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Detail Commercial Solicitors

POTENTIAL IMPACT OF CHINA-NIGERIA CURRENCY SWAP ARRANGEMENT ON NIGERIAN BUSINESSES

The Central Bank of Nigerian (CBN) and the Peoples Bank of China (PBOC) executed a Foreign Currency Swap Agreement (FCSA) in May 2018, the purpose of which is to enable local Nigerian traders access the renminbi (RMB) under the FCSA. This below infographic highlights the potential impact of the FCSA on Nigerian Businesses.

CBN REGULATION ON FCSA

Availability of RMB The RMB may only be accessed through a bi-weekly bidding process conducted by the CBN.	**Trade-backed transactions** The RMB will only be made available for trade-backed transactions.
Purchase of RMB The RMB purchased must be for the benefit of a beneficiary in China.	**Mode of Payment** The Regulations prescribe different payment methods for different types of transactions, viz: (a) Letter of Credit transactions; (b) Bills for Collection transactions; and (c) Not-Valid-for-FX transactions.
Rate of Exchange The rate of exchange shall be determined through the bidding process.	**Resale of RMB** If the RMB purchased is not utilised within 72 hours, it will be resold to CBN at the purchase price.

POTENTIAL IMPACT OF THE FCSA ON BUSINESSES IN NIGERIA	
Reduction of Transaction Cost The direct exchange of Naira against the RMB, without the Dollar as the middle currency, will reduce transaction costs and eliminate currency fluctuations.	**Improvement of Foreign Reserve** The introduction of the RMB into Nigeria's foreign reserves will reduce the demand for the dollar and will boost Nigeria's reserves.
Increase in Imports The trend in Nigeria-China trade from 2015 indicates that with the reduction in transaction costs, there will be a continuous increase in imports from China without a corresponding increase in exports.	**Competition between locally manufactured goods and imports** Given the likely increase in imports from China into Nigeria, there may be increased competition between locally manufactured goods and imported goods.

A. Background

The Central Bank of Nigerian (CBN) and the Peoples Bank of China (PBOC) executed a Foreign Currency Swap Agreement (FCSA) in May 2018, the purpose of which is to enable local Nigerian traders access the renminbi (RMB) under the FCSA.

In furtherance of the above, the CBN on the 8th of June, 2018, introduced a regulatory framework, titled "*Regulations for Transactions with Authorised Dealers in Renminbi*," which lays out the eligibility criteria to access RMB and the framework for payments using the RMB under the FCSA in Nigeria.

The FCSA is worth sixteen billion renminbi (RMB 16,000,000,000) or the naira equivalent of nine hundred billion naira (NGN 900,000,000,000) and it represents a positive step towards deepening economic cooperation between Nigeria and China. This is especially as Nigeria is China's 3rd largest trading partner and 2nd biggest importer of Chinese products in Africa, with trade deals between the countries amounting to over twelve billion United States dollars (USD 12,000,000,000) in 2017. (Central Bank of Nigeria Regulations for Transaction with Authorised Dealers in Renminbi).

This article provides a brief overview of the regulation introduced by the CBN to govern the FCSA framework and the potential impact of the FCSA on the Nigerian economy. The article will also provide some recommendations on how the arrangement can be utilized for the benefit of local businesses.

B. Regulation on the FCSA

According to the regulation, the FCSA may only be used to finance trade and direct investment between both countries, maintain financial stability and for any other purpose, which both countries may agree upon from time to time. The key provisions of the regulation are itemized below:

I. **Availability**: RMB under the FCSA may only be accessed through a bidding process conducted by the CBN [bi-weekly].

II. **Eligibility**: By laying down specific eligibility criteria, the CBN has taken steps in the regulation to curtail demand of the RMB in order to ensure that the price of the RMB against the naira does not increase indiscriminately. Therefore, the RMB can only be accessed where the following eligibility criteria have been met:

a) There must be an existing transaction requiring the use of the currency;

b) The transaction must be such that the RMB purchased during the bidding process shall be for payments to a beneficiary in China;

c) Authorised Dealers must open RMB accounts with a correspondent bank who may either be onshore or offshore China and provide the Account details to the CBN. Also, Authorised Dealers are prohibited from opening domiciliary accounts in RMB for the benefit of Customers; and

d) Importers must obtain a proforma invoice denominated in RMB in addition to any other documents required for the registration of the Form M.

III. **Mode of payment by Authorized Dealers**: The regulation prescribes acceptable methods of payment by Authorized Dealers with respect to the different types of transactions. The following are applicable in respect of the different types of transactions:

a) For payment to be made in a Letter of Credit transaction, all negotiating, and shipping documents must be sent directly through the Beneficiary bank to the Issuing bank:

b) In a Bills for Collection transaction, the regulation prescribes that payment can only be made where the documents are routed either from the Suppliers bank or the offshore correspondent bank of the Beneficiary bank to the Issuing bank; and

c) For payment to be made when it is a Not-Valid-for-FX transaction, the documents involved shall be routed directly from the Supplier to the applicant's bank that validates the e-Form M for that transaction.

