NIGERIA'S FOREIGN EXCHANGE POLICY REFORMS: A BOOST FOR FOREIGN INVESTMENTS

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Nigeria's foreign exchange policy raised concerns in the business community both domestic and international. The multiple exchange rate regime generated significant concerns with respect to the attendant market distortions, perceived limited transparency and arbitrage ensuing from the price differentials of the respective exchange rates. The Central Bank of Nigeria ("CBN") introduced the multiple exchange rate regimes between 2014 and mid-2023 with the objective of allocating foreign exchange to exporters and SMEs under different foreign exchange windows such as the Investors & Exporters (I&E) window. The exchange rate system had its benefits and negatives, however, it would appear that in recent times the negatives were considered to outweigh the benefits.

In particular, the multiple exchange rate regime was considered to restrict foreign investment inflows into Nigeria as investors became wary of the uncertainties associated with the exchange rate regime. The lack of clarity and transparency was believed to have discouraged foreign investment. In addition, the foreign exchange regime did not help to provide the much-needed foreign exchange supply which is critical to guarantee the repatriation of the proceeds of investment by foreign investors and this constituted a major deterrent for foreign investment inflows.

The CBN under the President Tinubu administration embarked on a number of foreign exchange policy reforms which are geared towards boosting foreign investment with the objective of providing transparency, certainty and eliminating inconsistency in rates.

1. Elimination of the Multiple Foreign Exchange Rates

The Foreign Exchange Reforms

Prior to mid-2023, Nigeria operated up to five (5) exchange rate systems. The exchange rate systems are the following: (a) NAFEX rate which was a rate set by the CBN and utilized for government transactions, official foreign reserves and some priority sectors; (b) Interbank rate being the rate by which commercial banks traded foreign currencies; (c) Investors and Exporters (I&E) Window was created to attract investors and encourage export earnings. Investors and exporters were allowed to trade foreign currencies at market determined rates; (d) Bureau De Change ("BDC") rate. BDCs are licensed by the CBN to carry out retail foreign exchange business. BDCs source foreign exchange from the CBN and independently and their rates are usually reflective of the price at which they source foreign exchange; and (e) Parallel market rate. Parallel markets typically develop when central banks' foreign exchange supply is unable to meet legitimate demands for foreign exchange. Players in the parallel market would source foreign exchange through informal channels and the rates are usually higher than NAFEX and interbank rates. The premium on parallel market rates (i.e. the difference between the official and parallel markets rates) prior to mid-2023, was as high as 61.93%.

On 14th June, 2023, the CBN announced the abolition of the multiple exchange rate system and collapsed all segments of the multiple exchange rate regime into the I & E window. The abolition of the multiple exchange rate system sought to remove market distortions and created a level playing ground in the foreign exchange market. The single market-driven rate helps to create transparency and certainty allowing businesses to clearly understand the value of the Naira and make informed decisions regarding investments.

2. Re-Introduction of the "Willing-Buyer, Willing-Seller" Model

The CBN in its announcement of 14th June, 2023 also re-introduced the "willing-buyer, willing-seller" model. The re-introduction of the "willing-buyer, willing-seller" model implies that the market forces of demand and supply will determine the exchange rate rather than the initial foreign exchange allocation and set price model mechanism. Further to the re-introduction of the "willing-buyer, willing-seller" model, the official market moved from about N474 per dollar to N664 per dollar on the same day thereby significantly closing the premium on the parallel market. The decision of the CBN to re-introduce the "willing-buyer, willing-seller" model was widely celebrated as the right move towards achieving a unified exchange rate system or at least substantially eliminate the rate differential between the official market and the parallel market.

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In addition, the CBN in its official circular dated 31st January, 2024, directed that in line with its commitment to liberalize the Nigerian Foreign Exchange Market, International Money Transfer Operators ("IMTOs") be required to quote exchange rate for naira payouts to beneficiaries based on the prevailing market rates at the Nigerian Foreign Exchange Market on a "willing-seller, willing-buyer" basis. The CBN thereby superseded its earlier circular dated 13th September, 2023 requiring IMTOs to quote exchange rates within allowable limits.

The "willing-buyer, willing-seller" model creates a level-playing ground across players within the Nigeria Foreign Exchange Market and will curb speculation and restore investors confidence in the Nigerian economy.

