**NAIRA DEVALUATION**

**Matters Arising**

There are many factors that affect the value of a nation’s currency, but the most important is its ability to earn enough foreign earnings to pay for its imports conveniently.

Therefore in Nigeria’s instance, the current devaluation of the Naira is as a result of

* Mono-product export profile (94% of our FX earnings in from Crude Oil)
* “Anything-goes” import profile.

We are not earning enough foreign currency yet we are using this scarce foreign currency to buy even the things we can conveniently produce locally. Now that the price of Crude Oil cannot continue to sustain our consumption of imported goods, the reality is unpleasant.

Contrary to common belief, it isn't only the Monetary Policy that affects the FX Rate, there are 3 other very important Government Policies that have direct impact on the FX Rate

1. **Trade Policy** – what can we import & at what Import Duty (any penalties?). What are we exporting – Raw Materials or Processed Goods?
	* Why do continue to export raw Cocoa beans? Why aren't we exporting Refined Petroleum products?
	* Why have we refused to develop our local production and continue to import Rice, Fish, Glucose and other items we can readily produce in Nigeria? Why have we rejected Cassava Bread?
	* What about services? Where is the FX income we have generated from the telecom and banking services we are exporting all across Africa? Why are pirated Nollywood films being freely sold across Africa – depriving us of FX income?
2. **Industrial Policy** – how much of their Raw Materials can Industries import?
	* In Nigeria many of our industries are just Assembly Plants, they continue to import the things that are ready available in Nigeria – we need to revive the Backward Integration Policy of the 80s.
	* Manufacturers are one of the greatest users of FX, they need to start sourcing more of their inputs locally. This way a large chunk of our FX expenditure would be conserved.
3. **Fiscal Policy** – what does the Government spend their Revenue on? How does it impact FX Conservation? Do they run Training Programs in Dubai when the same Program can be held successfully in Abuja?
	* How effective is the Government’s **FX Revenue** collection, especially Tax Administration, Duties and Tariffs Collection, Rebates and Penalties? How effectively are leakages being plugged?

Main Reason for Current Drop in Crude Oil price

The U.S. Government decided to do its own Backward Integration and develop technologies for the cheaper extraction of the Shale Oil that is abundant in the US. They have done this successfully and Entrepreneurs were encouraged to buy the technology and start producing Crude Oil from small Oil Wells scattered around the US. This led to higher Supply and lower Demand from the U.S. (the world’s bigger consumer). The U.S. was Nigeria’s NUMBER ONE buyer of Crude Oil, now they hardly buy from us at all.

Simple Laws of Economics – higher Supply combined with lower Demand surely leads to lower prices.

Effects of Current Drop in Crude Oil Prices on Nigerians

The resultant effect of the drop in Crude Oil prices was the reduction in Nigeria FX receipts and consequently a drop in our FX Reserves.

Less Dollar available (laws of demand and supply) led to Higher Price for the Dollar.

**Devaluation of the Naira was actually a way to ameliorate the effects of the drop in Oil Receipts.**

* Simple Maths – less Dollars multiplied by higher exchange rate puts slightly more Naira in the hands of Government. Since Government is the biggest spender in the Economy, they can continue to pay salaries and give out the contracts that have a positive ripple effect on the economy.

Effects of Devaluation

Below are some of the effects that we should expect –

* Lower purchasing power due increase in the price of imported goods – the same Naira can't buy what it used to buy before
* Manufacturers have a higher cost profile but they can't pass all the cost increase to their consumers, because the consumers are already suffering from an erosion of purchasing power. So, they pass some of the costs and absorb the rest. This results in
	+ Higher price of manufactured goods
	+ Lower Dividend (because of lower profit margin) declared by manufacturers to their shareholders
		- Lower dividends would impact the Returns from Equities and this could adversely affect their Stock Prices on the Nigerian Stock Exchange
* Other sectors begin to increase their prices in order to safeguard their own purchasing power
* Salary earners discover a serous erosion on their purchasing power and soon begin to demand Salary Increases
* **All these Price Increases bring Inflationary Pressures**

To handle Inflation, CBN would have to look at other Monetary Policy Tools to manage the situation e.g.

* Interest Rate Management
* Money Supply Management etc.

The **Medium/ Long Term Solutions** to the Negative Effects of Crude Oil Price Fluctuations and Naira Devaluation are 2-Pronged:

1. **Expand FX Earnings (Increase Exports)** – Value-Added Agric Products, Refined Petroleum Products, Banking, Telecoms, Manufactured Goods, Tourism, Nollywood
2. **Reduce FX Expenditure (Reduce Imports)** – Develop Local Production of Goods that can be readily produced locally, revive Backward Integration Policy for all Manufacturers. The LOCAL CONTENT POLICY in the Oil Industry is an excellent example of how local production/ servicing can be used to conserve FX. We need more of such policies.

There are no short term solutions to the Naira’s Devaluation, except to tighten our belts and observe Austerity Measures. Those who can, may begin to explore additional sources of income to enable them earn more money and shore up their purchasing power.