

Cash Crunch and Macroeconomic Stability: A Scenario-Based Outlook for 2023

February 2023







Setting the Context

Although the currency redesign policy of the Central Bank of Nigeria (CBN) is commendable in terms of its appropriate objectives, its implementation has come as a surprise and has exacerbated the challenges that are currently plaguing the Nigerian economy. The inadequate execution of this policy has intensified the impact of pre-existing shocks from the electoral process and the persistent structural difficulties that the economy faces.

As citizens struggle with confusion surrounding the currency redesign policy, the deadline for compliance was extended to February 10th, 2023. Despite delays caused by the judiciary, on the morning of Thursday, February 16th, 2023, the President issued a proclamation stating that the old N200 banknotes will be reintroduced into circulation and will be accepted as legal tender alongside the new N200, N500, and N1000 banknotes for a period of 60 days from February 10th, 2023 to April 10th, 2023, after which the old N200 notes will no longer be recognised as legal tender.

The measure of immediately phasing out the N1000 and N500 notes, which make up over 88 percent of the total currency in circulation, may appear to be a superficial solution. As a result, the currency shortage will likely persist for an extended period. Furthermore, the impact of the cash scarcity on the economy could be more severe and prolonged than previously anticipated, compounded by social and political unrest, and may alter the growth trajectory for 2023. Therefore, this brief presents a scenario-based outlook of the impact of the cash crunch on the macroeconomic environment and its implications for Nigerians.

Snippet Review on the Currency Policy

The introduction of the currency redesign policy was accompanied by a short deadline, providing citizens with only six (6) weeks from the date (December 15, 2022) of the release of the new notes to discontinue the use of the old N200, N500, and N1,000 notes, which represent 95.6 percent of the total value of the currency in circulation.

The currency redesign policy was introduced to address various issues, including banknote hoarding, currency counterfeiting, insecurity, price instability, financial exclusion, and the promotion of a cashless economy in line with global best practices. However, the poor implementation of the new currency release has exacerbated the economic situation, primarily due to the critical role of cash transactions in economic activities and the lack of preparation by economic actors for the rapid changes.

Consequently, the country has experienced a currency crunch, increased pressure on the banking system and heightened social tensions.



The policy's inability to take effect successfully can be attributed to improper timing, a dominantly large informal sector in the economy, low levels of financial inclusion, ineffective policy coordination, insufficient public sensitisation, and limited stakeholder engagement.*

***For a comprehensive analysis and action points for the currency redesign policy, kindly visit www.nesgroup.org/research**

The Currency Crunch Scenarios



The cash scarcity in Nigeria is expected to exacerbate the macroeconomic instability in the country. The persistent inflationary pressure in the economy may intensify as the economy struggles to access cash and pay premiums to conduct economic activities.

The impact on the economy will be significant, with profound effects on trade and other sectors as business transactions become constricted and rigid. Furthermore, the cash shortage will lead to the halt, if not closure, of more than half of the economic activity in the informal sector, which primarily relies on cash transactions and accounts for approximately 65 percent of Nigeria's Gross Domestic Product (GDP). Additionally, it will further constrain the investment climate and lower the year's investment level.

The cash scarcity will distort the economy's trajectory, highlighting the need to revise and develop scenarios for our macroeconomic outlook and projections. The policy's impact as we advance depends on the CBN's ability to make the new note available and alleviate the cash scarcity effectively.

"With a 65 percent share of the informal sector, which relies on cash, the prolonged cash blackout will disrupt the economy."

Scenario 1: Quickly normalises

In this scenario, the successful implementation of the CBN's plan to provide sufficient cash to ensure liquidity in the economy is crucial. If this is achieved, the economy is expected to return gradually to normalcy, deviating slightly from its projected growth path. The impact of the policy is predicted to ease out by the end of Q1-2023, and the economy will gradually retrace its growth path. According to the scenario-based outlook, the real GDP growth will slightly decline to 2.7 percent in Q1-2023, 2.9 percent in Q2-2023, 2.8 percent in Q3, and 2.6 percent in Q4-2023, respectively. This represents a deviation of 0.23 percentage points from our Macroeconomic Outlook Report for FY'2023 forecast of 2.98 percent, based on quarterly forecasts of 3.0 percent, 3.2 percent, 2.9 percent, and 2.8 percent.

