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EXCHANGE RATE VOLATILITY AND NON-OIL IMPORT TRADE IN NIGERIA: AN EMPIRICAL INVESTIGATION

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ABSTRACT

The study seeks to empirically assess the effect of exchange rate volatility on non-oil importation in Nigeria. The discussion over exchange rate volatility and trade remain ambiguous among researchers, some unveiled positive volatility-trade link while negative to others. The study considered fundamentals: exchange rate volatility, domestic income, terms of trade and index of openness to predict non-oil import. This research employed econometric tools through unit root test, ARDL bound test. ARDL Bound test indicates existence of long run relationship among the variables at 1% level of significance. It further revealed that, in the long run exchange rate volatility and terms of trade are insignificant and negatively determined non-oil import, domestic income and openness have positive and significant impact on non-oil import in Nigeria. While in the short run, the signs remain the same only that terms of trade although negative but significantly determine non-oil import. The error correction term shows that about 49% of disequilibrium is corrected within one year. The study recommends that public authority ought to vehemently enhance import-substitute policies and provision of infrastructural facilities especially power supply and means of transportation.

KEYWORDS
ARDL bound test, exchange rate volatility, non-oil import, GARCH.

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INTRODUCTION

The discussion over volatility-trade link remain ambiguous, consequences of exchange rate volatility on trade have long been at the centre of debate on the optimality of alternative exchange rate regimes. In one hand, the exponents of fixed rates argue that since the advent of the floating regime, exchange rates have been subject to excessive volatility and deviations from equilibrium values have persisted over sustained periods of time. In this regard, exchange rate volatility deters industries from engaging in international trade and compromises progress in trade negotiations. In other hand, proponents of flexible rates argue that exchange rates are mainly driven by fundamentals, and that changes in fundamentals would require similar, but more abrupt movements in fixed parities. Therefore, a system of fixed rates would not reduce unanticipated volatility. Moreover, greater exchange rate flexibility facilitates balance of payments adjustment in response to external shocks, and hence, reduces the need to raise protective tariff barriers or to impose capital controls to achieve equilibrium. (Cote, 1994)

In the recent past, Nigerian naira exchange rate have been rapidly fluctuating, level of agricultural productivity as well as industrial sectors apparently reduced drastically, these associates with less non-oil export with high level of non-oil importation in Nigeria. In the same vein, these incidents may throw Nigerian economy in to doom, this is because Nigeria have been mono-cultural economy, supply primary goods and/or raw materials and importing intermediate and finally produced goods. Therefore, by high volatility in naira exchange rate makes Nigerian currency to be depreciated, paying more and more naira to purchase fewer goods from its trade partners. As a result of this economic menace, the study intends to examine the effect of exchange rate volatility on non-oil importation in Nigeria.

OBJECTIVE

The objective of the study is to measure the effect of exchange rate volatility on non-oil import trade in Nigeria.

EMPIRICAL LITERATURE REVIEW

Using cointegration and vector error correction model (VECM) techniques, Bilquees et al (2010), investigate the impact of exchange rate volatility on export of three South Asian countries: India, Pakistan and Sri Lanka. They discovered that, exchange rate regime and related issues are one of the important yardsticks of the macroeconomic management in striving for economic development through improving the performance of foreign sector.

Theoretically, general appreciation of national currency negatively affects export earnings of country as stated by Hasonov and Ilaha (2010) this theoretical hypothesis is crucial in the case of Azerbaijan due to by one hand increasing appreciation of exchange rate which mainly sourced from huge inflow of oil revenues and by the other hand declining share of non-oil export caused by domination of oil sector in overall economy in recent years. Based on estimation outputs they conclude that real effective exchange rate and real non-oil GDP has statistically significant impact on non-oil export both in the long- and short-run.

Using moving average standard deviation of the percentage change in the real exchange rate as a proxy of exchange rate volatility. Junnan (2010) analyzes the dynamic relationship between real exchange rate volatility and the volume of real export in a small open economy, New Zealand, by employing the error-correction model. The results concerning the effects of exchange rate volatility on real exports suggest that the long-run relationship between New Zealand's real exports and its bilateral real exchange rate volatility is negative and statistically significant, and short-run impact is insignificantly positive.

