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An Analysis of The Determinants of Current Account in Nigeria (1981-2022)

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Abstract

This paper investigated the determinants of current account in Nigeria. Auto Regressive Distributed Lag (ARDL) approach was used to analyse annual time series data from 1981 to 2022. The findings showed that age dependency ratio, real effective exchange rate, broad money supply, interest lending rate and gross domestic product annual growth rate were the main determinants of current account in the long run. Gross domestic product and broad money supply are positive determinants of current account in the short run but investment with age dependency ratio as negative determinants of current account in the short. The short run result indicates that any disequilibrium in the model is corrected at -216% adjustment speed annually implying that the system will adjust farther from the equilibrium than back to it, a worsening of the error in future. The diagnostic result suggests that the explanatory variables account for 98% of the variations in determining the current account. Thus, the government should work on policies that will encourage savings and domestic investment, provide job opportunities for the growing dependent populace as well as efficient monetary policies that will improve and sustain the current account.

1. Introduction

Achievement of internal and external economic balance is one primary objective that governments strive to achieve (Gureech 2014). The persistence of internal and external imbalance over the years has become a global concern as every economy whether developed or developing, is confronted by it. The impact of the external balance can transcend to various sectors of the economy which is the reason why the analysis of current account determination has gained significant attention from researchers. Stojkov & Warin (2016) and Beirne et al. (2020) stated that there has been a persistent current account deficit witnessed in most developed and developing countries in the last two decades. As an important indicator of a country's economic performance, the current account

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portrays vital information on a country's economic activities; it covers all transactions in goods, services, income flows and current transfers between the domestic economy and the rest of the world as well as provides information on the competitiveness of an economy (Tarawalie and Marah, 2022).

In addition, Raiz et al (2019) asserted that one significant area that economists, policymakers, and stakeholders closely monitor is the current account. Often referred to as the gap between imports and exports, it is seen as a key marker of an economy's macroeconomic health which also influences expectations and economic decisions. It consists of net cash transfers, balance trade ties, and net factor income, also known as primary income, which is the difference between payments made to foreign investors and receipts on foreign investments (Ogunniyi et al., 2018). Considering that a country's current account shows the state of its overall foreign profits and spending as a percentage of gross domestic products (GDP), is a major economic variable that provides a good idea of economic activity and is likewise considered by investors and the global market when making investment decisions (Nigeria's Cash Flow Builds to Tackle Foreign Exchange Backlog, 2023).

Nigeria's current account has experienced frequent and sometimes undesirable swings. For example, Nigeria's current account has been both positive and negative throughout the early 1970s oil boom and the oil price increase of 2000 and 2007, the global recession of 2008/2009 has also been attributed to the current account fluctuations (Uneze and Ekor, 2012). In the same vein, Nigeria has experienced fluctuations in its current account over the years and this has posed a significant challenge to the nation's policy framework; the fluctuations in the current account have reached an unviable stage and have become a binding constraint in the realization of the government's growth and development objectives (Diallo, 2020). Such fluctuations can be attributed to poor non-oil export performance coupled with the drastic declines in oil prices of the 1980s and 1990s, global recessions in 1981–1982 and 1991–1992, the economic recession of 2007 and 2008, high import bills, stagnated agricultural sector, high taste for foreign goods and services, continuous fall in the country's foreign exchange, inflationary pressure, inefficient manufacturing sector and mishandling of the oil boom revenues among others (Imoisi, 2012).

Similarly, the recession and the depreciation of the Naira to the dollar, and the deterioration of the fiscal and external balances in Nigeria had its effect on the current account fluctuations (Ogunniyi et al., 2018). A relative improvement in oil exports led the current account to a small surplus of 0.1% of GDP in 2022, reversing three years of deficit (African Development Bank, 2022). Additionally, previous years such as 2017, had a surplus of US$13.56 billion higher than 2016 which was largely attributed to the decrease in imports and payments on net income. A decline of US$7.28 billion was also experienced in 2018, deficits of US$-13.69 billion, US$ -15.99 billion, and US$-3.25 billion were also recorded in 2019, 2020, and 2021 respectively (World Bank Open Data, 2022).

A significant and ongoing current account deficit can lead to a country's declining international reserves, growing external debt, economic and currency crises, and decreased competitiveness in

the world market (Uneze and Ekor, 2012). Reasons have been provided in both theoretical and empirical literature on the relevance of investigating the determinants of current account. One such reason is that a nation's current account shows how resource-conservative a country is and how competitive its economy is on a global scale. Additionally, it assists in predicting risks to macroeconomic stability and guides foreign investors when they make investments, both of which are essential for economic growth and development (Deistaings et. al., 2013). Since it reflects a nation's overall prospects, the state of a country's current account and the factors that influence it have significant effects on investment and capital flows, exchange rate competitiveness, and macroeconomic stability (Chete, 2001). It is vital in illustrating the scope and movement of borrowing. A Study on factors influencing the current account will not only provide an insight into its determinants but also its sustainability as well as indicate the levels of current accounts that may be considered normal for a country (Chinn & Prasad, 2003).

