flexible exchange rate regime. The

new regime is expected to stabilize the foreign exchange market as prices would be determined by the forces of demand and supply.

- The flexible exchange rate has brought about a sense of security because it calls for greater efficiency in the management of scarce foreign reserves. Since the value of the Naira has fallen under this exchange rate regime, a higher amount of foreign exchange is required to pay for imports. Nigeria is now forced to look toward locally produced or import substituted products in an attempt to save its residual foreign reserves.

Some of the Issues Raised by Participants on the New Flexible Foreign Exchange

- How liberal is the new foreign rate exchange policy? Under a flexible exchange rate regime there should only be a single market for foreign exchange determined by the forces of demand and supply. This is currently not the case in Nigeria as there are still parallel markets and a significant gap between them. This means that there are still opportunities for arbitrage and rent seeking.
- How do we control transactions which are not eligible to have access to Forex as stated in the Central Bank of Nigeria's Guidelines? Traders who demand foreign currency for unauthorized transactions (such as importing toothpicks) would be forced to source for funds from the black market. Traders who have been importing banned items for decades may not stop even after restrictions have been made. These traders would instead seek foreign exchange from the black market to carry out their transactions since there are still parallel markets.
- The eligibility to operate as an Authorized Foreign Exchange Dealer must be monitored closely to avoid abuse
- There is a cloud of uncertainty regarding the effectiveness of this new exchange rate policy. A couple of months after this regime was introduced, investors are still fleeing Nigeria while production has decreased and inflation rates are at an all-time high.
- There is widespread insecurity across Nigeria which has disrupted normal economic activities. For example, the activities of the militants in the Niger Delta, has disrupted crude oil production. Oil production in Angola has now surpassed that of Nigeria.
- The new exchange rate regime has caused a "Catch 22" dilemma. This is because, while we do not have enough foreign reserves to sustain the previous fixed exchange rate, the new floating exchange rate presents challenges of a persistent increase in costs.

Implications of the Floating Exchange Rate Regime

- Since the introduction of the new exchange rate regime, there has been a direct increase in costs without a corresponding increase in income. Likewise, purchasing power of the average Nigerian has reduced significantly.
- The price of oil recently increased to $50 per barrel but Nigeria could not take advantage of this price hike because we are not producing at full capacity.
- Issues of backlogs and debt financing in the downstream sector are yet to be resolved. Dollar denominated loans and security instruments generated in the previous exchange regime have been affected as the value of the Naira to the Dollar has been adjusted.
- Authorized Foreign Exchange Dealers may be discouraged from patronizing the official rate due to arbitrage gains to be earned in the black market
- The current exchange rate regime needs more capital to operate on the same level as it was in the fixed exchange rate regime.

Recommendations

- The Government needs to restore peace to the Niger Delta and other conflict affected parts of Nigeria so that production of crude oil and other economic activities operate at their full capacities.
- The Government needs to implement more import substitution and export promotion policies. This could be done by reducing the amount of bottlenecks in the system affecting potential exporters. In countries like Kenya and Ghana, the locals have the capacity to produce quality products due to their collaborative relationships with the governments.
- We must increase our competitive capacity. The quality of Nigerian exports must improve if foreigners are to patronize our products and services. This would positively affect foreign exchange earnings.
- CBN should clear the backlogs of foreign exchange debts so as to prevent systemic loss.
- The Government should provide incentives for businesses who succeed in their quest to provide more import substituted products as well as export promoted products.
- Nigeria needs to regain the confidence of investors and trading partners. Nigeria's credit worthiness is questionable to the international community and must be improved upon.
- The CBN should encourage the developments of more products whose payments can be deferred (forward contract).
- The Government should create an enabling business environment by encouraging transparent incentives that would attract Nigerians in the Diaspora to come and invest in the country. This would also attract Foreign Direct Investments (FDIs) from friends of Nigerians in the Diaspora.
- The Government should put in place an operative Securities and Commodity Exchange Board.

- The Government should encourage the establishment of the Nigerian Financial Centre and create more Export Processing and Free Trade Zones.
- The quality of made-in-Nigeria goods should be improved to encourage local consumption.
- The Government should develop programmes for the SMEs that would not only provide them with the needed funds but also with the attendant technical support to efficiently manage the funds.
- There is also the need for an AMCON type of structure for the SMEs as a safety net for them.
- Authorized dealers must be scrutinized before they are offered licenses to operate.