EBS/86/235

CONFIDENTIAL

October 20, 1986

To: Members of the Executive Board

From: The Secretary

Subject: Nigeria - Exchange Arrangements

There is attached for the information of Executive Directors a paper on recent changes in Nigeria's exchange arrangements.

Mr. Quirk (ext. 8520) is available to answer technical or factual questions relating to this paper.

Att: (1)

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INTERNATIONAL MONETARY FUND

Nigeria--Exchange Arrangements

Prepared by African and Exchange and Trade
Relations Departments

(In consultation with the Legal Department)

Approved by A.D. Ouattara and S. Kanesa-Thasan

October 20, 1986

In the attached communication dated September 29, 1986, Nigeria has informed the Fund of its adoption on that date of a package of measures that includes floating of the exchange rate for most transactions, exchange and trade liberalization, and price decontrol. These measures, which represent a major step in the implementation of Nigeria's Structural Adjustment Program, have been supported by monetary policy adjustments in the form of increased interest rates and commercial bank reserve requirements.

The exchange rate of the naira will henceforth be determined for a transitional period in a dual exchange rate system. The official exchange rate, which is managed flexibly against the U.S. dollar, has been retained in this period for the servicing of external obligations incurred prior to the enactment of the new exchange market, and for official payments and transfers to multilateral institutions and Nigerian embassies abroad. The corresponding supply of foreign exchange to this market will be from official sources and from a portion of oil receipts. On September 29 the official exchange rate was changed to N 1.54 = US$1 from N 1.35 = US$1, representing a depreciation of 12 percent. Since the beginning of the year, the naira has steadily depreciated by 35 percent vis-à-vis the U.S. dollar. In the transitional period the Nigerian authorities intend to continue this policy of depreciating the official exchange rate in order to achieve convergence with the exchange rate in the second-tier market, following which all external transactions will take place at a market-determined exchange rate.

In the second-tier foreign exchange market (SFEM), introduced concurrently, transactions not eligible for the official exchange rate will take place at market-determined exchange rates, in the transitional period. It is estimated that some 70 percent of all foreign exchange transactions will be conducted in the SFEM. The major source of foreign exchange in this market is that part of oil receipts not required for the payments described above that take place in the first-tier market. Oil receipts enter the SFEM through the medium of a weekly auction

ATTACHMENT

Office of the Honourable Minister
Federal Ministry of Finance
New Secretariat- Ikoyi, Lagos
Tel. 619577

September 29, 1986

Mr Jacques de Larosiere
Managing Director
International Monetary Fund
Washington D C 20431
U S A

My dear Managing Director

The Government of Nigeria has today enacted a package of measures aimed at providing a suitable environment for the revitalization of the economy and a strengthening of the external position. This package represents a further set of fundamental steps in the implementation of Nigeria's Structural Adjustment Programme.

The key measure introduced with effect from today is the commencement of the Second-Tier Foreign Exchange Market (SFEM) in which the exchange rate for most transactions will be freely set by the interplay of market forces. All foreign exchange transactions except those involving the servicing of debt obligations incurred up to now, transfers to Nigerian embassies and to multilateral institutions, and a corresponding amount of sales of foreign exchange from oil and official foreign exchange receipts, will now take place in the SFEM. This includes purchase of foreign exchange by Government and by parastatals. The new market is a combination of a weekly auction for foreign exchange, largely from petroleum receipts, and a dealer market which will operate freely in response to supply and demand throughout the week. In order to provide protection for the market in the early stages, limits have been placed on the foreign exchange dealers' net positions, and on spreads between the buying and selling rates in dealings with their customers. The new market is intended to bring a new realism into exchange rate policies, provide incentives for the rationalization of production, and strengthen Nigeria's external accounts.

For a transitional period, an official exchange rate will be maintained, mainly for debt servicing and for the corresponding conversion into naira of some oil receipts. As of today the official exchange rate has been devalued to N1 = US$.65. Nigeria's policy of depreciating the official rate will be continued until the official rate reaches the rate prevailing in the SFEM, after which the exchange rate for all transactions will be set by market forces. Nigeria is requesting Fund approval for the multiple currency practice arising from the official and SFEM rates.

Under these new exchange rate arrangements, forward transactions that are related to an underlying import transaction and have a maximum maturity of six months may be freely entered into at rates negotiated between dealers and their customers. The Nigerian Government is undertaking not to enter into forward commitments with the public or with the dealers.

Other measures introduced with effect from today include the complete abolition of both import licensing and the 30 per cent import surchage, and exchange restrictions on current international transactions and capital inflows. Exchange controls on those capital outflows that are judged to be destabilizing to the SFEM have been retained for the meantime, and will be reviewed shortly in the light of the experience with SFEM. The import prohibition list has been reduced from 72 to 17 items.

Export ban and duties, and most of the export licensing system have been eliminated with effect from today. Henceforth, exporters will be able to retain all receipts in domiciliary accounts, to be freely used. The system of factory gate price controls has also been eliminated. This broad programme of deregulation is aimed at complementing the more realistic incentives provided by the new exchange rates. In order to lend further emphasis to the enhanced incentives for priority sectors, a revised structure of import tariffs and duties has been put into effect from today. A comprehensive review of the tariff structure will be commenced shortly, in order to take into account the new structure of prices arising from the SFEM and the other measures. The procedures for payments of import tariffs and duties, including prepayment of import duties on the basis of import preshipment inspections, will be retained pending a thorough overhaul of customs and related arrangements.

In support of these measures, particularly to provide an auspicious environment for the new exchange rate regime, monetary policies have been adjusted to further reduce available liquidity following the institution, recently, of blocked counterpart deposits against exchange applications. The maximum lending rate has been raised from 13 per cent to 15 per cent. In addition, commercial bank reserve requirements have been raised to within ten per cent of their actual liquidity ratio.

In addition, further fiscal and monetary actions have been approved by Government in the context of the Structural Adjustment Programme. Further details of specific policy actions will be elucidated in a subsequent letter.

Yours truly

Chu S P Okongwu
Minister of Finance