A REVIEW OF THE IMPLICATIONS OF THE NIGERIA-CHINA CURRENCY SWAP

DANIA EVELYN NDIDI (PhD)

DEPARTMENT OF ECONOMICS, MICHAEL AND CECILIA IBRU UNIVERSITY,

AGBARHA-OTOR, DELTA STATE,

Abstract

This study theoretically reviewed the Bilateral Currency Swap Agreement (BCSA) between Nigeria and China. The main objective of the study is to review the positive and negative implications of .the Bilateral Currency Swap Agreement (BCSA) between Nigeria and China. The secondary source and content analysis was used for the review. From the results it is clear that the transaction has a lot of benefits like liquidity for Nigerian businesses, mitigating dollar volatility, improve trade flow from China into Nigeria etc. It also has some negative effects like: making Nigeria a dumping ground, worsen trade balance between Nigeria and China, killing of infant industries etc. It is advised that the Nigerian government should review its export policies to avoid Nigeria being a dumping ground for China goods as China is an aggressive exporter while Nigeria is an aggressive importer.

Keyword: Currency, Swap, Fluctuation , Bilateral, Investment.

Introduction

The Central Bank of Nigeria (CBN) April, 27 2018 signed a bilateral Currency Swap agreement with the People's Bank of China (PBoC) worth about US$2.4 billion. In local currencies, the Swap is worth 15 billion Renminbi (RMB) or N720 billion. The deal will be valid for three years and may be renewed following the approval of the two countries. The deal will allow for the direct exchange of RMB and Naira for the purpose of trade and direct investment between both countries.

According to the PBoC, the aim of the Swap arrangement is to facilitate bilateral trade, direct investment, and safeguard financial market stability. The trade is expected to reduce the demand for US Dollar by Nigerians importing from China and consequently strengthen the value of the Naira. The deal will reduce some barriers for Nigerian importers of goods from China and China importers from Nigeria and reduce the cost of transactions in third party currencies.

According to FSDH (2018) the last five years showed that Nigeria's imports from China are higher than the exports to China, leading to a negative trade balance. China has been one of Nigeria's largest import partners over the last five years, with imports from China accounting for an average of 20.95% of total imports between 2013 and 2017. Imports from China increased by 21.16% from N1.48 trillion in 2013 to N1.79 trillion in 2017. On the other hand, Nigeria's exports to China averaged just 1.50% of total exports over the period. Exports to China increased by 28.99% from N171 billion in 2013 to N220.57 billion in 2017.

According to United Nations (2018) database on international trade Nigeria imports from China was US$5.85 Billion during 2017. With Machinery, Nuclear Reactors, Boilers accounting for 27%, Electrical, Electronic Equipment accounting for 14%, Vehicles Other Than Railway, Tramway accounting for 6.8%, Miscellaneous Chemical Products 5.2%, Plastics 4.6%, Iron and Steel and Rubbers 3.2% respectively, Articles of Iron or Steel 3.0%, Organic Chemicals 2.7%, Inorganic Chemicals, Precious Metal Compound, Isotope 2.6%, Optical, Photo, Technical, Medical Apparatus 2.5% and others in less than2%. In the other hand, Nigeria Exports to China was US$721.26 Million in 2017. With, Mineral Fuels, Oils, Distillation Products accounting for 82%, Oil Seed, Oleagic Fruits,Grain, Seed, Fruit accounting for 4.4%, Wood and Articles of Wood, Wood Charcoal accounting for 3.3%, Plastics 3.5%, Ships,Boats, and Other Floating Structures 2.2%, , Cocoa and Cocoa Preparations 2.1%, Ores Slag and Ash 1.2% and others in less than 1%. From the statistics, it is clear that though, it was a good deal, the Nigeria government has a lot to do in order to improve our expert to China.

According to FSDH, the currency swap agreement may improve foreign exchange stability and aid external reserves management to a certain extent. It presents downside risks as shown in the trade balnce between the two countries. The fact that it removes some trade barriers between the two countries may increase Nigeria's imports from China. This development without a corresponding increase in Nigeria's exports to China will further increase Nigeria's trade deficit with China. Nigeria needs to develop competitive advantage in the production of certain exportable goods that China currently imports in order for Nigeria to get the full benefit from this currency swap deal.

