

## Coronation Economic Flash Note

### DEEPER INSIGHTS: CBN'S DIALOGUE WITH INVESTORS

On Thursday (29 Feb '24) we attended the CBN dialogue with investors hosted by NGX. Below are a few points for your attention.

The dialogue reaffirmed the CBN's dedication to rectifying distortions within the foreign exchange market. We understand that a payment of USD400m has recently been made towards the outstanding FX backlog of USD2.2bn, resulting in a remaining balance of USD1.8bn. Cardoso revealed that the remaining backlog, associated with five banks, would be swiftly cleared in the near future.

The discussion underscored the CBN's commitment to rebuilding trust within the financial ecosystem. It was disclosed that the apex bank is already attracting foreign capital (i.e., billion-dollar volumes). Regarding the recently concluded MPC, options available to the committee were largely to tighten.

#### ***Inflation and FX are extremely correlated, how will CBN convince Nigerians to convert their USD holdings to Naira?***

Given the notable pass-through effect of foreign exchange pressure on inflation, CBN's strategic approach involves moderating the FX rate to facilitate price discovery. This, in turn, enhances confidence and fosters price stability, thereby significantly contributing to the overarching objective of inflation management.

Comment: To shed additional light on the second leg of the question above which was not directly answered, stabilizing the Naira's value against the USD, reduces the perceived risk of holding Naira. Furthermore, providing assurances of the Naira's stability and purchasing power through effective communication and transparent monetary policies should assist with convincing Nigerians to convert their USD holdings to NGN.

#### ***Sale of USD20,000 at N1,300/USD to BDC, what is the rationale behind this?***

The first objective is to enhance regulatory compliance within the Bureau de Change (BDC) segment, aligning it more closely with AML/CFT regulations and reporting standards, while integrating technological advancements to ensure the delivery of enhanced, efficient, and well-regulated services to its customer base. In recent years, this segment has operated with limited oversight, prompting the CBN to pursue improved supervision measures.

Regarding interventions in the BDC segment, the CBN prioritizes maintaining stability within the foreign exchange market. Consequently, when excessive volatility is detected, the CBN is prepared to intervene. It is crucial to clarify that such interventions are not aimed at influencing market prices but are driven by the goal of ensuring stability.

In recent weeks, heightened activities by market manipulators led to a significant surge in prices, with the NGN/USD exchange rate reaching unprecedented levels, notably diverging from the intrinsic value of the naira. Despite efforts to curb speculation, numerous BDCs are holding onto resources (i.e., USD) acquired at elevated naira price levels, resulting in a sticky situation. In response, the CBN has stepped in to provide assurance of USD supply to facilitate a return to price levels conducive to transparent price discovery. Furthermore, the CBN diligently monitored interbank market rates to determine appropriate intervention rates within the BDC segment, aligning actions with broader market dynamics and regulatory imperatives.

Comment: From our vantage point, the interventions would contribute to stabilizing the FX market by mitigating excessive volatility, thereby instilling confidence among market participants. This stability is crucial for maintaining macroeconomic equilibrium and facilitating sustainable economic growth.

### ***On FX reserves***

A deliberate strategy is in place to enhance reserves accretion through various channels. Efforts are underway to tap into all potential sources, with a recent development being the reinstatement of remittance by NNPC (formerly NNPC). Over the past three years, there has been a hiatus in such inflows to the CBN, contrasting sharply with the substantial USD92bn remitted in 2012 alone.

Additionally, other highlighted factors aimed at bolstering reserves accretion encompass anticipations of improved oil production and positive outcomes stemming from ongoing reforms within the oil sector. On another note, the encumbrances to the reserves such as the fx backlogs is something the CBN is working towards resolving in coming days. Furthermore, increased revenue generation by the federal government, driven by fiscal reforms, is expected to bolster reserves growth. The fiscal authorities are committed to ensuring that FX-earning ministries and agencies contribute effectively to CBN's resource pool.

Looking ahead, the CBN anticipates significant reserves accretion over the next one to two years, supported by these multifaceted efforts and conducive economic conditions.