Bakhromov (2011) described exchange rate may fluctuate quite substantially relative to major currencies, in transition economies, and thus, have a strong impact on country's foreign trade dynamics. This work estimates the effect of exchange rate volatility on the international trade in Uzbekistan during the 1999-2009 period. The empirical findings indicate that, the real exchange rate volatility has a substantial impact on the exports and imports of the country during the above period.

In contrast to most previous works, ARDL approach was found to be an appropriate method to estimate the influence of continuous devaluation on export supply as carried out by Mehere and Edriss (2012) to find the effect of exchange rate variability on export of oil seeds in Ethiopian economy. The result revealed that export of oil seeds has negative relationship with exchange rate variability.

Samimi et al (2012) study the relationship and impacts of uncertainty in currency exchange rate on non-oil exports in Iran. The study covers the years 1978 to 2008. They used cointegration followed by vector error correction model (VECM), the result show that uncertainty in real exchange rate during the period subject of study had negative impacts on exports in Iran. Specifically, fall in exchange rate uncertainty will increase export and vice versa.

Rahutami (2012) examine the impact of exchange rate volatility on real export of ten ASEAN (Association of South East Asian Nation) members on export and import. Panel regression method was used to verify the relationship among variables. The result provides evidence that exchange rate volatility has no statistically significant on the export and import of ASEAN member states (AMSs).

Lewis (2012) discovered that, U.S. imports and exports respond little to exchange rate changes in the short run. Further says that, pricing behaviour has long been thought central to explaining this response: if local prices do not respond to exchange rates, neither will trade flows.

Nuroglu and Kunst (2012) analysed the effects of exchange rate volatility on international trade flows by utilising two different approaches, the panel data analysis and fuzzy logic, the estimated result is clearly negative. Both approaches provide very similar results and fuzzy approach is recommended to be used as a complement to statistical methods.

Calio and Bas (2012) discovered the impact of exchange rate volatility on international trade is small for industrialized countries, especially since the late 1980s.

Dickson (2012) evaluate the effect of exchange rate volatility on economic growth in Nigeria on the basis of annual data from 1970 to 2009. His findings show that in the short run, economic growth is positive responsive to exchange rate volatility, while in the long run a negative relationship persist between the two variables.

In line with above although different objectives but same methodology, Dickson and Andrew (2013), investigate the hypothesis that exchange rate risk affect international trade. Theoretically and empirically, the results are mix and inconclusive. The result revealed that exchange rate volatility is insignificant in explaining variations in import but significant and positive for export.

Cetin and karakaya (2013) examine the impact of real exchange rate volatility on the demand for electrical export, which is second largest sub-sector of machinery in Turkey through multivariate cointegration and error correction models. Their estimated result suggest that real exchange rate exerts a negative and significant impact on electrical export both in long and short run, while its volatility has only a positive and significant impact in the long run.

Adeniran et al (2014) found that exchange rate has positive impact on economic growth but not significant.

GARCH-based exchange rate volatilities and the least-squares dummy variable technique with fixed-effects estimation to measure the volatility impact on trade with reference to Pakistan's trading partners was used by Abduljalil et al (2014). They evaluate a series of exchange rates from 1970 to 2009 to compare the long run impact of volatility with that of the short run. The results indicate that, when Pakistan employed the US dollar as currency with its trading partners, volatility discouraged both imports and exports (international trade).

Danladi et al (2015) discovered that volatile exchange rate makes international trade and investment decisions more difficult, because volatility increases exchange rate risk. In their effort to evaluate the impact of exchange rate volatility on international trade in Nigeria on the basis of annual data from 1980 to 2013, it was observed from ECM analysis that exchange rate volatility negatively affects international trade.

Using a vector error correction model on time series annual data from 1971 to 2012 by Odili (2015) examined the long-run and short-run impacts of real exchange rate volatility and the level of economic growth on international trade in Nigeria. The empirical findings revealed that in both short-run and long-run, exports and imports were chiefly influenced by free determine variables. The findings further indicate that, exchange rate volatility reduce exports and imports in the long-run.

