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EBS/87/173

CONFIDENTIAL

July 31, 1987

To: Members of the Executive Board
From: The Secretary
Subject: Nigeria - Real Effective Exchange Rate - Information Notice

Attached for the information of the Executive Directors is an information notice on the real effective exchange rate of the Nigerian naira.

Mr. Bélanger (ext. 8671) is available to answer technical or factual questions relating to this paper.

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INTERNATIONAL MONETARY FUND

NIGERIA

Real Effective Exchange Rate--Information Notice

Prepared by the African Department and the
Exchange and Trade Relations Department

(In consultation with the Legal Department
and the Research Department)

Approved by A.D. Ouattara and H. B. Junz

July 30, 1987

Recent movements in the real effective value of the naira, as measured by the standard index developed in connection with the information notice system, are set out in the attached table and chart. Based on this index, as of May 1987, the Nigerian naira has depreciated by more than 10 percent since the last occasion on which the Executive Board had the opportunity to discuss Nigeria's exchange rate policy in January 1987 in the context of Nigeria's request for a stand-by arrangement. 1/ The depreciation is estimated to have amounted to 19.7 percent.

The centerpiece of Nigeria's Structural Adjustment Program, in support of which the stand-by arrangement was approved, is the adoption of a market-determined exchange rate which covers all current transactions other than debt service and some public sector transfers, which, for a transitional period, were conducted at a less depreciated official rate. The move to a market-determined exchange rate was accompanied by an extensive liberalization of the trade system: import licenses were abolished and there was a substantial reduction in the number of prohibited imports. 2/ It was reported that the official rate was merged with the market-determined exchange rate on July 2, 1987.

During January-May 1987, the exchange rate for the naira depreciated against the U.S. dollar. Compared to an average exchange rate of ₦ 3.23 per dollar in December 1986 and ₦ 3.52 in January 1987, the

1/ Based on "Nigeria--Request for a Stand-By Arrangement" (EBS/86/246, 11/5/86 and Supplement 1, 12/11/86).

2/ The operation of the foreign exchange market was discussed in EBS/86/246 and supplement.

exchange rate averaged ₦ 3.8 per dollar in April and depreciated further to an average of ₦ 4.1 per dollar in May. These movements reflect two main developments. First, starting in April the authorities reduced the average level of funding to the auction from about US\$51 million a week in January and February to US\$36 million per week in April. This was necessary to forestall further declines in official foreign exchange reserves which fell by US \$481 million in the last quarter of 1986 and by a further US\$364 million in the first quarter of 1987. At the same time, the authorities reduced the frequency of the Central Bank auctions from one a week to one every second week and moved from a marginal price auction to a "Dutch" auction in which each successful bidder pays the actual value of his bid.

The second major factor which has affected the level of the exchange rate is the stance of demand management policy. Credit expansion in the last quarter of 1986 exceeded the program target by almost 4 percent and by another 1 percent in the first quarter of 1987. In addition, fiscal policy, particularly in the first quarter of 1987 has also been more expansionary than envisaged.

More recently, on June 15, the Central Bank issued a circular prohibiting the resale on the interbank market of foreign exchange sold on the auction market. At the same time, access to the fortnightly auction was restricted significantly. Banks which have not been in operation for at least three years cannot present bids to the auction, and can only trade in foreign exchange purchased from the private sector. This led to 18 out of 48 banks being disqualified. As a result, the naira appreciated to ₦ 3.7 per US\$1 compared to ₦ 4.3 per US\$1 in the previous auction. At the auction held on July 2, however, the marginal exchange rate depreciated to ₦ 3.95 per dollar.

The staff has had discussions with the Nigerian authorities in the context of the first review under the stand-by arrangement and the 1987 Article IV consultation. The staff views with concern the recent slippages with respect to monetary and fiscal policy, and the decision by the Nigerian authorities to tighten access to the fortnightly exchange auction and reduce the role of the interbank market. Exchange rate policy and related policy issues will be examined in greater detail in the staff report which is to be issued shortly.

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Table 1. Nigeria: Real Effective Exchange Rate and Related Series

(Indices: 1980 = 100)

	Real Effective Exchange Rate <u>1/</u> <u>2/</u>	Nominal Effective Exchange Rate <u>1/</u>	Relative Consumer Prices (Local Currencies)	Exchange Rate in Terms of U.S. Dollars <u>1/</u>	Consumer Price Index (Seasonally Adjusted)	Consumer Price Index (Not Seasonally Adjusted)
Quarterly						
1982						
I	112.0	104.7	107.0	83.4	128.2	126.6
II	110.5	105.7	104.6	81.1	128.2	128.9
III	113.3	109.8	103.2	80.2	129.1	131.2
IV	119.3	112.5	106.1	79.9	135.1	133.8
1983						
I	122.9	111.8	109.9	79.4	142.3	140.3
II	128.1	111.7	114.7	76.6	151.5	152.6
III	136.5	111.9	122.1	73.1	165.2	168.0
IV	150.1	114.0	131.6	73.0	182.4	180.3
1984						
I	161.4	116.1	139.1	73.0	196.5	193.6
II	182.6	117.7	155.2	72.8	223.3	225.4
III	199.7	123.0	162.4	71.2	238.4	242.7
IV	196.4	124.8	157.4	69.0	236.1	233.3
1985						
I	194.9	124.6	156.5	64.5	239.6	235.5
II	172.8	113.8	152.0	61.4	237.7	240.3
III	155.1	106.5	145.6	60.6	231.7	236.1
IV	141.0	96.7	145.8	58.5	235.8	232.7
1986						
I	123.4	86.3	143.0	54.6	235.1	231.0
II	113.2	78.6	144.1	51.7	238.0	240.9
III	85.1	59.4	143.1	40.7	237.9	242.4
IV	31.4	22.3	140.9	15.3	236.1	232.7
1987						
I	28.7	20.6	139.3	14.9	236.5	
Monthly						
1987						
Jan. <u>3/</u>	30.5	21.7	140.5	15.6	237.1	
Feb.	29.1	20.9	139.4	15.1	236.5	
March	26.5	19.2	138.1	13.9	235.9	
April	26.5	19.5	136.5	14.3	235.3	
May	24.5	18.2	134.7	13.5	234.7	
Percentage change						
Jan. 1987	-19.7	-16.1	-4.1	-13.5	-1.0	

