Article

Another Side of the Coin: Exchange Rate Movements and the Manufacturing Sector in Nigeria

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Abstract

This study estimated the impact of exchange rate (EXCH) movements on the manufacturing sector in Nigeria over the period 1981–2016. Time series data and ordinary least square (OLS) estimation technique were employed in this study to address the specified objective. The variables analysed were EXCH, manufacturing GDP (MGDP), government capital expenditure, foreign direct investment (FDI), credit to private sector and value of imports. From the result, it is apparent that EXCH movements play a significant role in the manufacturing sector's performance in Nigeria. Specifically, the findings showed that EXCH, government capital expenditure (GCEXP), imports and FDI were positively related to MGDP, while credit to private sector was negatively related. Among others, the study recommends that the apex bank keep a closer watch on EXCH developments in order to keep formulating up-to-date policies that will ultimately enhance EXCH stability. This will largely contribute to the development of the manufacturing sector in the short and long run.

JEL Classification: D51, F31, Q24

Keywords: Exchange rate, manufacturing sector, Nigeria

1. Introduction

Manufacturing has over the years proved that its role in achieving economic growth cannot be overemphasised. Hong Kong, Taiwan, South Korea, Singapore, China and even India are glaring examples of nations who have been soaring on the wings of increased manufacturing output for decades with manufactured goods contributing over 80 per cent of both Taiwan and South Korea's foreign exchange

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earnings. China's export goods comprise machinery, textiles, iron and steel, optical and medical equipment as well as almost every single category of industrial products. World Bank estimates revealed that in 2014, China raked in an estimated US$2.3 trillion from the exports of manufactured products, specifically electronic equipment and machinery, whereas the US and Japan raked in US$1.6 trillion and US$684 billion, respectively, from the sales of manufactured capital products. In 2016, India was ranked sixth among the world's 10 largest manufacturing countries in the world by the United Nations Industrial Development Organization (UNIDO) which explains the country's increasing rate of growth and development. An analysis of the 2016 global manufacturing competitiveness index shows that the manufacturing sector creates a clear path towards economic prosperity and has a strong influence on driving global economies. This includes its influence on job creation, infrastructure development and contribution to GDP. Proof of this can be seen clearly in India and China which were formerly among the world's poorest countries but are now considered the fastest growing economies in the world. Hence, these incontrovertible facts have led economists to conclude that the role played by the manufacturing sector cannot be overemphasised.

Nigeria, like other growing economies, recognised the fact that the industrial sector was the heartbeat of modern economic development. Thus, Nigeria established so many policies in order to grow the manufacturing sector. One of such policies was the Structural Adjustment Programme (SAP) which was implemented in July 1986 to correct the low productivity in the real sector as well as revive the economy. It was fundamentally aimed at promoting exports through the complete restructuring of the productive base of the economy. The SAP judiciously combined trade policies and EXCH reforms with the sole aim of increasing the competitiveness of the non-oil sector. Unfortunately, the SAP policy opened the doors of rising EXCH movements as shown in the figure below. Prior to the implementation of the SAP package, EXCH was quite stable and assumed values between 0.71 naira/dollar and 0.89 naira/dollar. However, since 1986, EXCH has continuously moved from 1.75 naira/dollar in 1986 to 101.7 naira/dollar in 2000 to 253.49 naira/dollar in 2016.

Economic theory proposes that rising EXCH values imply that the value of a nation's currency is depreciating consequently, causing the exports of such a nation to become cheaper while its imports become expensive. As expected, Nigeria conformed to a priori and as a result, the prices of imported goods gradually became more expensive than its exports.

This outcome was initially meant to be an industrialisation strategy which was expected to boost productivity and consequently increase export sales and foreign exchange earnings. However, the reverse turned out to be the case. Some economists like Opaluwa, Umeh and Ameh (2010) argued that the rising prices of imports, which was a direct consequence of the deregulation, adversely affected the nation's ability to import. This greatly affected the manufacturing sector because unlike raw materials, some of which could be sourced locally, virtually all industrial machinery and spare parts were imported. This was a result of the lack of engineering industries and the prevailing technological backwardness in the country (Simon-Oke and Aribisala 2010).

As a result of the inability of the SAP policy to achieve all its long-term objectives, various EXCH systems were adopted over the years in a bid to maintain a healthy balance of payment (BOP) as well as foster the necessary economic growth. The substantial transformations in EXCH policies have led to up-and-down movements in EXCH from 1960 till date. Consequently, these movements have generally affected the manufacturing sector's performance, thus preventing the nation from achieving optimum growth and development.

Table 1 shows the average contribution of the manufacturing sector to GDP from 1981 to 2013.

Available evidence seems to suggest that the manufacturing sector's performance over the years has been rather unimpressive. As shown in the table, the manufacturing sector evidently contributed