CBN Stops USD Sale to BDCs. What We Expect…

At the Monetary Policy Committee held on Monday and Tuesday, 26 and 27 July 2021, members observed the abuse of regulations by BDC operators and frowned at their excessive rent seeking behaviors and therefore moved to arrest the arrest the situation. Consequently, members decided the following:

1. CBN to stop forex sale to BDC operators,
2. CBN to suspend licensing of more BDCs in the country,
3. CBN to re-channel forex sales to commercial banks to meet PTA, BTA needs of customers,
4. Commercial banks to dedicate teller points in every branch for sale of forex to customers,
5. Customers to report banks who fail to sell forex to them despite meeting requirements.

CBN Drops the Hammer on Bureau De Change Business

In what appeared to be a punitive measure, CBN stopped USD sale to BDCs. Instead, the apex bank resolved to meet end user USD needs via Commercial banks. By selling to Commercial Banks directly, it is expected that speculators will have difficulty accessing USD from official channels and would have to compete with black market operators for foreign remittances. We also expect BDC operators to compete for limited foreign remittances. In the short term, increased competition could exacerbate the depreciation of the Naira as a result of CBN' policy action.

Short term Implications for the Real Sector

In the meantime, businesses, manufacturers in particular, which depend of imported raw materials for the core operations are expected to experienced increasing difficulties following the rise in exchange rate. Of course, any increase in incurred costs as a result of Naira depreciation would be passed on to the final consumer in the form of inflation. Also, owing to existing backlogs (a long queue) for foreign exchange at the official channel, and given CBN's limited USD source, Genuine end users would experience increased difficulty accessing USD at higher, more exorbitant rates at the black market.

What Happens to the N5 for USD1 Scheme?

Target recipients of foreign remittances who currently enjoy the N5 for USD1 Scheme will likely may be salivating at potentially increased rent opportunities presented by further Naira depreciation at the parallel market, in addition to the N5 reward. We feel the Scheme may be seeing its last days soon as it will no longer make justifiable sense if recipients change money at higher black market rates and still get the N5 incentive.

Stability Expected in the Medium to Long Term

If its targets are met as planned, Dangote Refinery is expected to begin fuel production and sale in the first quarter of 2022. Also, there is possibility of Nigeria recording a marginal increase in crude oil output as Opec adjusts upward their overall production by 0.4 mbd on a monthly basis starting August 2021 until phasing out the 5.8 mbd production adjustment. These should boost the capacity of the apex bank to meeting dollar demand, both existing and fresh demand. Hence, we expect a narrowing of the official and parallel market rates in the medium.

Recommendations for Long term Solutions

By stopping USD sale to existing BDC operators and stopping further license issuance to new BDCs, CBN may have signaled its intention to move on with foreign exchange reforms on the road to harmonizing the multiple exchange rates. In order for the latest policy to succeed, CBN must prohibit USD cash transactions and ensure all funds are transferred electronically or digitally between local banks and foreign correspondent banks on behalf of customers. There must also be political backing in order to end the parallel market or bring it under the financial system so that all USD transactions come under the ambit of the monetary authority, in the same way as the local currency, in order to bring to an reduce discomfiting challenges of foreign exchange round tripping and money laundering. Already, CBN promised to come down hard on commercial banks who were found to have connived with foreign embassies, missions and institutions who have conducted their forex businesses illegally and in flagrant abuse of local regulations. The apex banks would also report such errant institutions to the relevant authorities in their home countries in an effort to redirect forex business to the I&E FX window or NAFEX.

A Case for Half a Loaf Better than None for the BDCs

Finally, we believe BDCs would have been better off complying with the officially sanctioned spread of N2 or so than no spread at all had they complied with the directive of the central bank.