Comment: Based on our current projections for end-2024, we have gross reserves at +/- USD34bn for base case, +/-USD30bn for downturn case and +/-USD38bn for optimistic case.

### ***How would the expected fx inflow be utilized?***

When considering the utilization of inflows from foreign portfolio investors (FPIs) and International Money Transfer Operators (IMTOs), a delicate balance must be struck between bolstering reserves and maintaining the functionality of the market. Presently, the CBN's foremost objective is to guarantee a well-supplied and efficiently operating market, conducive to investor participation and liquidity.

In the medium to long term, there may be opportunities to optimize the utilization of these FX inflows, allocating a portion towards reserves while leveraging the remainder for market support. Nonetheless, the immediate focus remains on nurturing a seamlessly functioning market that facilitates unhindered entry and exit for investors.

### ***On OMO Auction Frequency***

The frequency and size of OMO auctions would increase. This approach aims to absorb excess liquidity from the system while simultaneously presenting attractive investment opportunities. Anticipate higher rates, commencing with the OMO auction scheduled to hold on Friday 01 March '24 and extending to the NTB auction, including one scheduled for next week. These adjustments in rates will align with the MPR, signaling an upward trajectory. While the CBN does not foresee a 27.5% level, their focus remains on edging closer to the upper boundary of the MPR where feasible.

Comment: At the OMO auction yesterday (01 March '24), the CBN offered N500bn but allotted N1.1trn worth of OMO bills to market participants. The stop rates increased for all the three tenors at: 95-day: 19% (previously, 10%), 179-day :19.5% ( previously, 13.5%), and 361-day: 21.5% (previously, 17%). We note that the average stop rate at the OMO auction was 20% compared to 13.5% at the previous auction. Turning to money supply, it is worth noting that broad money supply (M3) increased by +215% to N64.9trn in June '23 from N20.6trn recorded in June '14. The growth in M3 can be partly attributed to the rapid increase in the ways and means advances during the same timeframe. However, since June '23 till January '24, M3 has risen further by +44.4% from N64.9trn to N93.7trn.

### ***Real Interest Rate expectations***

The last MPC meeting was the first in a series of meetings planned for this year. The CBN/MPC's trajectory aims towards achieving positive real rates, yet this objective will not materialize within a single MPC meeting. The deliberations and determinations will unfold progressively. The MPC comprises several members, each contributing to robust discussions and decisions. Given the necessity for voting by each member, the precise outcome of the committee's direction remains uncertain. However, the committee recognizes the prevailing concerns and imperatives and are committed to addressing them accordingly.

Comment: The personal statements from the MPC meeting that was just held will be released soon. We look forward to gaining more insights from each statement.

**Is the Naira liquid, can portfolio investors come in and out an exchange currency efficiently?**

Addressing the liquidity of the Naira and facilitating efficient currency conversion has historically posed challenges. The CBN is committed to preventing this from becoming a persistent issue in the present or future. Their primary objective is to diligently work towards ensuring ample liquidity of the Naira, facilitating seamless entry and exit for FPIs. The pass-through effect of foreign exchange on inflation is significant. The CBN's strategy prioritizes measures aimed at moderating exchange rate volatility. Furthermore, by fostering transparent price discovery mechanisms, the CBN aims to instill confidence among market participants, thereby fostering a conducive investment environment.

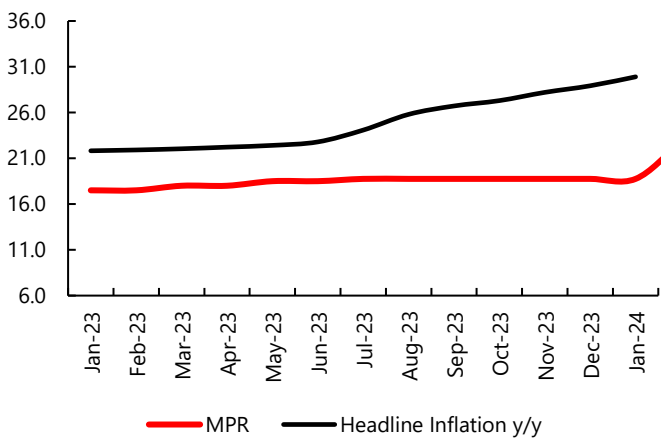
Comment: In our view, this is encouraging as prioritizing market integrity and transparency reflects a commitment to fostering an efficient financial market. A well-functioning market environment enhances resource allocation, promotes competition, and fosters investor confidence, contributing to overall economic efficiency and productivity.