Currency Swaps in Retrospect

The concept of currency swaps originated from that of foreign exchange swaps. A foreign exchange (FX) swap, or FX swap, refers to the transaction between two or more parties normally exchanging spot foreign exchange for forward foreign exchange through contract, while a currency swap is referred to as various parties exchanging their own currencies or act for different terms of other foreign currencies. The original purpose of both FX swaps and currency swaps is to avoid turbulence and other risks on the foreign exchange market, and these transactions are usually made by commercial banks, with exporters and other international business practitioners as clients. Yet gradually, currency swaps have been used for other purposes as well. A most outstanding case took place before 2008, which was the currency swap between the Greek government and Goldman Sachs, intended to reduce the government deficit and debt scale of Greece.

Currency swaps of central banks can also be regarded as a means to provide standby credit for relevant countries, in which one country uses its national currency to exchange for that of the other or even a third country. Therefore, a currency swap agreement may be either bilateral or multilateral. In general, some conditions or terms are formulated in the agreement. For instance, when Party A, by contract, seeks to exchange its domestic currency for the national currency of Party B or certain foreign currency provided by Party B, the latter should do so according to their agreed conditions or terms. Such currency swap agreements are normally signed between central banks of countries concerned

The earliest currency swap between central banks dates back to the Bretton Woods era when, on February 28, 1962, the U.S. Federal Reserve and the Central Bank of France signed a currency swap agreement which took effect on March 1, for the U.S. was urging European countries to intervene in the foreign exchange market to maintain stability of the USD exchange rate. By this agreement the Central Bank of

France credited 500 million Francs into the U.S. Federal Reserve account, while the Federal Reserve credited US$50 million into the account of the Central Bank of France. This swap was initially a short-term one only valid for three months. However, with the worsening of the USD crisis, the U.S. expanded the scale of its swap transactions to include Austria, Belgium, Britain, Germany, Italy, Holland, Switzerland, Canada and several other countries, with a total credit amount of swaps of $900 million by 1963. Even after the U.S. announcement of abandoning the USD-Gold linkage in August 1971, the amount of currency swaps between the U.S. and European countries continued rising. By the mid-1970s, the amount had soared to $20 billion.

The currency swaps during the Bretton Woods era embraced the obvious purpose of saving the U.S. from its dollar crisis, and served as a cooperative means to suppress the trend of underselling the USD and buying other currencies.

In parallel, the IMF-sponsored General Arrangement to Borrow (GAB) was signed in 1962. To further mitigate the dollar crisis, the IMF facilitated another agreement among U.S., Britain, Germany, France, Japan, Belgium, Holland, Canada and Sweden under the GAB framework. According to this complementary agreement, the IMF, if in need, could borrow money from the above countries with an initial quota of $$6 billion, and the quota could be constantly increased. Up until 1983, the quota had reached SDR 17 billion. The GAB agreement provided another kind of standby credit and was certainly different from currency swap agreements between central banks, although both were employed to cope with the dollar crisis.

After the collapse of the Bretton Woods system, strong foreign exchanges were much more needed by most countries to stabilize their domestic markets in the enduring financial crisis. Although, the IMF still keeps its obligation to extend short-term credit to those in need, it could hardly meet their demands, though. Currency swaps of central banks, thus, became a new approach to deal with market shocks, with swap funds included into the standby foreign exchange reserve.

Nigeria-China Currency Swap Agreement

The Central Bank of Nigeria (CBN), on June 6, 2018, issued the Regulations for Transactions with Authorized Dealers in Renminbi (Regulations). The Regulations provide the framework for implementing the Bilateral Currency Swap Agreement (Currency Swap Agreement) the Agreement) which was concluded on April 27, 2018, at a ceremony in Beijing, China, which was between the Federal Republic of Nigeria (FGN) and the People's Republic of China (PRC). The CBN and the People's Bank of China (PBoC) executed the Currency Swap Agreement on behalf of their respective countries.

