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OVERVIEW OF THE BILATERAL CURRENCY SWAP AGREEMENT: IMPLICATIONS AND OPPORTUNITIES

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Introduction

The historic signing of the Bilateral Currency Swap Agreement (BCSA), with the People Republic of China has generated a lot of publicity and rightly so, given the radical yet significant impact of the swap arrangement on the Nigerian economy. The signing ceremony marked the culmination of two years of negotiation between the two countries, which commenced during the official state visit of the Nigerian President Muhammadu Buhari to the People's Republic of China in April 2016.

Nigeria's vulnerability to external shocks and issues with maintenance of its external reserves as a result of over dependence on oil, Nigeria largest foreign exchange (FX) earner is welled researched and documented. Faced with a need to create an alternative to her over-dependence on the Petrodollar, the BCSA allows for direct currency exchange between traders and investors in Nigeria and China thereby utilizing the liquidity of the swap deal. The question then is, what is the BCSA about? How does it work? What are the potential implications and opportunities, if any, for individuals and corporate citizens?

A Bilateral Currency Swap Agreement involves a process where two countries make available to each other, its liquid currency to facilitate the election of either currency to denominate aspects of their mutual trade on a direct exchange backed by their respective national currencies, rather than a third-party intermediary currency.

Overview of the Bilateral Currency Swap Agreement

According to data made available by the National Bureau of Statistics, China is the 3rd largest trading partner with Nigeria after India and United States of America. The figures show that trade in goods between Nigeria and China was at a record high of circa N2.0tn in 2017, with total import from China valued at N1.8trn, while total Export from Nigeria was valued at N220bn giving a trade deficit of about NI.6trn.

With the increasing volume of trade between Nigeria and China, the tripartite arrangement where Nigerian businesses involved in the importation of finished products or raw materials from China had to first convert their Naira currency into the United State Dollars (USD), and then into the Chinese Renminbi for payment to their Chinese business counterparts was unsustainable, as the practice piled huge pressure on the Nigeria's foreign reserve.

The BCSA entered into by the Nigerian Government and the People's Bank of China is a 3 (three) year agreement for the exchange of a maximum amount of 15 Billion Chinese Renminbi for 720 Billion Nigerian Naira. Consequently, Nigerian manufacturers, small and medium-sized enterprises and import dependent Nigerian businesses can now import products, raw materials, and parts from the People Republic of China and pay directly with the Renminbi obtained from an authorized dealer under the currency exchange deal.

Conversely, Chinese manufacturers and investors seeking to buy raw materials from or invest in Nigeria, may obtain Naira or Naira denominated loans from Chinese banks to pay for their imports or investments.

Understanding the BCSA Architecture

The mechanics of the BCSA were given life by the recently released **CBN Regulation on Transactions with Authorised Dealers in Renminbi (the "Regulation")**. The CBN via the Regulation has announced that it would be conducting bidding for the Renminbi bi-weekly, and access to the Renminbi offering would be through authorized dealers who are required to utilize the funds within 72 hours from the value date, failing which such funds must be returned to the CBN for repurchase at the Bank's buying rate. The Regulation further provides for modes of payment to be limited to Letters of Credit transactions and Bills for Collection transactions.

Interestingly, the 41 items noted in the June 2015 circular of the CBN are not valid to access the Renminbi at the official FX market, thus this points to the retention of status quo on this issue.

Potential Implications of Swap Arrangement

Based on our analysis of the BCSA and the Regulation, we outline below the potential effect of the Renminbi accessibility.

a. Renminbi Liquidity for Nigerian Businesses

One of the immediate impacts of the 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.

b. Mitigating the adverse effects of Dollar Volatility

Having 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.

c. Foreign Reserves Accretion

Nigeria which is an import dependent economy has most of its import bill and international trade transactions settled in dollars. This practice has heavily impacted the foreign currency earnings and reserve 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.

d. Provision of Renminbi denominated Loans

It is envisioned 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.

e. Improve trade flow from China into Nigeria

The Chinese public and private sector 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.

f. 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 and Nigeria, 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 consummate trade with other African nations based on the Renminbi rather than the United State Dollars.

Key issues arising from Swap Deal

a. Triumph of consumerism over Creativity

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.

b. Dominance of Chinese Products

Furthermore, 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.

c. Nigeria's growing trade deficit with China

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, therefore any further increase on the import side of trade will worsen Nigeria's position on the Trade Chart.

d. Round Tripping of the Renminbi

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 Authorised Dealers who will be allocated the Renminbi for disbursement to customers.

Conclusion

Taking a cue from the positive reception of the BCSA by the public and private sector participants in the economy, we expect business operators to take advantage of the vast offerings of the deal to incentivize and improve their trading activities. Whether or not the BCSA will negatively impact or rather help build the Nigerian economy is a question that can only be answered in time. Nonetheless, only a strategic and well-structured implementation will secure a favourable outcome for Nigeria.

Key Contacts

Abayomi Adebanjo
Co-Head, Financial Services Sector

e: abayomiadebanjo@jacksonettiandedu.com

Kunle Soyibo
Co-Head, Financial Services Sector

e: kunlesoyibo@jacksonettiandedu.com

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For further information, please contact us at finserv@jacksonettiandedu.com

Jackson, Etti & Edu

RCO Court 3-5, Sinari Daranijo Street,
Victoria Island, Lagos, Nigeria.

t: +234 (1) 4626841/3, +234 (1) 2806989
e: jacksonettiedu@jacksonettiandedu.com

f: +234 (1) 2716889
www.jacksonettiandedu.com