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NIGERIA RESEARCH NOTE

Lagarde sounds the alarm

The IMF chief's address to the National Assembly on Jan. 6th was a diplomatic* tour de force *that delivered a number of urgent policy prescriptions wrapped in a series of compliments*[1] *that will have appealed to her hosts'* amour propre. *The title alone speaks volumes: "Nigeria—Act with Resolve, Build Resilience, and Exercise Restraint".

1) Lagarde begins with an enumeration of **the exogenous threats** facing the Federal Republic:

"Oil prices have fallen sharply; global financial conditions have tightened; growth in emerging and developing economies has slowed; and geopolitical tensions have increased."

Her verdict - ***"Nigeria faces some tough choices going forward"*** - makes it clear that this is a subject to which she intends to return in due course.

2) Next, the statement offers **an unvarnished assessment of the domestic economy**:

*"**Growth in 2015 is estimated at about 3.2 percent—its slowest pace since 1999**—and only a modest recovery is expected in 2016.*

*"On top of the slowdown, **vulnerabilities have increased**. The ability to manage shocks is restricted by low fiscal savings and reserves. And the weakening oil sector could stress balance sheets and put pressure on the banking system."*

3) But it is **the prescriptive section of her address that makes the most compelling reading**. On the management of Nigeria's public finances Lagarde declares:

"***I see an immediate priority—a fundamental change in the way government operates*** …

This means that hard decisions will need to be taken on revenue, expenditure, debt, and investment going forward."

4) Her **recommendations for addressing Nigeria's external vulnerabilities** are even more striking and so bear quoting *in extenso:*

"I see another immediate policy priority—strengthen Nigeria's external position. […]

*"To be clear, the goal of achieving external competitiveness requires a package of policies, including business-friendly monetary, **flexible exchange rate** and disciplined fiscal policies, as well as implementing structural reforms.*

***"Additional exchange rate flexibility**—both up or down—**can help soften the impact of external shocks, make output and employment less volatile, and help build external reserves**. It can also help **avoid the need for costly foreign exchange restrictions** - which should, in any case, remain temporary. And going forward, improved competitiveness from improved **exchange rate flexibility** and other reforms will facilitate the needed diversification of the exports base and, ultimately, growth."*

[1] e.g. *"My first visit to Africa as IMF Managing Director was in late 2011, and the first country on my itinerary was Nigeria. […] Since that visit, Nigeria has been acknowledged as the largest economy in Africa—with a maturing political system […] a strong sign of Nigeria's commitment to democracy, to a new Nigeria."*

5) It is inconceivable that that the above prescription, with its **repeated emphasis on exchange-rate flexibility** was not drawn up in full knowledge of President Buhari's astonishing remarks on the subject last week, viz.:

"I need to be convinced on the naira devaluation. […]

"If you seriously look at our state of development and that of other countries, as well as the IMF and World Bank that play around with currency devaluation, you will know that ***devaluation is for developed countries that can compete with their goods and services****."*[2]

6) In effect, the **IMF has lent its voice**[3] **to the orthodox tendency within Nigeria's monetary policy committee** that has been arguing against the effort to defend the exchange-rate peg[4] at N197 = USD[5].

With Brent crude ending today at $33.83[6], a 2016 budget based on an oil price assumption of $38 per barrel and the central bank's reserves shrinking, those arguments are likely to carry considerably more weight at the Committee's next session, in a fortnight's time.

In our view, the countdown to the peg's demise has already commenced.

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[2] Remarks made during the presidential news conference on Dec. 30, 2015, as transcribed in *"Presidential Media Chat: Buhari's maiden chat — LIVE UPDATES"*, posted by *Premium Times* at 20.05 hrs.
[3] There is reason to believe that the Fund is particularly concerned about the vulnerability of the W. African sub-region to the economic shock that a disorderly currency adjustment in the Federal Republic would trigger. As Mme. Lagarde diplomatically observes (earlier in her address), ***"Nigeria also has a large regional footprint, and its fortunes affect that (sic) of its neighbors, especially through trade."***
[4] For a summary of these arguments, see our previous report, "Insights into November's MPC deliberations", dated Jan. 4, 2016.
[5] With the US dollar commanding N270 on the parallel market, a premium of 37%.
[6] This after hitting an intra-day low of $32.16.