The swap deal is an agreement with a three (3) year tenour which allows both the CBN and PBoC to swap a maximum amount of Fifteen Billion Renminbi/Chinese Yuan (CNY 15 Billion) for Seven Hundred and Twenty Billion Naira (NGN 720 Billion). This amount is equivalent to US$2.5 Billion using an exchange rate of NGN305: 1US$.The Currency Swap Agreement was purposely executed to:

- finance trade and investment between China and Nigeria;
- maintain financial market stability; and
- facilitate other connected purposes as may be agreed upon by both countries

The Currency Swap Agreement seeks to create a platform that provides Naira liquidity to Chinese firms and investors considering doing business with Nigeria on the one hand; and also provides Chinese Yuan liquidity to Nigerian firms and investors considering to do business with China on the other hand. The Currency Swap Agreement is designed to aid trade transactions between China and Nigeria and remove the need to first source for the "greenback" (US Dollars) before payments for transactions involving the two countries can be made.

Accordingly, both the CBN and the PBoC shall (subject to the maximum amount indicated under the Currency Swap Agreement to make available liquidity in their respective currencies for the facilitation and promotion of trade and investments between the two countries through the purchase, sale, and subsequent repurchase and resale of the Chinese Yuan against the Naira and vice versa. For this purpose, under the Currency Swap Agreement, the CBN may conduct bi-weekly Renminbi bidding sessions.

The Regulations stipulate the terms and conditions guiding the operation of the Currency Swap Agreement and make provisions in respect of:

a) Eligibility criteria for Authorized Dealers to participate in the CBN bi-weekly Renminbi bidding sessions;
b) Relevant documentation to be provided by the importer in order for an Authorized Dealer to make authorized Renminbi payments;
c) The medium through which the CBN would provide Renminbi to the market (i.e. bidding sessions or special retail or wholesale sessions); and (d) applicable charges which Authorized Dealers may earn for relevant transactions, among others.

By the Regulations,

- All Authorized Dealers (Deposit Money Banks and Merchant Banks only) are henceforth required to open Renminbi bank accounts with a corresponding bank (either onshore or offshore China) and provide the CBN with the details;
- Authorized Dealers shall not open domiciliary accounts denominated in Renminbi for customers;
- Importers of China goods from China shall obtain pro-forma invoice denominated in Renminbi, as part of the documents required for the registration of Form M
- Foreign exchange purchased in the window shall not be used for payments on transactions in which the beneficiaries are not domiciled in China;
- Authorized Dealers shall utilize funds within 72 hours from the value date or return such funds to the CBN for repurchase at the apex bank's buying rate;
- Bids shall be settled spot through a multiple-price book bidding process, and will cut-off at a marginal rate (which will be disclosed after the conclusion of a Special Secondary Market Intervention Sales ("SMIS") process (i.e. retail process);
- All Renminbi bid requests shall be treated by the CBN by debiting Authorized Dealers' current account with the Naira equivalents;
- Transactions earlier classified as "Not Valid for Foreign Exchange" by CBN extant Circulars have the same status under the Regulations; and

- Modes of payment under the Currency Swap Agreement shall be in line with Memorandum 9 of the Foreign Exchange “(FX”) Manual.

Implications:
Positive Implications
Renminbi Liquidity for Nigerian Businesses

One of the immediate impacts of the Bilateral Currency Swap Agreement (BCSA) is the liquidity of Chinese Renminbi for Nigerian Businesses. Businesses which had previously issued invoices to their customers in Dollars can transit to the issuance of Renminbi or Naira denominated invoice as the businesses will now have access to the liquidity of each currency to settle bills and invoices directly.

Mitigated adverse effects of Dollar Volatility

Having allowed transactions denominated in third party currencies can be quite volatile, as was the case in Nigeria during the recession period where dollar was at its most volatile level. The BCSA between CBN and People’s Bank of China will greatly mitigate the adverse effects of dollar volatility and hence our susceptibility to Naira fluctuations. The agreement allows the respective Central Banks to obtain each other’s currency at a pre-determined exchange rate which would not be susceptible to fluctuation of the currencies.

Foreign Reserves Deposit

Nigeria which is an import dependent economy has most of its import bill and international trade transactions settled in dollars. This practice would heavily impact on the foreign currency earnings and reserves of the country. With the operationalization of this BCSA, enormous pressure will be taken off the dollar, while allowing more dollar earnings to be retained in the foreign reserve. Though, this is more in principle than in practice as the deal only covers only 15% of Nigeria total import. By implication, 85% of Nigeria imports will be sourced via dollars.

