Olayemi Cardoso: Invitation to sectoral debates by the House of Representatives

Speech by Mr Olayemi Cardoso, Governor of the Central Bank of Nigeria, at the sectoral debates by the House of Representatives, Lagos, 6 February 2024.

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Protocols

The Speaker, House of Representatives: Rt. Hon. Abbas Tajudeen

Deputy Speaker, House of Representatives: Rt. Hon. Benjamin Kalu

Honourable Members of the House of Representatives

Other Guests

Gentlemen of the Press

Ladies and Gentlemen

Good afternoon, Honourable members. I am honoured to appear before House to address critical concerns related to exchange rates and inflationary pressures in the economy.

Upon receiving the invitation letter, I keenly sensed the urgency and the acknowledgment of the economic challenges and resistance to proposed solutions by various stakeholders.

However, I want to emphasize that we are now at a turning point, and the bold reforms underway across different segments of the economy, though initially challenging, are aimed at addressing these challenges sustainably.

I am confident that positive outcomes are already emerging and will become more apparent in the near future. The dedicated and relentless efforts being made are certain to bring about significant and positive changes for our economy.

Notably, recent reports from international rating agencies such as Fitch, Moody's, S&P and commendations from multilateral banks like the World Bank reflect this positive trajectory, with upgrades to Nigeria's ratings from stable to positive. These reports acknowledge the potential reversal of the deterioration in the country's fiscal and external position due to the authorities' reform efforts. While recognizing the painful adjustments, they all point to a direction that will unlock much-needed growth and development for our economy in the medium to long term.

Honourable members, I acknowledge that despite these commendations, the concerns regarding the cost of living and currency exchange rates remain. Indeed, this is the major topic of concern in our villages, our towns and our cities. The urgency of the matter is not lost on us at the Central Bank and i assure you we are working tirelessly with colleagues from across government, including with the leadership of this House, to bring lasting solutions.

Given that this will be the first time I will be before this esteemed body this year 2024, please permit me to provide you with what we consider our outlook for 2024.

Global Outlook

The global economy is currently grappling with persistent challenges, including inflation and subdued growth prospects. Despite GDP growth outperforming expectations in 2023, it is projected to further moderate in 2024 due to tightened financial conditions, sluggish trade expansion, and reduced business and consumer confidence. The International Monetary Fund (IMF) initially projected a mild slowdown in global economic growth to 2.9% in 2024 now reviewed upwards to 3.1 with Asia driving the majority of the projected global growth in 2024, similar to the previous year.

The near-term outlook is clouded by downside risks, including heightened geopolitical tensions such as the Israel-Hamas conflict and the ongoing Russia-Ukraine war. Broader escalation of conflicts could disrupt energy markets, trade routes, and financial markets, leading to a slowdown in growth and increased inflationary pressures. Additionally, rising trade barriers, protectionist policies, and global value chain restructuring could exacerbate uncertainties in global trade.

In this challenging landscape, key policy priorities involve ensuring durable inflation reduction, addressing fiscal pressures, and fostering sustainable and inclusive growth. The global monetary policy environment is expected to remain restrictive until sustained inflation reduction becomes evident. Governments must grapple with rising fiscal pressures, necessitating credible medium-term fiscal frameworks to effectively manage debt burdens.

Domestic Outlook

The Federal Government of Nigeria anticipates a 3.76 percent real GDP growth in 2024, slightly surpassing the estimated 3.75 percent for 2023. This optimism is backed by key government reforms and the expectation of improved crude oil prices and production, which are set to drive economic growth.

A. Each sector may face unique challenges and opportunities in 2024. The services sector is expected to thrive due to increased digital lending offerings, while the agriculture sector is projected to grow faster with improved productivity. Anticipated growth in the industry sector is linked to increased crude oil production.

B. Inflationary pressures are expected to decline in 2024 due to the CBN's inflation-targeting policy, aiming to rein in inflation to 21.4 percent, aided by improved agricultural productivity and easing global supply chain pressures.

The CBN's inflation-targeting framework involves clear communication and collaboration with fiscal authorities to achieve price stability, potentially leading to lowered policy rates, stimulating investment, and creating job opportunities.

The Nigerian foreign exchange market is currently facing increased demand pressures, causing a continuous decline in the value of the naira. Factors contributing to this situation include speculative forex demand, inadequate forex supply due to non-remittance of crude oil earnings to the CBN, increased capital outflows, and excess liquidity from fiscal activities.

The shift to a market-driven exchange rate was intended to create a stable macroeconomic environment and discourage currency hoarding. However, short-term volatilities are attributed to arbitrage and speculation.

To address exchange rate volatility, a comprehensive strategy has been initiated to enhance liquidity in the FX markets. This includes unifying FX market segments, clearing outstanding FX obligations, introducing new operational mechanisms for BDCs, enforcing the Net Open Position limit, and adjusting the remunerable Standing Deposit Facility cap.

Honourable Members, we understand the economic costs of these developments not just for the economy, but also as they affect ordinary Nigerians.

However, as I have mentioned in previous engagements, these costs are temporary, and our decisions will address a lot of fundamental issues bothering Nigeria's macroeconomic landscape.

Honourable Members, these measures, aimed at ensuring a more market-oriented mechanism for exchange rate determination, will boost foreign exchange inflows, stabilize the exchange rate, and minimize its pass-through to domestic inflation.

