

THE DOLLAR RAIN

a look at the FX situation



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We employ various methods of data collection such as personal interviews, telephone, mail and the Internet. Depending on the survey design, our methods can be used separately or combined. Our Data Collection Methodology (DCM) team advises on data collection methods for all ONS social and business surveys. With clients both within the business and the wider government community, we aim to provide expert advice on data collection procedures and carry out research leading to improvements in survey quality.

Since 2013, when SBM Intel started its operations, the firm has provided data analytics and strategic communication solutions to dozens of clients across various sectors in Nigeria, Ghana, Cote d'Ivoire and the United Kingdom.

In 2015 we became a partner to Stratfor, an American geopolitical intelligence firm that provides strategic analysis and forecasting to individuals and organisations around the world, including the various United States departments and agencies like the Department of Defense (DoD) and the Federal Bureau of Investigations (FBI). Since the partnership came into effect, several SBM Intel generated reports have been published on the Stratfor website; stratfor.com.

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Last week saw a rare sell-off in the FX parallel market. After recording all time lows the previous week, the naira strengthened to between ₦440 and ₦460 per US dollar following the release of new foreign exchange policy guidelines by the Central Bank of Nigeria, and subsequent market intervention.

2016 was an oddity. Facing declining FX inflows and drop in the country's foreign reserves, the CBN was forced to consider abandoning its currency peg, which at the time was ₦190 (+/- 3) per dollar. In June, the CBN finally devalued the naira and introduced some derivative products to better meet future demand. This eased pressure on the foreign reserve but the naira continued to depreciate. In the spot market, volumes supplied by CBN were still declining - annual interbank sales fell over 50% from the previous year to less than \$17 billion in 2016; sales to BDC operators dropped drastically to a meagre \$55 million in 2016.

Considering that CBN is the largest source of forex in the market, liquidity subsequently dried up and the spill-over demand from the interbank caused parallel market to jump over 50%.

The question at this point is which market reflects the true value of the naira. Is it an under-supplied interbank market into which CBN intervenes to repeatedly to cushion the closing rate? Or is it an equally under-supplied parallel market?

At the turn of the year, following an appreciation of the reserves, the CBN began boosting supply. It seems to us that the regulator was jolted into action by above ₦500 dollar exchange rates. For weeks industry operators and watchers had been raising the alarm that demand for dollars for school fees payment and personal travel was taking a toll on the exchange rate at the parallel market. In addition to this supply boost was the restoration PTA/BTA sales via banks. These sales had been largely taken over by BDC operators.

Clearly, the CBN is now genuinely selling to clear backlog - it supplied \$500 million last week and the banks could not take it all (note that pre-2015 CBN used to supply about \$300 million a week).

The policy actions of CBN are tailored at meeting specific demands, and

the action caused speculators to sell off some of their dollar holdings and wait for the exchange rate to stabilise before taking further decision. Within a few months it will be summer time in Europe and America, and the demand for dollars will rise again. If the CBN is able to provide the extra supply in the official market then rates could remain around current levels, if not the chase for naira's true value will continue into the "ember" months.

We think that the CBN is losing a crucial opportunity to correct years of market controls which it has proven unable to sustain once the dollar supply is affected by events such as the drop in oil price. The main reason for this is political, and the CBN has chosen to sacrifice sound economics on the altar of political expediency. These controls, where CBN is the main supplier of FX in the market means that growth and economic activities are somewhat limited by the CBN's capacity, a situation which is a handicap to an economy that should ordinarily be growing rapidly.

It is clear that the CBN cannot sustain this level of interventions for long. It will deplete its dollar supply and in the end achieve nothing significant. While we accept that a full float at this time, two years to elections will be politically imprudent, a policy approach that may work is to drive down the FX rate by the current oversupply, flush out speculators and follow up with a managed float to let the market determine the price without the added pressure of the speculators hoarding. We think there is a sliver of hope that the Acting President might consider this approach, if he is in power long enough to implement it before President Buhari returns.



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