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Nigeria | Macro Research | Currency

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Monetary reforms are yielding early fruits

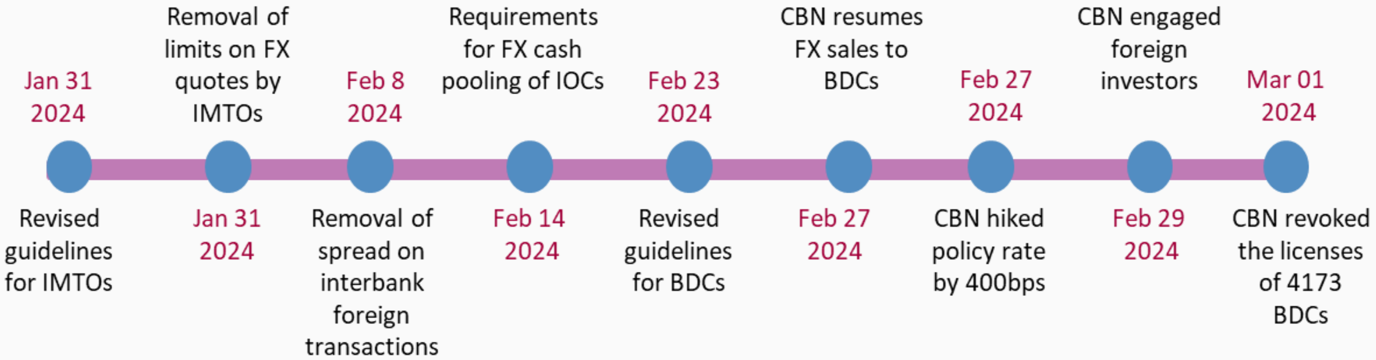
In this report, we assess recent developments in monetary policy, the notable recovery of the Naira, and the resurgence of foreign capital flows.

Olaolu Boboye
olaolu.boboye@cardinalstone.com

Philip Anegbe, CFA
philip.anegbe@cardinalstone.com
(Team lead)

In the last few weeks, the CBN leadership has intensified efforts to restore market confidence and improve communication with investors, which has largely been positive for Nigeria's investment case. To provide context, confidence in the Nigerian FX market has materially improved due to the restructuring of market frameworks, intensifying of hawkish rendition, and the clearing of all legal outstanding FX backlogs.

Figure 1: Timeline of CBN's recent actions



Sources: CBN, CardinalStone Research

Investors taking a bet on Nigeria

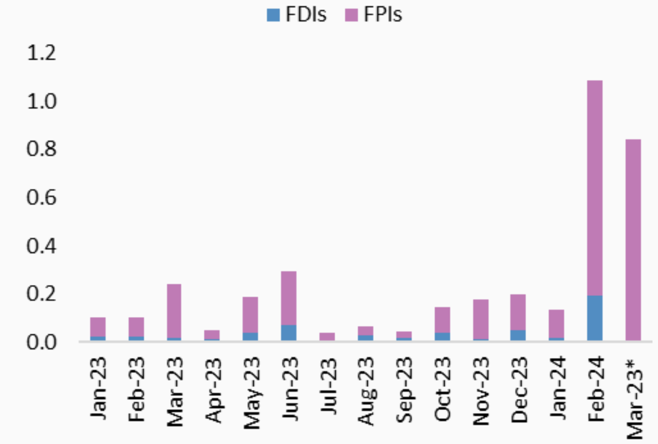
The payments of FX backlogs and improving carry trade opportunities are piquing investors' interest. Precisely, the cumulative foreign inflows (through FPIs and FDIs) since the beginning of the year are estimated at $2.1 billion, compared to $1.6 billion in 2023. The level of inflow is consistent with Nigeria's robust carry trade vis-a-vis those of major African countries and aided by hawkish monetary policy and the relative stability of the Naira evinced by the 12-month currency forward.

Elsewhere, daily FX turnover—a measure of liquidity—has surged to a YtD average of $4.3 billion compared to $2.3 billion in 2023. This notable improvement ties finely with the mentioned inflows of foreign capital and improved intervention by the apex bank in segments of the currency market.

Hence, we view the associated accretion to Foreign reserves (YtD +$1.4 billion) as a natural consequence of current monetary policy reforms and investors' re-assessment of the Nigerian investment case.

We see latitude for further improvements in FX reserves due to sustained foreign inflows, higher remittances, and the recent decision to house some NNPC accounts with the CBN. Additionally, with the US Fed sticking to its prediction of three rate cuts this year, Nigeria's carry trade may further improve, and the associated cost of the proposed Eurobond issuance may become more manageable for Nigerian authorities. We expect these to cascade to more dollar inflows in the near to medium term.