On the exchange rates,

Permit me to say that put simply, the exchange rate is determined by the dynamics of supply and demand for a product or service. In essence, similar to the pricing of cows or cars, the value of the US Dollar in Nigeria is determined by the balance of US Dollars entering the country and the demand for US Dollars among Nigerians. Applying this demand and supply principle, let's examine how the exchange rate has performed in recent years. The exchange rate in Nigeria has increased/depreciated due to the simultaneous occurrence of two factors: a decline in the supply of US Dollars coinciding with a surge in the demand for US Dollars.

Looking at the demand side of the exchange rate, it's important to note the growing number of Nigerian students studying abroad. In the 1980s and 1990s, the need for US Dollars for their living expenses was minimal. However, recent data shows a significant change. According to UNESCO's Institute of Statistics, the number of Nigerian students abroad increased from less than 15,000 in 1998 to over 71,000 in 2015. By 2018, this figure had reached 96,702 students, as per the World Bank. Another report projects the number of Nigerian students studying abroad to exceed 100,000 by 2022. Additionally, the UK's Higher Education Statistic Agency noted a 64% increase in Nigerian students studying in the country, rising from 13,020 in the 2019/2020 academic session to 21,305 by the 2020/2021 session.

Given this data, it's crucial to highlight that between 2010 and 2020, foreign education expenses amounted to a substantial US$28.65 billion, as per the CBN's publicly available Balance of Payments Statistics. Similarly, medical treatment abroad has incurred around US$11.01 billion in costs during the same period. Consequently, over the past decade, foreign exchange demand for education and healthcare has totaled nearly US$40 billion. Notably, this amount surpasses the total current foreign exchange reserves of the CBN. Mitigating a significant portion of this demand could have resulted in a considerably stronger Naira today.

Personal Travel Allowances have accounted for a total of US$58.7 billion during the same period. Notably, between January and September 2019, the CBN disbursed US$9.01 billion to Nigerians for personal foreign travel.

Continuing on the topic of the demand for US Dollars, Nigeria's annual imports, which require dollars for payment, amounted to US$16.65 billion in 1980. By 2014, the annual import expenditure had significantly surged to US$67.05 billion, although it gradually decreased to US$54.71 billion as of last year. Similarly, food imports escalated from US$2.63 billion in 1980 to US$14.84 billion in 2019.

In 1980, more than 75 percent of the vehicles used in Nigeria were domestically produced by companies like Volkswagen in Lagos, Peugeot in Kaduna, and others. Presently, over 99 percent of the cars driven are imported, necessitating dollar payments. Similarly, in 1980, the majority of the clothing worn was sourced from Nigerian textile mills in Funtua, Asaba, Kano, Lagos, and various other towns and cities. Today, nearly all the clothing worn is made from imported fabrics.

Given the substantial demand for education, healthcare, professional services, personal travel, and similar needs, the exchange rate is bound to face ongoing pressure.

On the supply side of the exchange rate, to bolster the inflow of US Dollars into a country, the economy must "earn" these dollars through exports, whether oil or non-oil, or by attracting foreign investments. A robust economic foundation is essential to produce goods and services that the global market is willing to pay for in US Dollars. When such supply surpasses demand, the exchange rate appreciates, causing the price of the dollar to fall. Unfortunately, in Nigeria, the contrary has taken place.

In 1980, our import expenditure stood at US$16.65 billion, while our exports amounted to US$25.97 billion, resulting in a surplus of US$9.32 billion. Thus, during that year, we managed to fulfill the demand for US Dollars from our existing supply and still had over US$9 billion in surplus. In such a situation, the exchange rate (the value of the US Dollar) would not increase because, similar to any commodity, its supply surpassed the demand. Moreover, from 2003 to 2013, we experienced a surplus of US$331.73 billion in the economy, with oil exports alone contributing over US$798 billion. This surplus of dollars would typically stabilize the exchange rate, leading to a "strong" Naira.

Regrettably, over the past 12 years, oil exports, constituting over 90 percent of our foreign exchange earnings, have declined from US$93.89 billion in 2011 to US$31.4 billion in 2020.

From the aforementioned points, we can infer that the genuine issue impacting the exchange rate is the simultaneous decrease in the supply of, and increase in the demand for, US Dollars. It also seems that the task of stabilizing the exchange rate, while an official mandate of the CBN, would necessitate efforts beyond the Bank itself and indeed to an attitudinal change of all our citizens.

Concluding Remarks

Honourable members, my team and I are dedicated to refocusing the Bank by giving primacy to price stability. We also aim to build confidence in the Nigerian economy through the maintenance of stability in consumer prices and the foreign exchange market.

We are aware that the twin challenges of inflation and exchange rate depreciation on our economy are daunting, however, they are not insurmountable.

Monetary policy actions are sometimes inhibited by transmission lags, nonetheless, it is expected that the policy measures implemented by the Bank will permeate the economy in the short- to medium-term.

Inflation pressures may persist, albeit temporarily, but are expected to moderate significantly by Q4 2024. Exchange rate pressures are also expected to reduce with the smooth functioning of the foreign exchange market.

We are committed to implementing policies that will ensure a stable macroeconomic environment and guarantee improved livelihoods for all Nigerians.

Thank you for your attention.