Economy Alert:

Nigeria-China Discussions: Buying More Time?

22 April 2016

Context

Two key highlights emerged from President Muhammadu Buhari's week-long visit to China. First was China's offer of a loan estimated at $6 billion to fund infrastructure projects across the agricultural, solid minerals and industry sectors. If utilised, Nigeria's external debt profile could potentially rise marginally to 2.9% of GDP in 2016 (2015: 2.1%).[1] Nonetheless, our expectation is that the terms of China's loan would be cheaper than an equivalent Eurobond issuance given the upward shift across the longer dated yields in recent times. Furthermore, Nigeria could potentially gain from the technical expertise provided by the Chinese contractors selected to implement the projects.

Second was the announced currency swap agreement by the Industrial and Commercial Bank of China Limited (ICBC) and the Central Bank of Nigeria (CBN) which will provide a new medium for both countries to settle bi-lateral trade in the Renminbi as well as minimise the exchange rate risk when the US$6 billion credit line is eventually utilised.

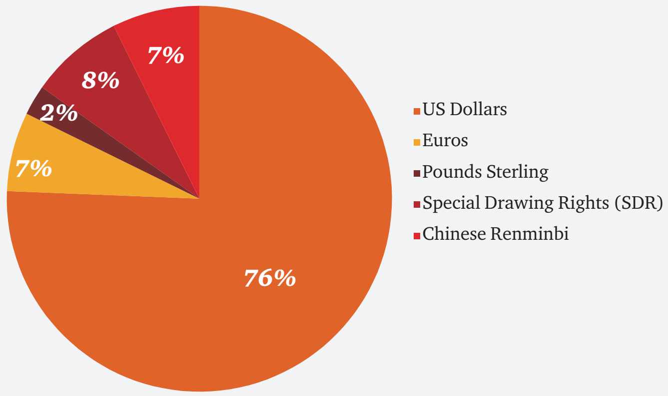
Dynamics of a typical currency swap

- Country A (Nigeria) approaches Country B (China) to initiate a swap.
- The Naira is exchanged for the Renminbi at a predetermined exchange rate, volume, tenor and interest rate.
- Renminbi is provided to importers from China through the commercial banks.
- At maturity, the Renminbi is exchanged to Naira at the same exchange rate but with interest.

Source: PwC Analysis

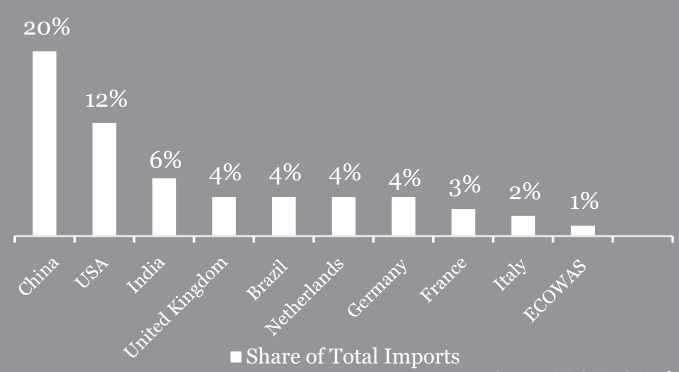
Imports from China represented 21.3% of Nigeria's total imports in 2015 and 20% on average for the past 5 years, ranking China as Nigeria's largest import partner. Therefore, the currency swap could mildly ease the demand pressure on the dollar in the short term for this proportion of imports, depending on the size and duration of the deal, as Chinese importers are able to settle trades directly in Renminbi.

Currency Composition of Nigeria's External Reserves (Q3 2015)



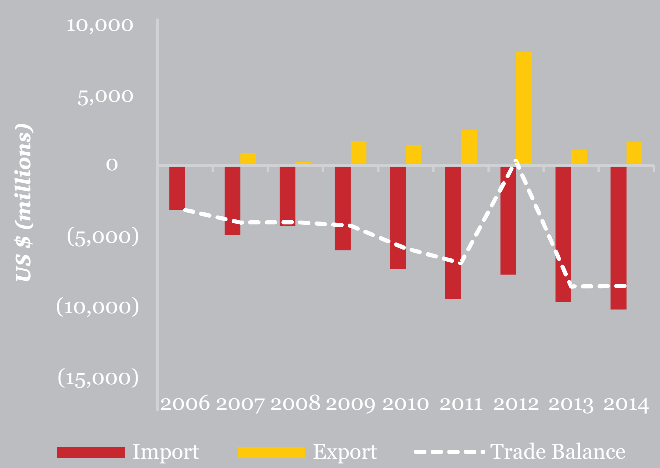
Source: CBN, PwC Analysis

Nigeria's Top Import Partners (2011-2015)



Source: NBS, PwC Analysis

Nigeria-China Trade Balance



Source: UN Comtrade, PwC Analysis

[1] PwC Analysis. GDP (based on IMF World Economic Outlook Estimates) projected to grow by 3%.

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However, with exports to China at 1.62% of total exports in 2015, and 7% of Nigeria's foreign reserves in Renminbi, there is a massive trade imbalance which can only be evened out gradually through value-added diversification, in particular, across the agriculture and services sectors.

For China, the slow pace of domestic growth and over-capacity concerns represent a huge motivation for this agreement. Despite short-term headwinds, Nigeria remains an attractive long-term destination for investments supported by favourable demographics and a massive infrastructure deficit. In addition, this deal marks another step in China's emergence as a global economy in which the Renminbi can be a 'freely usable' currency just like the Dollar.

The Bigger Problems?

Having stated these, PwC's view is that these discussions are useful but serve as no silver bullet in solving Nigeria's challenges:

- First, improving dollar liquidity still remains imperative to unlocking FDI, which Nigeria needs to support diversification and job creation. This will require a more flexible exchange rate.
- Second, Nigeria has to become an easier place to do business. In the 2016 Ease of Doing Business ranking, Nigeria ranks 169th (2015:170th) out of 189 economies surveyed. The obvious policy approach is to create an economic and regulatory environment that is unambiguous, transparent and conducive for business. This means simplifying complex regulation and processes, and eliminating the hurdles that stand in the way of a bigger and more productive private sector.
- Third, trade policies need to be strengthened to encourage import competition by local industries.

In addition, collaboration between Nigeria and China should aim to reduce unemployment and underemployment by ensuring that potentials for knowledge transfer and capacity development are exploited.

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