Source: Information Notice System.

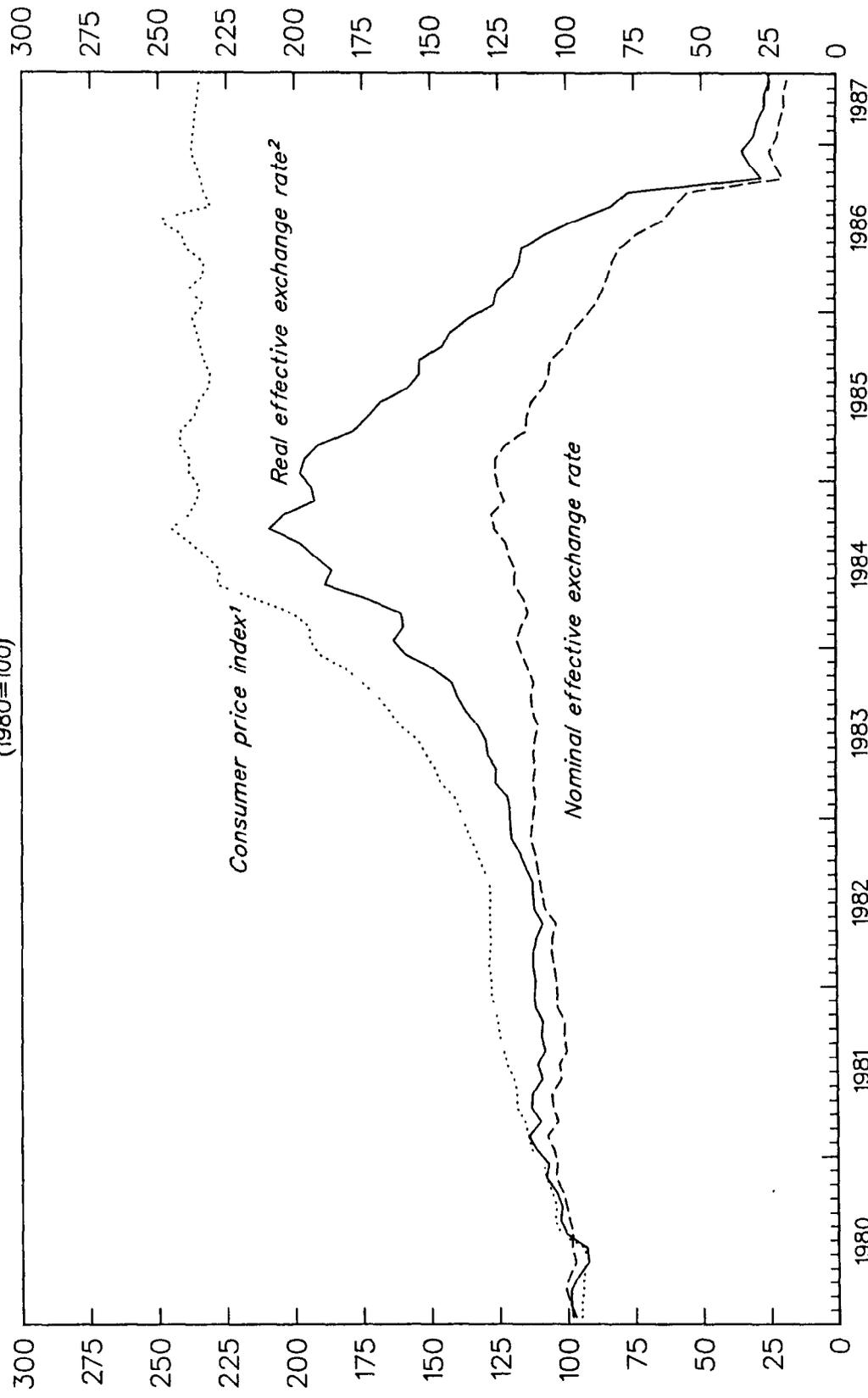
1/ Increases mean appreciation.

2/ Using seasonally adjusted price indices.

3/ Date of latest consideration by Executive Board.



CHART
NIGERIA
INFORMATION NOTICE SYSTEM INDEX OF REAL EFFECTIVE EXCHANGE RATE
(1980=100)



Source: Information Notice System.
1. Seasonally adjusted.
2. Trade-weighted index of nominal exchange rates deflated by seasonally adjusted relative consumer prices; increases mean appreciation