> **"... with a more vibrant foreign exchange market based on transparency, efficiency and certainty, Nigeria will be able to attract both foreign direct and portfolio investments which will also serve as a veritable source of foreign exchange..."**

3. Strengthening of the Regulation and Operations of IMTOs and BDCs

Reports indicate that diaspora remittances in Nigeria were at an all-time low. The report indicated that the substantial premium on the parallel market rates might have diverted diaspora remittances to unofficial foreign exchange channels. Diaspora remittances into Nigeria at its peak stood at US$24.31 Billion . However, in 2023 the diaspora remittances amounted to about US$20 Billion (i.e. a reduction of over US$ 4 Billion) and reports have indicated that only a fraction of the amount was inflowed into the Nigerian Foreign Exchange Market while a substantial portion of the amount was externalized through several means. The CBN on 31st January, 2023 released the Reviewed Guidelines on IMTOs in Nigeria. The objectives of the revised guidelines includes (a) to boost diaspora remittances and other capital inflows into Nigeria; (b) promote efficient price discovery mechanism and the evolution of appropriate market determined exchange rate; and (c) enhance the ease of doing business for IMTOs in Nigeria and money transfer recipients.

The guideline increased the minimum capital of the foreign IMTOs to US$1 Million and required the IMTOs licensed to operate in Nigeria to have the naira equivalent in share capital. The guideline also expanded the scope of target users from a "person-to-person" basis to "business to person" and "business-to-business" basis. The guideline also restricted IMTOs to undertake only in-bound activities and would have to work with commercial banks as agents to effect outbound international money transfers. In addition, IMTOs would only make payout in Nigerian currency and not foreign currency.

The CBN on 23rd February, 2024 released the exposure draft of the Revised Regulatory and Supervisory Guidelines for Bureau de Change Operations in Nigeria. The guidelines sought to eliminate arbitrage, ensure adequate capitalization of BDCs and efficiency and transparency in the regulation of BDCs. The guideline amongst others (a) carved-out 16 categories of person who cannot partake in the ownership of BDCs such as commercial banks, other financial institutions, payment service providers, etc. The guideline also introduced two categories of BDCs (Tier 1 – having national operation with authority to open branches or appoint franchisees; and Tier 2 – authorized to operate in one State and may have up to three (3) locations with the approval of the CBN). In addition, the guideline increased the capital requirement of BDCs. Tier 1 BDCs will have a minimum capital of N2 Billion (circa US$1.4 Million) while Tier 2 will have a minimum capital of N500 Million (circa US$350,000).

4. Raising Bond Yields on Nigeria Government Local Currency Securities

The CBN raised the interest rates on Nigerian government local currency debt instruments. This move is aimed at attracting foreign investors, and on the broader effect, to address excess liquidity, combat inflation and stabilize the value of the Nigerian currency. Nigeria's Debt Management Office in February, 2024 received a record high of N1.9 Trillion (circa US$1.3 Billion) in two (2) Federal Government of Nigeria bond auctions from both domestic and foreign investors. The Government sold 7-year bond at a yield of 18.5% compared to 15% in January while the 10-year bond was auctioned at 19% as against 16% for a similar bond in January.

The move by the CBN to reprice Nigeria's debt instruments will attract foreign portfolio investments into Nigeria and will serve as an important source of foreign exchange for the country thereby shoring up foreign exchange supply.

Conclusion

The CBN foreign exchange policy reforms is set to restore investor-confidence in the Nigerian economy. The re-introduction of the "willing-buyer, willing-seller" model creates efficiency and certainty, and provides transparency to investors. The CBN in the first quarter of 2024 cleared all valid foreign exchange backlog payments amounting to about US$7 Billion which was a further step by the CBN to fulfil its promise to stabilize and restore confidence into the Nigerian economy. Also, since the implementation of the foreign exchange policy reforms, the premium between the parallel market and the official market has narrowed to 12.0% since the end of January 2024 from 61.93% in January, 2023.

It is envisaged that with a more vibrant foreign exchange market based on transparency, efficiency and certainty, Nigeria will be able to attract both foreign direct and portfolio investments which will also serve as a veritable source of foreign exchange and alongside with complimentary reforms in other sectors of the economy, Nigeria will be able to improve supply of foreign exchange, meet its daily foreign exchange demands and restore confidence into the economy.

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