Almohaisen (2015) investigates the Exchange Rate volatility effects on Jordanian International Trade from 1997Q1 to 2013Q2. Empirical findings revealed that, there is negative effects of real exchange rate volatility on imports and exports of Jordanian economy and a positive effect on real GDP.

RESEARCH METHODOLOGY

The study employed Autoregressive Distributed Lag (ARDL) model in assessing the effect of exchange rate volatility on non-oil trade in Nigeria. This is in line with methodology used by Mehere and Edriss (2012). Using the sample of 33 years starting from 1981 to 2013, the variation in non-oil import assumed to be explained by exchange rate volatility, domestic income (gross domestic product as a proxy), and Nigeria's terms of trade and index of openness. The methodology begins with checking the stochastic process of the data series using augmented dickey-fuller and Phillips-perron tests. The former uses parametric while the later uses non-parametric statistical method, idea behind this is phillips-perron account for serial correlation in the disturbance term, without necessary adding lagged difference terms.

MODEL SPECIFICATION

As stated earlier, exchange rate volatility, domestic income, terms of trade and index of openness were taking as a fundamental to determine non-oil import in Nigeria, in essence we are interested in this relationship:

IMP = f (EXC, DI, TOT, OPN) (1)

For the purpose of this study, we want to measure whether long run relationship persist among these non-stationary variables, in its basic form, ARDL model can be specified as:

$$\Delta Y_t = \alpha_0 + \sum_{i=1}^{p} \beta_i \Delta Y_{t-1} + \sum_{i=1}^{q} \gamma_i \Delta X_{t-1} + \delta Z_{t-1} + E_t \quad (2)$$

Y_t = the value of dependent variable

Y_{t-1} = the lagged value of the dependent variable Y

X_{t-1} = the lagged value of independent variable X

Z_t = first lag of the independent variables in relation to long run elasticity

E_t = the error term which assumed to be serially independent and homoscedastic α_0, β_i, γ_i, δ are the coefficient

The only co-integration and error correction method that allows some of the variable to be stationary I(0) and non-stationary I(1) is ARDL Bound test approach advocated by Pesaran et al (2001).

For the purpose of this study, all variables are converted into log, so that to analyse the rate of changes in the regressors, reduce the level of serially correlated that may happen in the error term as well as the Heteroscedasticity. To estimate the long run relationship among the variables, equation three below is considered:

$$\ln IMP = \alpha_0 + \beta_1 \ln EXC + \beta_2 \ln DI + \beta_3 \ln TOT + \beta_4 \ln OPN \quad (3)$$

ARDL approach considers two things. First, examine if there is long run relationship among the non-stationary series (in variable under investigation). Second, estimate the coefficient of the long run relationship and the error correction model.

FINDINGS AND DISCUSSION

This section involves the presentation of all results found in this work. While using time series data it's necessary to check whether the series is white noise. In other words, it's very vital to check time series data to whether it's stationary or not. To this end, this section will start by presentation of stationarity test using Augmented Dickey-Fuller (ADF) and Phillips-Perron (PP) unit root test. The table 1 below summarises ADF tests:

TABLE 1: AUGMENTED DICKEY-FULLER TEST

Variables	Level		First difference		order
	Intercept	Trend & int	Intercept	Trend & int	
LNIMP	-0.52	-2.34	-6.98*	-6.85*	I(1)
LNEXC	-1.94	-0.91	-4.80*	-5.25*	I(1)
LNDI	-0.77	-1.13	-4.97*	-4.13**	I(1)
LNTOT	-1.26	-2.12	-4.61*	-5.44*	I(1)
LNOPN	-1.52	-3.45***	-7.97*	-7.84*	I(0)

Source: author's computation using e-views 9, *, ** and *** denote rejection of null hypothesis at 1%, 5% and 10% level respectively.

From the stationarity test above, all the series were non-stationary except index of openness (lnopn) which become stationary I(0) at 10% level of significant. Other data become stationary after taking the first difference I(1) at 1% level of significant.