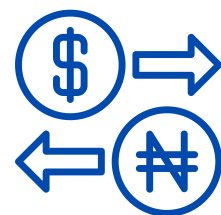
As a result, we anticipate a decline in the real GDP growth for FY'2023 to 2.75 percent from the previously projected 2.98 percent. Furthermore, the average inflation rate is likely to remain elevated and rise to 21 percent, slightly above our initial projection of 20.5 percent. However, we do not expect the official exchange rate depreciation to exceed our initial projection of N500/US\$, as the shortage in money supply is expected to ease the demand for foreign exchange amid a persistent shortage in foreign exchange inflows.



Real GDP Growth
Projection slips slightly
to 2.75% from initial
projection of 2.98%



Average inflation rate
inches up slightly to
21% from initial
projection of 20.5%



Official exchange rate
projection would not
exceed the initial
projection of N500/US\$

Scenario 2: Gets worse slightly

In this scenario, managing the current situation amidst worsening cash scarcity will be crucial. The impact of the policy will deepen the strain on the productive sector throughout the year as economic activities continue to be limited by the cash shortage. The scenario projects a lower real GDP growth of 2.0 percent, 2.2 percent, 2.4 percent, and 2.3 percent in Q1, Q2, Q3, and Q4, respectively. As a result, the FY'2023 real GDP growth is expected to decline to 2.23 percent, representing a deviation of 0.75 percentage points from the earlier projected 2.98 percent.

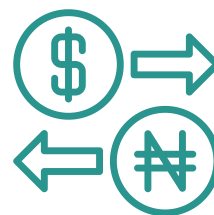
The average inflation rate is also projected to increase to 22 percent as scarcity significantly impacts the supply chain, and low liquidity drives down aggregate output. The official exchange rate is expected to depreciate further to N530/US\$ as the investment climate becomes more uncertain and investors take a cautious stance while seeking safer assets across boarder.



Real GDP Growth
Projection slips to
2.23% from initial
projection of 2.98%



Average inflation rate
trends upward to 22%
from initial projection
of 20.5%



Official exchange rate
depreciates to
N530/US\$ from initial
projection of N500/US\$

Scenario 3: Degenerates

In this scenario, it is assumed that the liquidity shortage will become more severe, amplified by electoral misgivings. As a result, the policy's impact will significantly affect productivity, and economic activities will become disrupted, leading to chaos and tension. In this scenario, the projection for real GDP growth is a sharp decline to 1.8 percent, 2.0 percent, 2.2 percent, and 2.1 percent in Q1, Q2, Q3, and Q4, respectively. Consequently, the FY'2023 real GDP growth will decline to 2.1 percent, representing a deviation of 0.88 percentage points from the earlier projection of 2.98 percent.

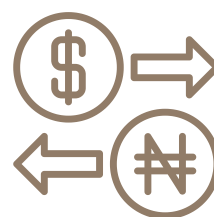
The disruption to productivity will increase the average inflation rate to 24 percent, and the official exchange rate will depreciate to N590/US\$ as capital flight intensifies and investment halts.