**On the adjustment to the Cash Reserves Ratio**

Drawing from historical practices, it has been observed that the effective Cash Reserve Ratio (CRR) hovered around 40%, few banks exceeded 45%. The MPC decision has mandated all banks to adhere strictly to the 45% CRR requirement. Consequently, banks with CRR debits exceeding 45% will receive refunds, while others will be adjusted to meet the 45% threshold. Notably, the central bank has streamlined this process to operate automatically, eliminating the previously encountered stress.

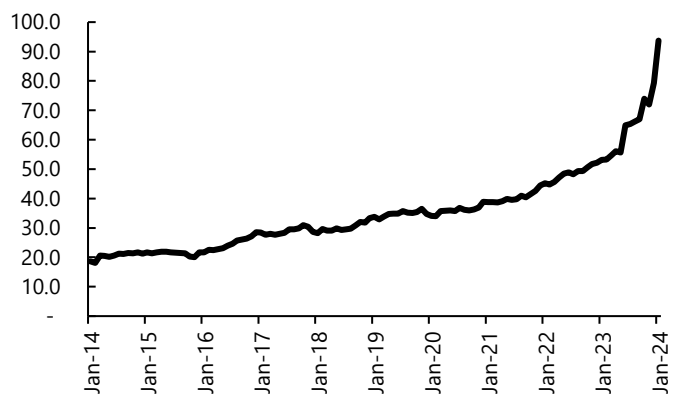
Below are six charts we have curated for your attention, which provide trend movements for interlinked indicators.

**MPR and Inflation (%)**



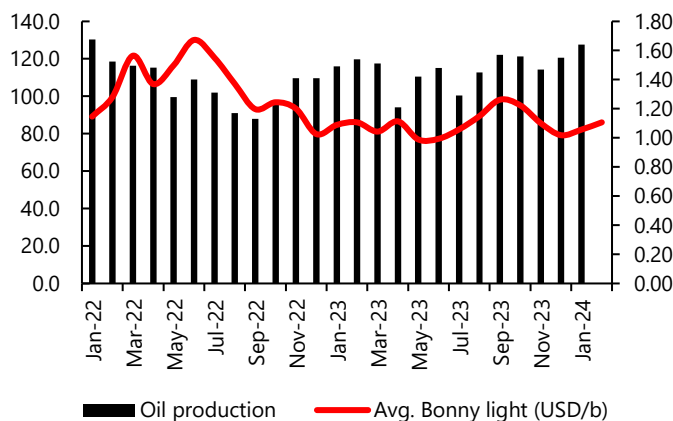
Sources: CBN, NBS, Coronation Merchant Bank Economic Research

**Broad Money Supply (M3), N 'trn**



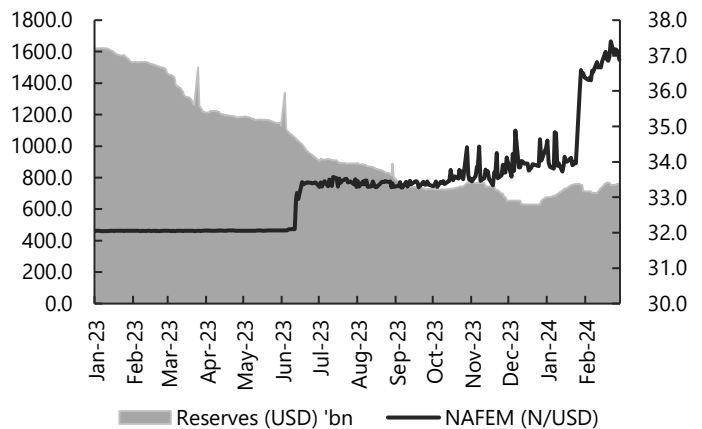
Sources: CBN, Coronation Merchant Bank Economic Research