In other hand, the series were rechecked using Phillips-Perron test, the summery of the results is presented in the table 2 below:

TABLE 2: PHILLIPS-PERRON TEST

Variables	Level		First difference		Order
	Intercept	Trend & intercept	Intercept	Trend & intercept	
LNIMP	-0.35	-2.49	-6.95*	-6.86*	I(1)
LNEXC	-2.09	-0.88	-4.80*	-6.09*	I(1)
LNDI	-0.76	-1.26	-4.94*	-4.96*	I(1)
LNTOT	-1.31	-2.74	-5.43*	-10.02*	I(1)
LNOPN	-1.34	-3.64**	-7.97*	-8.01*	I(0)

Source: author's computation using e-views 9 NOTE: * and ** denote rejection of null hypothesis at 1% and 5% level respectively.

The result is almost similar to ADF, where all series were not stationary except lnopn which become stationary at 5% level of significant. Other variables become white noise after taking the first difference. Here, we have mixture of both stationary and non-stationary data, and the only cointegration test that permit or allow such combination of data is the ARDL/Bound test. This test will help us to analyse whether a long run equilibrium persist among the variables in the model. In other words, ARDL approach infers whether there is long run association among these non-stationary series. Therefore, ARDL/Bound test can be presented in table 3 below:

TABLE 3: BOUND TEST

F-statistics	Critical bound values		significance
	I(0) bound	I(1) bound	
5.438094	2.45	3.52	10%
	2.86	4.01	5%
	3.25	4.49	2.5%
	3.74	5.06	1%

Source: author's computation using e-views 9

Table above indicates the existence of long run relationship among the variables. The criterion is that; f-statistics is at the extreme right of the critical upper bound at each level. Therefore, accept that long run relationship exists among the variable at 1% level of significant. In other words, f-statistics exceeds upper bound limit of the critical values at all level, which is clear indication of rejection of null hypothesis.

Since we accept persistence of long run relationship among fundamentals, next is to estimate the long run coefficients and error correction model. Simply, we can estimate long run and short run coefficients. Table 4 below present long run coefficient:

TABLE 4: LONG RUN COEFFICIENTS

Variables	coefficients	probabilities
LNEXC	-0.023070	0.8447
LNDI	0.893350*	0.0000
LNTOT	-0.119561	0.4113
LNOPN	1.482524*	0.0005
C	0.944531	0.3979

Source: author's computation using e-views 9 NOTE: * denote rejection of null hypothesis at 5% level.

From the table above, exchange rate volatility found to be negatively insignificant, a unit change in exchange rate volatility implies reduction in non-oil import by 0.023. Domestic income was positive and statistically significant; a unit change in domestic income causes non-oil import to increase by 0.89. Also in the long run terms of trade although negative but statistically insignificant, a unit change in terms of trade may decrease non-oil import up to 0.12. Finally, the index of openness which theoretically assumed positive relationship with import, in line with this claim, this empirical work verified the statement by estimating openness as positively significant in relation to non-oil import, a unit change in openness increase non–oil import by 1.48. Based on the above result, the normalized equation can be presented below:

LNIMP=0.945-0.023*LNEXC+0.893* LNDI -0.120*LNTOT+1.483*LNOPN

Having estimating long run coefficients, the best thing is to estimate the short run behaviour of the variables. This is to say, we can now estimate the short run coefficient and their speed of adjustment towards equilibrium or simply the error correction term. Table 5 below present the cointegrating coefficients:

TABLE 5: SHORT RUN COEFFICIENTS

Variables	Coefficients	probabilities
D(LNEXC)	-0.169452	0.0554
D(LNDI)	1.047783*	0.0000
D(LNTOT)	-0.446256*	0.0008
D(LNOPN)	1.024994*	0.0000
Cointeg(-1) or Z(-1)	-0.494394	0.0028

Source: author's computation using e-views 9NOTE: * denote rejection of null hypothesis at 5% level.

From the short run variable relationship above, exchange rate volatility was found negative and insignificant, a unit change in the volatility of exchange rate may cause about 0.17 decreases in non-oil import. This implies that, in accordance with demand theory, consumer reduces purchasing imported products as the price increase. This is to say that, high volatile in naira exchange rate makes price imported commodities to rise, it's then expected that, demand of domestic currency (naira) will fall and consequently reduce non-oil import.