Figure 2: Foreign inflows ($'billion) have gained traction in recent weeks



*Data for March 2023 was as at 22nd of the month

Figure 3: Nigeria's carry trade appears attractive compared to African peers

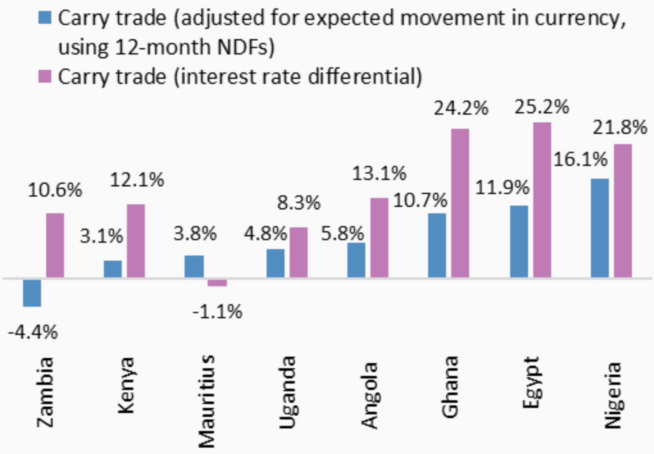


Figure 4: FX turnover ($'billion) has improved since Feb-2024

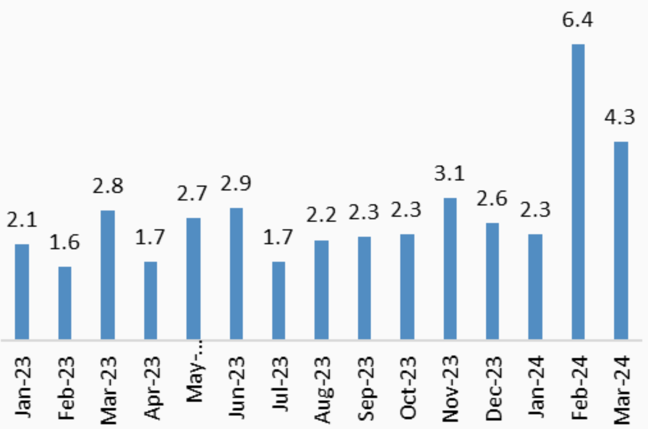


Figure 5: FX reserves has gained ($1.4 billion YtD)

Sources: Bloomberg, CBN, FMDQ, CardinalStone Research

Improving FX inflows aiding CBN's intervention

The Naira has exhibited notable resilience in recent weeks and has strengthened by 11.4% at the official markets since the beginning of March, positioning it as one of the top-performing currencies in Africa. These gains are attributed to the resumption of foreign exchange sales to Bureau de Change (BDC) operators, with the CBN selling approximately $20,000 to each BDC on a weekly basis. Furthermore, the CBN has intensified its oversight of BDCs, leading to the revocation of licenses of 4,173 out of the total 5,690 operators in Nigeria. Additionally, the CBN raised the minimum capital requirements for BDCs to N2.0 billion for Tier 1 license holders and N500.0 million for Tier 2 licenses (previously 35.0 million for both Tiers), which eased the burden of regulation and streamlined players in the space to institutionally strong players. Moreover, the CBN has mandated that at least 75.0% of any foreign currency sale must be electronically transferred to the customer's Nigerian domiciliary account or prepaid card.

Aside from BDC sales, the CBN has ramped up its sales to banks, with recent transactions consummated between N1280.0/$ and N1350.0/$. These interventions are likely to subsist on the impact of continuously improving inflows through FPIs and FDIs, with potential proceeds from Eurobonds and higher crude oil sales as upside risks.

The expectations for foreign inflows into Nigeria remain sanguine, aided by the elevated fixed-income rates and CBN's pro-FX market policies. However, Nigeria is expected to face intense competition for foreign flows from countries such as Egypt. Aided by a string of supportive policies, Egypt recently secured over $35.0 billion in investments from the United Arab Emirates (UAE) and agreed to an $8.0 billion bailout loan with the International Monetary Fund (IMF).

