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Re-Introducing and Operationalizing Nigeria's Flexible Exchange Rate Market¹

Godwin I. Emefiele, CON²

Good afternoon ladies and gentlemen and welcome to the Central Bank of Nigeria (CBN). The Management of the Bank has called this Press Conference in response to one of the commitments contained in the Communiqué of the Monetary Policy Committee (MPC) of 24th May 2016. Having consulted widely and prepared carefully, I am delighted to unveil to relevant stakeholders and the general public, the broad framework and guidelines of the Flexible Exchange Rate Inter-bank Market, which we alluded to at the end of that MPC Meeting. Before I go into the details of this new policy, let me first give you a brief context.

2. We all know by now that Nigeria has been dealing with the effects of three significant and simultaneous global shocks, which began around the third quarter of 2014. These include:
 - The over 70 percent drop in the price of crude oil, which contributes the largest share of our Foreign Exchange Reserves;
 - Global growth slowdown and geopolitical tensions along critical trading routes in the world; and
 - Normalization of Monetary Policy by the United States' Federal Reserve Bank.
3. In view of these headwinds, we have witnessed a significant decline in our Foreign Exchange Reserves from about US\$42.8 billion in January 2014 to about US\$26.7 billion as of 10th June 2016. In terms of inflows, the Bank's foreign exchange earnings have fallen from about US\$3.2 billion monthly to current levels of about US\$1.3 billion per month.
4. Despite these outcomes, the demand for foreign exchange has risen significantly. For example, in 2005 when we had oil prices at about US\$50 per barrel for an extended period of time, our average import bill was ₦148.3 billion per month. In stark contrast, our average import bill for 2015 was about ₦917.6 billion per month. Unfortunately, the forces were accounting for a substantial reduction of our foreign exchange reserves.

¹ An Address presented at the unveiling of the framework for re-introduction of Managed Float Exchange Rate System on 15th June 2016

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5. In order to avoid further depletion in the reserves, the CBN took a number of countervailing policy actions, anchored on the prioritization of the most critical needs for foreign exchange as well as maintaining stability in the exchange rate. In this regard, we decided to manage the Naira-Dollar Exchange Rate at about ₦197/US\$1 over the last 16 months, and then provide the available but highly limited foreign exchange to meet the following needs:
 - Matured Letters of Credit from Commercial Banks
 - Importation of Raw Materials, Plants, and Equipment,
 - Importation of Petroleum Products, and
 - Payments for School Fees, BTA, PTA, and related expenses
6. Over the intervening period, I am happy to note that these policies have yielded some positive developments. In particular, we have managed to stabilize the exchange rate around February 2015, thereby creating certainty for both household and business decisions. We have largely eliminated speculators and rent-seekers from the Foreign Exchange Market. Our Reserves, despite having fallen, is still robust and is able to cover about 5 months of Nigeria's imports as against the international benchmark of 3 months. And domestic production of items prohibited from the FX market is picking up nationwide, thereby creating more jobs for many more Nigerians.
7. Despite these positive outcomes, the Central Bank of Nigeria has always maintained that it would continue to monitor situations on the ground and ensure that the Bank's policies reflect these facts and developments, rather than the sentiments of any groups or sectors. It is in light of this principle that we now believe that the time is right to restore the automatic adjustment mechanism of the exchange rate with the re-introduction of a flexible inter-bank exchange rate market. The workings of this market will be consistent with the Bank's objectives of enhancing efficiency and facilitating a liquid and transparent Foreign Exchange Market.
8. Although the detailed framework and operational guidelines of the market will be released to the public immediately after this Press Briefing, permit me to highlight its key aspects:
 - a. The market shall operate as a single market structure through the inter-bank/autonomous window;

- b. The Exchange Rate would be purely market-driven using the Thomson-Reuters Order Matching System as well as the Conversational Dealing Book;
- c. The CBN would participate in the Market through periodic interventions to either buy or sell FX as the need arises;
- d. To improve the dynamics of the market, we will introduce FX Primary Dealers (FXPD) who would be registered to deal directly with the CBN for large trade sizes on a two-way quotes basis;
- e. These Primary Dealers shall operate with other dealers in the Inter-bank market, amongst other obligations that will be stipulated in the FXPD Guidelines, which would also be released immediately after this Press Briefing;
- f. There shall be no predetermined spread on FX spot transactions executed through the CBN intervention with Primary Dealers, while all FX Spot purchased by Authorized Dealers are transferable in the inter-bank FX Market;
- g. The Forty-One (41) items classified as “Not Valid for Foreign Exchange” as detailed in a previous CBN Circular shall remain inadmissible in the Nigerian FX market;
- h. To enhance liquidity in the market, the CBN may also offer long-tenored FX Forwards of 6 – 12 months or any tenor to Authorised Dealers;
- i. Sale of FX Forwards by Authorised Dealers to end-users must be trade-backed, with no predetermined spread;
- j. The CBN shall offer non-deliverable over-the-counter (OTC) Naira-settled Futures, with daily rates on the CBN-approved FMDQ Trading and Reporting System;
- k. The OTC FX Futures shall be in non-standardized amounts and different fixed tenors, which may be sold on any dates thereby ensuring bespoke maturity dates;
- l. Proceeds of Foreign Investment Inflows and International Money Transfers shall be purchased Authorized Dealers at the Daily Inter-Bank Rate; and

- m. Non-oil exporters are now allowed unfettered access to their FX proceeds, which shall be sold in the Inter-bank market.
9. In terms of timelines, the Management of the Central Bank has agreed as follows:
- a. The detailed operational guidelines for the Flexible Foreign Exchange Market will be released immediately after this Press Briefing;
 - b. The guidelines for the selection and operations of FX Primary Dealers would also be released immediately after this Press Briefing;
 - c. Selected FX Primary Dealers would be notified by Friday 17th June 2016. All other non-Primary Dealers would remain valid and eligible to participate in the market;
 - d. Inter-bank trading under the new guidelines will begin on Monday 20th June 2016; and
 - e. The tenors and rates for the OTC Naira-settled FX Futures will be announced on Monday 27th June 2016.
10. In closing, let me note that the Central Bank is strongly determined to make this market as transparent, liquid, and efficient as possible. Therefore, we would neither tolerate unscrupulous behaviour nor hesitate to bring serious sanctions on offenders. I therefore urge market participants to assist us in ensuring that this new system enables the CBN to pursue its mandate in a more effective and efficient manner, which guarantees preservation of our scarce commonwealth, stability of our financial system, and growth of our economy to the benefit of all Nigerians.