Based on the above, this paper seeks to find out the key determinants of the current account in Nigeria.

The paper is structured as follows: Section 2 has the trend of current account in Nigeria. Section 3 covers the theoretical, methodological and empirical literature pertaining to current account determination. Section 4 consist of the theoretical framework and the methodology, while section 5 contains the estimation and interpretations of the results of the model with conclusions and recommendations for policy complete the final section.

2. Literature Reviews

2.1 Theoretical Underpinnings to Current Account Determination

A variety of theoretical models have been used to explain the determinants of the current account each having different economic policy implications. Analysis of current account fluctuations and their adjustment was based either on the elasticity approach, the absorption approach, and the intertemporal approach being a more recent approach.

The elasticity approach is one of the foremost models that play a crucial role in understanding the dynamics of current account. It refers to the degree of responsiveness of demand or supply to changes in price. In terms of current account, it analyses how changes in domestic and foreign incomes, as well as changes in the exchange rate, can impact the current account of a country. Absorption Approach has its base on the criticism of elasticity approach by Alexander (1952) as a partial equilibrium analysis. The approach focuses on the relationship between national income, domestic spending and current account, it explains how a country’s current account is being determined by the difference between its national income (Y) and its total domestic absorption (A) which includes consumption, investment and government spending. If a country’s domestic absorption (A) exceeds its national income (Y), such a country will run a current account deficit because it will have to borrow from abroad to finance its excess spending of deficit. Conversely, if national income exceeds domestic absorption, the current account will be in surplus and such a country can even lend its excess surplus to the rest of the world. Intertemporal Approach on the

other hand, views the current account as the outcome of dynamic optimization decisions made by consumers and firms over time. The core idea is that a country's current account reflects its intertemporal budget constraints, the need to finance any excess of domestic investment over domestic saving by borrowing from abroad with emphasis of fluctuations in the current account as arising from forward-looking decisions about consumption, investment, and government spending over time. The intertemporal approach, is founded on the basis of utility maximizing decisions by economic agents, it provides a better way to judge sustainability of the deficits as large deficits according to the intertemporal approach can be optimal and sustainable and therefore not a cause of concern for policymakers.

2.2 Empirical Review of Literature

Evidence from past studies indicates that there are conflicting results on the variables that determines the current account.

Following studies from developed and developing countries, Atoyan et al. (2013) confirms the main determinants of the Current account balance in Italy, Spain, Greece, and Ireland to be cyclical factors: a large capital inflow, high credit activity, and low unemployment. The estimated coefficients with these variables are statistically significant and had expected signs: large capital inflows, high annual credit growth, and low employment are factors that affected the Current account deficit while openness to trade was not statistically significant in explaining fluctuations of the Current account balance in these countries. Jonida and Ibrahimaj (2015) Used A panel Vector Auto regression (VAR) model with fixed effects over the period Q1 2005 to Q42014 their findings show that fiscal deficit worsening is likely to be accompanied with current account deterioration, the study also confirms the validity of the twin deficit hypothesis in the region. It also shows that the fiscal deficit is an important variable affecting the current account dynamics. Özdamar (2015) investigated which factors and to what extent affect the current account balance in terms of economic policy decisions in Turkish economy with Johansen co-integration test and with co-integrating regression analysis of a Fully Modified Ordinary Least Squares (FMOLS), Canonical Co-integrating Regression (CCR) and Dynamic Ordinary Least Squares (DOLS) for the 1994-2014 period. Findings show that foreign trade balance is a strong explanatory variable of the current account balance; terms of trade and gross domestic product also have statistically significant effects on the current balance the study also reveal that domestic interest rates and real effective exchange rate affects Turkey's current account balance as expected but these variables are found to be insignificant. Das (2016) investigated the determinants of current account imbalance for the large sample of developed, emerging and developing countries during 1980–2011. Using dynamic panel GMM techniques, findings show that current account balance is positively correlated with net foreign assets, trade openness and exchange rate stability and negatively associated with commodity price, real GDP growth and real effective exchange rate for the developed countries. While, among emerging countries, commodity price, real GDP growth, trade openness and de jure capital openness are positively correlated with net foreign asset, exchange rate stability index is negatively related to current account balance.

