Rhombus Advisors LLC

Omotunde A.J. Mahoney
+1-973 509 5300

August 21, 2015

NIGERIA FLASH-NOTE (PREPARED AT REQUEST OF THE WALL ST. JOURNAL)

W(h)ither the Naira peg?

Yesterday's decision by Kazakhstan to abandon the Tenge's USD peg has focused fresh attention on the Naira and the question of how long Nigeria's central bank will be able to hold its dollar parity at N197.

1) In fact, the **Naira has been under considerable pressure for the better part of a year**. Under the combined pressure of the accelerating oil price collapse and the spike in demand for USD that has long been the hallmark of election campaigns in Nigeria[1], the CBN was forced to accommodate an initially gradual depreciation beginning in Q4/2014. This saw the Naira's dollar-parity move from to N157 in mid-Nov., to 164 ten days later and 169.50 by Dec 1.

2) Concurrently, the central bank embarked on **a series of administrative decree, whose clear intention was to squeeze local demand for foreign currency**. These included, inter alia:

- restrictions on the use of proceeds from the CBN's twice-weekly auction of hard currency - announced Nov. 16;
- a prohibition against banks holding any foreign-currency positions overnight - announced Dec. 18.

3) With no let-up in the head-winds bearing down on the Naira, the CBN was forced to concede **a 15% devaluation in mid-Feb, that moved the USD parity rate to N197**.

4) Knowing that it lacked the fire-power to defend even this depreciated exchange rate, the central bank turned once again to **the only real tool at its disposal - the decree**. During the intervening six months it has rolled out at least as many Circulars (in one case, two in the space of 24 hrs), announcing inter alia:

- the cessation of its twice weekly auctions of FX - announced Feb. 18;
- a list of 41 items including cement (#3) private jets/planes (#8), cold-rolled steel sheets (#11), toothpicks (#30), eurobonds/foreign currency shares & bonds (#41) - announced June 23;
- restrictions on the use of FX proceeds sourced from bureaux de change - announced Jul. 1

5) Of course, in no import-dependent economy does the demand for hard currency evaporate upon a mere wave of the administrative wand. This is evident from the Naira's performance **on the parallel market where pent-up demand had pushed the USD rate to 243 earlier this month**.

The CBN subsequently announced yet another set of rules prohibiting local banks from accepting cash deposits of foreign currency (the form in which the proceeds from parallel market transactions are received). While the parallele rate has since subsided to below N215, the respite is bound to prove short-lived.

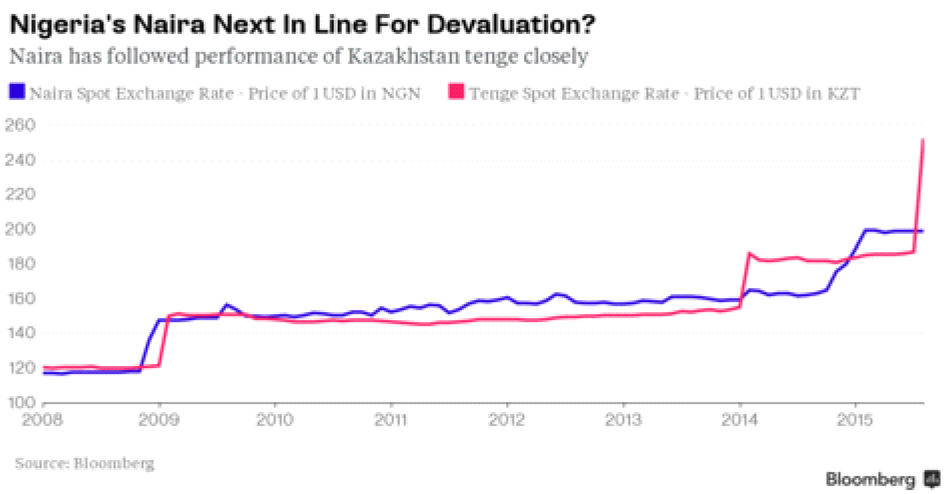
[1] Presidential and parliamentary elections were scheduled for Feb 28, 2015, with elections for Governor to be held one week later.

6) In other words, **the limits of the Naira peg have been apparent** sinc e long before the current wave of capitulation/devaluations buffetting the world of emerging-market currencies. As the CEO of First Bank (the country's largest by asset size), declared at a conference on June 25 in Lagos,

"People just don't believe the central bank has what it takes to sustain the exchange rate at the present level … The market needs to reopen. You cannot peg the naira at a level that the whole world knows is unrealistic.*"*

7) So, **a major devaluation of the Naira is simply a matter of when, rather than whether** - regardless of the Mr. Emefiele's defiant words which, to many an emerging-market veteran carry a distinct echo of Mr. Lopez Portillo's 1982 pledge re. the Mexican peso[2].

A propos, the fate of the tenge which had been held at a USD parity rate almost identical to the Naira's seems fraught with prophecy - as illustrated.



8) In fairness to the embattled Emefiele, it should be acknowledged that even the most orthodox central banker might be reluctant to implement a devaluation at a time when the new President (inaugurated May 29) is yet to nominate a single cabinet member or unveil his economic policy priorities.

But the objective reality remains that **the Naira peg is simply unsustainable**.

[2] i.e. *"A presidency that devalues the currency devalues itself . […] I will defend the Peso like a dog (sic)."* - President Jose Lopez Portillo , Feb. 4, 1982. Exactly two weeks later his Finance minister announced a 38% devaluation, moving the USD parity from P28.50 to P46.