Provision of Renminbi denominated Loans

It is proposed that the People’s Bank of China will use the available Nigerian currency to advance loans to Chinese investors, who have secured investment opportunities or intending to do business in Nigeria. This creates a unique and cheaper window for investors to import capital for their business interests in Nigeria.

Improve trade flow from China into Nigeria

The Chinese public and private sectors participation in the Nigerian Economy has continued to trend upwards. Footprint of Chinese investments in Nigeria can be found in the Telecommunication, construction, petroleum, mining, agricultural and manufacturing sectors. The availability of Nigerian Naira to Chinese businesses is expected to shore up the Foreign Direct and Portfolio Investment into Nigeria. The major attraction is not only the availability of liquidity to invest in the country, but the availability of the Renminbi for repatriation of profit and capital back to China.

Multi-nation currency swap backed by Renminbi

Also expected as a fall out of the currency swap agreements so far entered into between China and some African Governments such as, South Africa, Egypt, Nigeria etc, is a boost of inter African trade that will be powered by the Renminbi currency. The apex banks of these African countries may be able to perfect trade with other African nations based on the

Renminbi rather than the United State Dollars.

Negative Implications

Since the swap deal amount of NGN 720 Billion can only take care of about 15 percent of Nigeria's annual total imports from China, there is the fear that dollar will still be on the high demand because the remaining 85 percent is definitely going to be financed by dollars. This will still make dollars a preferred currency and the challenges faced in obtaining dollars will still persist.

It may discourage exports in the long run because Nigeria has no good export policies and also the fact that Nigerians are aggressive importers while China is aggressive exporters. This act will place Nigeria at risk of a possible economic take--over by China. With Nigeria's penchant for consumption of foreign goods, Experts have opined that the BCSA may be more favourable to Chinese businesses, which may flood the Nigerian market with Chinese products at a cheaper rate, thereby pushing the country to abandon its growing manufacturing sector and settle for a consumer nation status.

The deal when fully operational will secure an increase in the availability of Chinese goods in the Nigerian market. When this occurs, competition between the imported goods and our locally manufactured product will be difficult to maintain, as our locally manufactured product will struggle with indices such as, price, availability and quality. Invariably, this will lead to the dominance of Chinese goods in the Nigerian market and killing of Nigeria infant industries as China is an aggressive exporter.

It is feared that the BCSA may further impact the already lopsided balance of trade between Nigeria and China. According to the National Bureau of Statistics, between 2013 and 2016, Nigeria's trade deficit with China was USD 16.9 billion, and in 2017 alone the trade deficit was US$5.13b, therefore any further increase on the import side of trade will worsen Nigeria's position on the Trade Chart.

Nigeria has had a tough time addressing the problem of round tripping especially with the USD. The regulation has been structured to eliminate round tripping by providing for payment directly to sellers operating in China. Despite the above, the CBN must set up efficient modalities to prevent round tripping by Authorized Dealers who will be allocated to the Renminbi for disbursement to customers.

Conclusion

The CBN and the People's Bank of China (PBoC) executed the Currency Swap Agreement on behalf of their respective countries. The swap deal is an agreement with a three (3) year tenor which allows both the CBN and PBoC to swap a maximum amount of Fifteen Billion Renminbi/Chinese Yuan (CNY 15 Billion) for Seven Hundred and Twenty Billion Naira (NGN 720 Billion). The Swap Agreement seeks to create a platform that provides Naira liquidity to Chinese firms and investors looking to do business with Nigeria on the one hand; and also provides Chinese Yuan liquidity to Nigerian firms and investors looking to do business with China on the other hand.

However, there are reservation as to the potency of the Currency Swap Agreement to fully address the challenge of dollar demand by importers, as the money set aside can only account for 15 percent of Nigeria's annual total imports from China, there is the fear that dollar will still be on the high demand because the remaining 85 percent is definitely going to be financed by dollars. Also, with weak export base of Nigeria and high passion for imported items, there is fear that China may soon take over the economy. So the economic mangers in all levels should as a matter of urgency put up a robust export policies so that the economy call fully profit from the bilateral currency swap agreement. Otherwise, the deal will be a curse in disguise.

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