IV. **Rate of exchange and use of the RMB by Authorised Dealers**: The exchange rates for the sale of the RMB will be determined through a bi-weekly bidding process. The Bids shall be settled spot through a multi-price book bidding process and will cut off at a marginal rate. However, the CBN reserves the right to not make a sale where it is convinced that the exercise did not provide an effective price for the determination of the NGN/RMB exchange rate and may choose to offer another Secondary Market Intervention Sale. Where the bid is won by an authorized dealer, the CBN shall debit the Authorised Dealer's current account with the naira equivalent of the RMB bid request. It is important to note that the RMB purchased from the CBN must either be utilized within seventy-two (72) hours or be refunded to the CBN at the rate of purchase.

C. Potential Impact of the FCSA on Businesses in Nigeria

i. **Reduction of transaction cost**: By the first quarter of 2018, the total amount of imports from China was valued at N530.98 billion amounting to about 21.1% of Nigeria's total imports (National Bureau of Statistics; Foreign trade in goods statistics (Q1, 2018)). Payments in respect of these transactions typically involved the conversion of the naira to the dollar and subsequent conversion to RMB. This contributed to the transaction costs incurred by businesses in trading. With the advent of the currency swap deal, a layer of conversion is removed, and a level of currency risk will be eliminated as the naira will be able to be exchanged directly against the RMB, which will consequently amount to a reduction of transaction cost. This will effectively drive volume as well as convenience in respect of trade between Nigeria and China. It will also allow Nigerian importers to largely eliminate the challenge of "third currency" fluctuations when trying to make payments for Chinese exports to Nigeria.

ii. **Improvement of foreign reserve**: As at 2017, about $7.6 billion was required from the nation's foreign reserves to settle import transactions from China. The introduction of the RMB into the nation's foreign reserves to cater for a majority of China–Nigeria trade settlement will invariably reduce the demand for the dollar and will bulk up the nations reserve.

iii. **Potential increase in imports from China**: Bilateral trade volume between Nigeria and China was about $12.3 billion between January and November 2017. Nigeria is the second biggest importer of Chinese products and its third largest trading partner in Africa (National Bureau of Statistics, Foreign Trade in Goods Statistics). While China is recorded to be the biggest importer to Nigeria, the latter barely realizes up to one-third of the value of its imports from China in its exports to the Asian country. This has been illustrated in the table below:

Year in Review	Imports to Nigeria	Exports to China
2015	$ 13.7 billion	$1.2 Billion
2016	$7.6 Billion	$1.6 billion

Given the information above, the possible reduction of transaction cost and the possibility of speed and convenience with trade between China and Nigeria, the imports from China are expected to increase without a corresponding increase in Nigerian exports. This will further widen the balance of trade between both countries in favour of China.

iv. **Higher competition between imports and local manufactured items**: A combination of the issues highlighted in 3(i) and 3(iii) above will lead to a high influx of imports into the country. It is expected that there will be an increase in the availability of relatively cheaper imported goods. This may potentially create a competitive atmosphere for local manufacturers and possibly encourage efficiency in local production in order to prevent migration of the customers of local businesses.

v. **Potential conflict with existing regulations**: On the 5th May, 2017, the CBN via a press statement re-affirmed its position on the blacklisted forty-one (41) items, which it had declared to be not valid for access to the Nigerian foreign exchange market (Not-Valid-for-FX-Transaction). However, the status of these items in respect of access to the RMB appears to have changed as the new regulation recognizes Not-Valid-for-FX-Transaction. This potentially creates a conflict with already existing regulations.

D. Recommendations

In light of the analysis provided above, we recommend the following;

i. **Correction of balance of trade through trade deals**: The data presented in 3(iii) above proves a significant imbalance of trade in favour of China, which must be addressed in order for businesses and the country to adequately benefit from the deal. In order to do so, businesses must focus on China's import needs, which can be matched with Nigeria's export abilities and capitalize on those business needs. China is one of the world's largest importers and amounts for a total of 10% of the worlds imports (https://commodity.com/country-profiles/china/).
This means that China is a potential target market for Nigerian producers and export businesses. Major imports to China include coal, mineral fuels and iron ore, valued at $11.5 billion, $116.2 billion and $57.1 billion, respectively, annually. One way that Nigerian businesses may be able to participate in the Chinese market is through solid trade deals between both countries in respect of exports from Nigeria to China. China has entered into one of such trade deals with the USA for the import of soya beans worth billions of dollars from the US to China. Like the USA-China deal, trade deals between Nigeria and China will secure and maintain China's commitment to receive imports from Nigeria through Nigerian businesses.

E. Conclusion

The currency swap deal appears to be promising for businesses and the country as a whole as it provides an opportunity for growth and expansion of businesses. However, as identified above, more must be done if we are to achieve complete success of this deal and reap the benefits.

Image courtesy vanguardngr.com

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