Figure 6: minimum of $2.0 billion in CBN FX sales historically coincided with FX stability in Nigeria

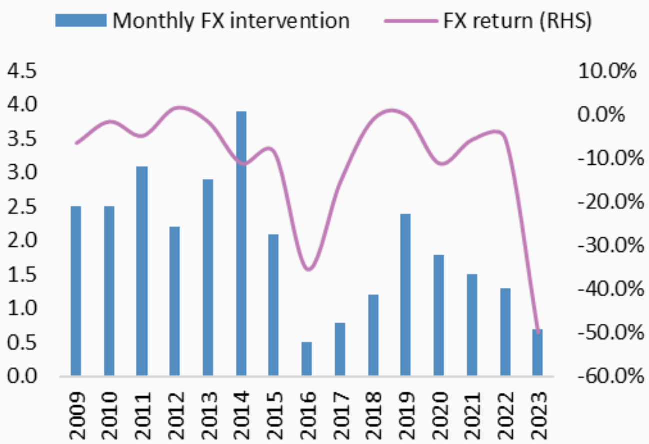
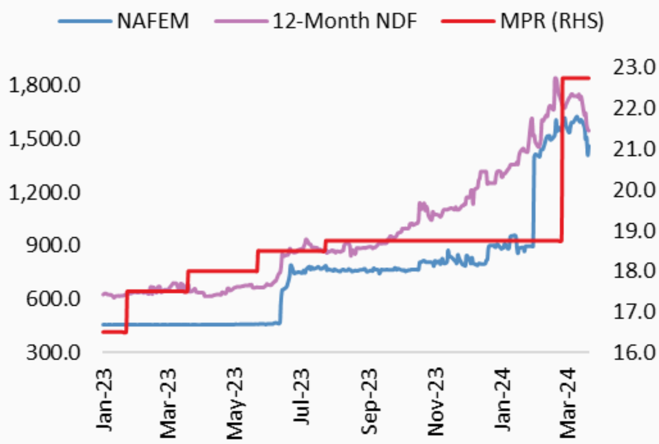


Figure 7: NAFEM has gained 11.4% since the start of March 2024



Sources: CBN, FMDQ, CardinalStone Research

Figure 8: Parallel market premium has dissipated

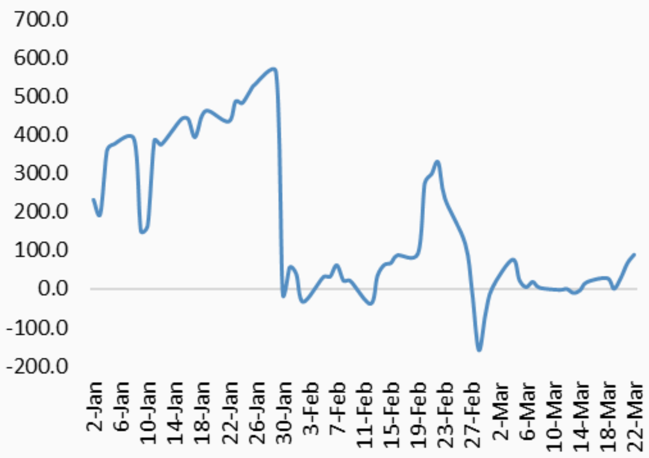


Figure 9: Nigeria's currency has been one of the best-performing in Africa since the start of March

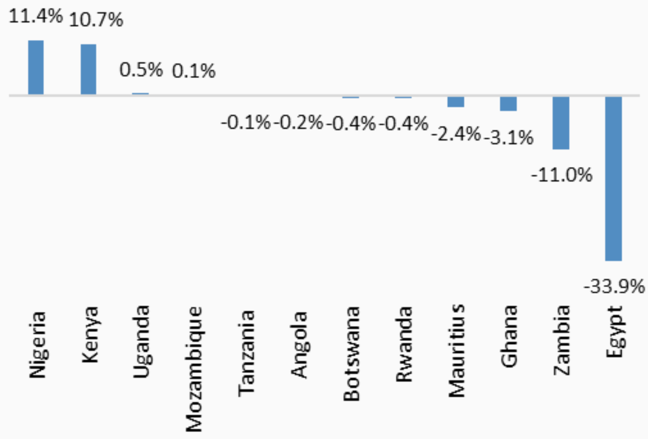
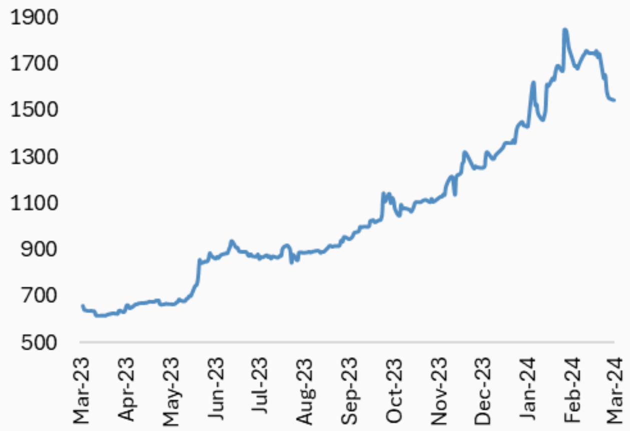


Figure 10: Risk of further devaluation appears to be moderating, with declining 12-month NDFs



Sources: Bloomberg, FMDQ, CardinalStone Research

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