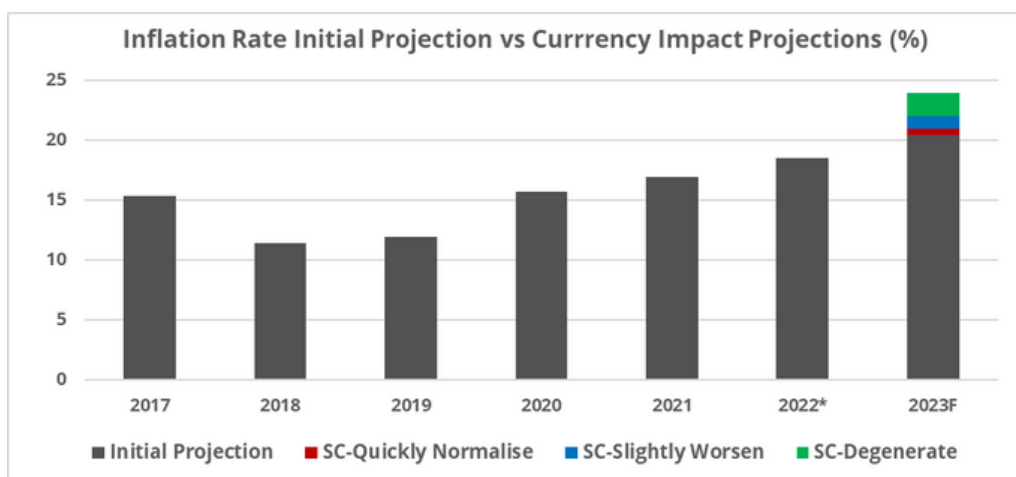
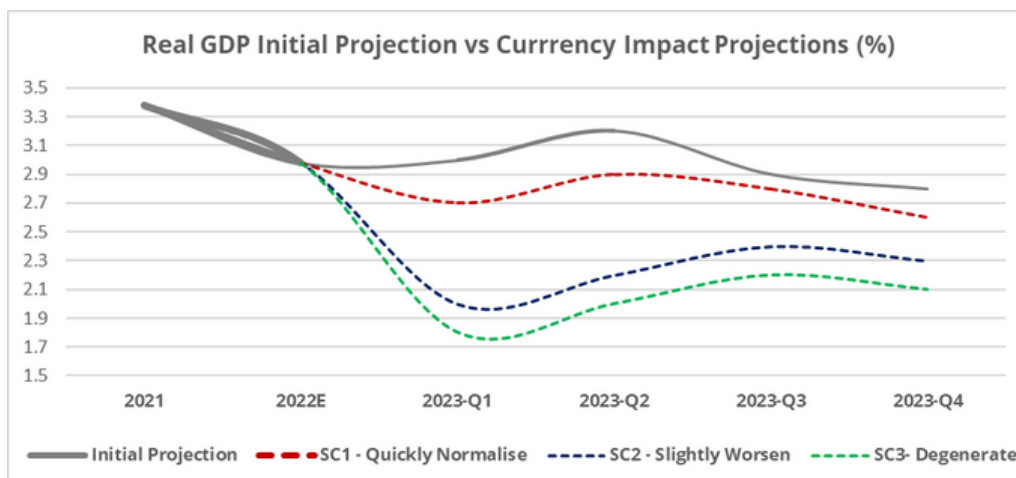
Real GDP Growth
Projection slips slightly
to 2.1% from initial
projection of 2.98%



Average inflation rate
inches up to 24% from
initial projection of
20.5%



Official exchange rate
depreciates to
N590/US\$ from initial
projection of N500/US\$



Conclusion

The cash scarcity associated with the currency redesign policy will likely slow economic growth as many productive activities have been halted due to the inability to access cash. Furthermore, the uncertainty associated with this policy and its economic effects may contribute to volatile movements in macroeconomic variables. Thus, the following socioeconomic outcome would accompany the policy:

Worsening Socioeconomic Condition

The decline in economic activities has implications for GDP and a domino effect on other economic indices. This can mean fewer job opportunities, increasing poverty incidence, thus adversely impacting the collective economic health of the population.

Amplifying Fiscal Constraints

As employment opportunities reduce, consumer spending decreases, resulting in an economic slowdown. This may consequently lead to a decrease in government revenue, primarily from non-oil sources.

Lowering Standard of Living

A lack of employment opportunities could impede access to education and healthcare, leading to a decreased standard of living. People would also have reduced spending power, which in turn would further hamper demand for goods and services. Ultimately, this could result in a population's overall decline in quality of life.

Decimating Social Order

The economic distress caused by low productivity, unemployment and inability to access cash could spur civil disobedience and amplify criminal activities, social unrest and security threats.

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The NESG is an independent, non-partisan, non-sectarian organisation, committed to fostering open and continuous dialogue on Nigeria's economic development. The NESG strives to forge a mutual understanding between leaders of thought to explore, discover and support initiatives to improve Nigeria's economic policies, institutions and management.

Our views and positions on issues are disseminated through electronic and print media, seminars, public lectures, policy dialogues, workshops, specific high-level interactive public-private sessions and special presentations to the executive and legislative arms of government.



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