**Avg. Bonny Light (USD/b) vs Oil Production (mbpd)**



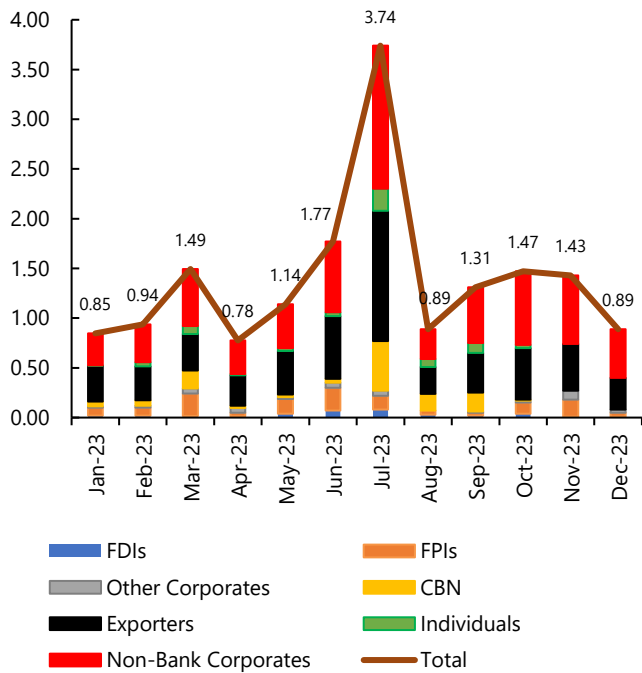
Sources: CBN, NUPRC, Coronation Merchant Bank Economic Research

**Reserves (USD 'bn) and NAFEM FX rate (N/USD)**



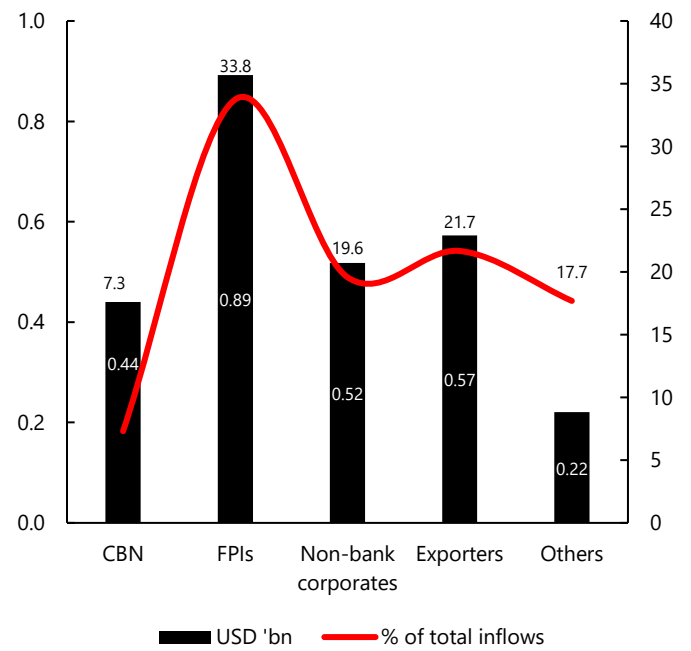
Sources: CBN, FMDQ, Coronation Merchant Bank Economic Research

### Composition of FX Inflow, 2023 (USD'bn)



Sources: FMDQ, Coronation Merchant Bank Economic Research

### Composition of FX Inflow, Feb 2024 (USD'bn vs % of total)



Sources: FMDQ, Coronation Merchant Bank Economic Research

#### Chinwe Egwim

Chief Economist

E-mail: [CEgwim@coronationmb.com](mailto:CEgwim@coronationmb.com)

#### Team

E-mail: [economicresearch@coronationmb.com](mailto:economicresearch@coronationmb.com) Tel: +234 (0) 1-2797640-43