Domestic income was found positive and statistically significant in explaining the variation in non-oil import, a unit change in domestic income will makes non-oil import to increase by 0.05. This robust relationship implies that, as there is too much naira in circulating, non-oil import tends to increase. That is people purchase more of non-oil imported commodities.

In the short run terms of trade was found to be significant and negative. This inverse relationship of terms of trade to non-oil import is apparently in line with its definition. Increase in terms of trade indicates fall in imports. As empirically found in this work, a unit change in terms of trade decreases non-oil import with about 0.45, therefore, any unit change in terms of trade will decrease non-oil import in Nigeria.

As a ratio of summation of trade to GDP, openness is expected to positively related with import. The result above indicates that, openness is positively related with non-oil import and statistically significant, a unit change in openness will bring about 1.02 increases in dependent variable.

Error correction term was negative and statistically significant. The negative and significant value of error correction term (ECT) or speed of adjustment, that is -0.494394(0.0028), further confirm the presence of long run relationship among variables. ECT indicates that, about 49% corrections towards long run equilibrium is corrected within the period of one year, within two years is expected to be near its initial equilibrium. R-squared value shows 99% variation of dependent variables is explained by explanatory variables. F-statistics and its probability indicate overall significance of the model i.e 1168.398(0.000000). Also Durbin-Watson (DW) statistics values shows that the model is free from serial correlation, that is the model is serially independent with value approximately to two (1.687).

RESIDUAL DIAGNOSTIC AND STABILITY TESTS

To ensure the robustness of the model used, some certain residual criteria are expected, such that different diseases which might misleadthe result and ends up wrong interpretation and conclusion. These diseases can be examined through; breusch-pagan-Godfrey test for heteroscedasticity, Breusch-Godfrey LM test for autocorrelation, Ramsey RESET test and Jarque-Bera normality test. These tests can be presented in the table 1.6 below:

TABLE 6: RESIDUAL DIAGNOSTICS AND STABILITY TESTS

Test	Null hypothesis (H_0)	F-statistics	Probabilities
Breusch-pagan-Godfrey heteroscedasticity test	Constant variance	0.313834	0.9869
Breusch-Godfrey LM test for autocerrelation	No serial correlation	0.284670	0.6051
Jarque-Bera normality test	Normally distributed	3.449238	0.1782
Ramsey RESET stability test	Model has no omitted variables	0.235605	0.6333

Source: author's computation using e-views 9

The table above clearly indicates the acceptance of null hypothesis at each test. That is to say the series is free from serial correlation, has constant variance and the residuals are normally distributed. Also the Ramsey RESET test indicates no variable excluded or omitted from the model. Therefore, these further indicate the significance of the model.

CONCLUSION

The purpose of this study is to estimate how exchange rate fluctuations affects non-oil import trade in Nigeria. Unit root test was conducted using Augmented Dickey-Fuller and Phillips- Perron tests, it revealed the evidence of stationarity at level for one variable while for others at first difference. To estimate the nature of such relationship only ARDL Bound test advocated by Pasaran and Shin (2001) allow the mixture of stationary and nonstationary data. The result shows the persistence of long run relationship among the variables at 1% level of significance. The estimated coefficients indicate that exchange rate volatility negatively affects non-oil import, but its effect is insignificant in both short run and long run. This perhaps due to Nigerian economy largely depends on import. Theoretically, high demand of foreign currency depreciates domestic one, therefore, Nigerian naira value falls drastically, this indicate paying more naira to purchase few goods from its trading partners. Though, the prices of imported commodities are increasing, the economy may find it difficult to cut down large volume of its importation, this makes the effect of exchange rate volatility although negative but insignificant to affects non-oil import trade in Nigeria. The empirical findings indicate that the model is significant, and the same in line with the theory. The study suggests that, public authority ought to vehemently enhance the policies for import-substitute commodities production; this will drastically reduce the level of naira demand for non-oil import. Strict import duties should be imposd, which may raise the revenue of the government and at the same time serves as import barriers.

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