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# NIGERIA'S FOREX CHALLENGES AND THE WAY FORWARD


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2022 has proved to be a challenging year for the naira. It has lost close to 36 percent of its value relative to the dollar in the parallel market. The naira is currently trading at N437.05/$ at the official rate and N760/$ on the parallel market, coupled with inflation at 20.7 percent and subdued forex earnings from the sale of crude oil; these factors have led to significant erosion in the wealth of the vast majority of Nigerians as prices of goods and services have doubled over the past four years.

Over the past six years, Nigeria has grappled with significant volatility in its forex market due to various factors. Key factors have been the 60 percent drop in oil prices between 2015 - 2017 and the impact of the COVID-19 pandemic on oil prices, which declined by over 65 percent in 2020. The reduction in oil prices was also accompanied by a decline in the foreign portfolio and foreign direct investments. The impact of the Russian - Ukraine crisis between 2021 and 2022 led to a spike in crude oil prices but did not lead to an increase in Nigeria's forex earnings, as oil production dipped from 2m barrels in 2019 to less than 1m barrels in September 2022. Nigeria's dependence on petroleum imports and a subsidized price regime for petrol further reduced the forex gains from the hike in oil prices. Low oil production, a high fiscal deficit, and hikes in US treasury bills discouraged portfolio investors. The government was also deprived of access to international capital markets to raise funds to meet its projected expenditures as borrowing rates rose to over 13 percent in the Eurobond market.

With subdued forex earnings, the CBN has sought to prevent the exchange rate at the official market from responding to the shortage of supply, which would lead to further depreciation of the currency. It has rationed the supply of forex in the official markets, which has led to further devaluation of the naira in the parallel market segment and a widening of the margin between the official rate and the parallel rate, which is nearly double the official rate.

Over time, the CBN has introduced several policy measures to mitigate the forex crisis, which has been ineffective in curbing demand. Some notable policies include the restrictions of 43 items on access to forex for imports, the discontinued sale of forex to the Bureau De Change market, and the naira4dollar scheme to attract foreign remittances, among others. Investors and Exporters are reluctant to sell forex in the official market because of the disparity, which has contributed to a reduced supply of foreign exchange.

Some scholars have argued that operating a flexible exchange market is required to reduce the difference between the parallel and official exchange rates and enable exporters and investors to remit foreign exchange into the official market. Others are worried about how a freely floating exchange rate could affect inflation. However, these risks can be mitigated through intermediate interventions of managed float and a regulated band system, a process Nigeria continues to adopt, exposing the economy to more significant risks rather than fixing the market.

To improve the forex market in Nigeria, the government should consider **Operating a flexible forex market.** The CBN may need to allow market forces to determine its exchange rate as the current structure impedes supply and constrains economic activity. Greater emphasis on maintaining a stable inflationary environment would be a stronger factor in preventing excessive depreciation of the naira.

The continuous attempt by the CBN to maintain a fixed exchange rate regime, independent monetary policy, and free capital mobility is a Herculean task that no central bank has achieved. Therefore, this appears to be the best time for the government to focus less on the exchange rate and more on fighting inflation.