In the Context of Nigeria, Oseni and Onakoya (2013) examined the effects of fiscal policy shocks on the current account as well as the dynamic interactions among fiscal policy shocks and current account with the other macroeconomic variables: real output, real interest rate and exchange rate for Nigeria, findings show that the expansionary fiscal policy shock has a positive effect on output, exchange rate and negative impacts on current account balance and interest rate. Longe et al (2018) conducted a study to investigate the relationship between oil price fluctuations and the current account balances in Nigeria, Autoregressive Distributed Lag (ARDL) model was used to estimate the short-run and long-run relationship between the current account and oil price fluctuations. It was confirmed that in the short-run, the oil price had a positive but insignificant impact on the current account balances, while in the long-run, it impacted negatively, but was found to be a significant determinant of current account balances in the economy. Other variables such as population growth, gross domestic product and trade had insignificant relationship with the current account balances in the short-run, while in the long-run, only gross domestic product and oil price were found to be significant determinants of the current account balances in the economy. Bosede and Olomola (2019) investigated the impact of external shocks to oil price, exchange rate and terms of trade on the fluctuations in current account balance, they found a negative and significant impact of external shocks on the current account fluctuations in Nigeria in the long run. Akalpler and Panshak (2019) studied the dynamic relationship between budget deficit and current account deficit in Nigeria. The study concludes that the source of the country's current account deficit problems could be traced to the mounting fiscal imbalances output fluctuations and an investment crowding out effect having major impact on budget balance and current account. These findings suggest that the current account determinants explain different characteristics in terms of a country's economic peculiarities.

3. Theoretical Framework and Model Specification

The theoretical framework underpinning this study is the intertemporal approach to current account determination which specifies a country's current account as the difference between total savings and total investment expenditure, its determinants must be found among the factors that may cause saving and investment within a country to differ in any period. Following the work of Oshota and Adeleke (2015), the study attempts to empirically test some of the determinants of the current account in Nigeria based on the saving-investment paradigm, also in line with the intertemporal approach as a benchmark to define the factors that affect the current account. Starting with the accounting identity of the current account (CA) which equals the difference between domestic saving (S) and investment (I);

The national income equation is specified as:

$$Y = C + I + G + X - M \quad (4.1)$$

Where Y is national Income, C is consumption, G is government expenditure, X is export and M is imports respectively.

Given Gross Domestic Savings to be S = C + I + G, equation (1) becomes

$$CA = X - M = S - I \quad (4.2)$$

Based on the intertemporal approach the study will focus on pattern of domestic savings and domestic investment and basic identity is specified as:

$$CA = S - I \quad (4.3)$$

To account for heteroskedasticity (a situation where the standard deviations of a predicted variable monitored over different values of an independent variable are not constant) that usually plaque the estimation of nominal variable equation, all variables are expressed as ratios of GDP (Y):

$$\frac{CA}{Y} = \frac{S}{Y} - \frac{I}{Y} \quad (4.4)$$

Specifying domestic saving to GDP ratio (S/Y) as a function of different economic variables, including GDP per capita, the real effective exchange rate and the ratio of domestic investment to GDP (I/Y). Often times, domestic investment plans by private agents affects private saving ratios to the extent that they are financed domestically, the basic saving specification is specified as thus:

$$\frac{S}{Y} = f\left(GDPGR, REER, \frac{I}{Y}\right) \quad (4.5)$$

Adding to the basic specification above, the following financial and demographic factors are considered to explain the domestic saving rate in Nigeria: (i) interest lending rate (ILR) (ii) broad money supply (M2) and (iii) Age dependency ratio (ADR). The domestic saving specification is specified as:

$$\frac{S}{Y} = f\left(GDPGR, REER, \frac{I}{Y}, ILR, M2, ADR\right) \quad (4.6)$$

GDP per capita (GDPPC) is an important factor in determining the current account and it characterizes an economy's stage of development. Anticipation a higher income in the future, triggers consumers in developing economies take on debt in order to smooth their long-term consumption. Besides the consumption smoothing, the comparatively high capital productivity provides an important explanation for a country's current account deficits especially for developing countries. However, by considering fixed investment, this component will explicitly be taken into account. Therefore the estimated influence of GDP per capita reflects consumption effects. Now, by substituting equation (4.6) into accounting identity of current account yields:

$$\frac{CA}{Y} = f\left(GDPGR, REER, ILR, M2, ADR\right)\frac{I}{Y} \quad (4.7)$$

Domestic investment is taken into the equation both as determining factor of saving, as well as an autonomous variable influencing directly the current account. A linear representation of equation (4.5) can be written as:

$$\frac{S}{Y} = \beta_0 + \beta_1 GDPGR - \beta_2 REER + (\beta_3 - 1)\frac{I}{Y} + \beta_4 IR + \beta_5 M2 + \beta_6 ADR \quad (4.8)$$

Where ($\beta_3 - 1$) = 0 and fixed domestic investment is assumed to be completely financed by domestic savings according to the Feldstein-Horioka hypothesis.

In line with the above analysis, the study will estimate a model expressed in the following general form:

$$CA = \beta_0 + \beta_1 GDPPC + \beta_2 REER + \beta_3 INV + \beta_4 ILR + \beta_5 M2 + \beta_6 ADR + \mu \quad (4.9)$$

4. Estimation Technique and Sources of data

4.1 Estimation Techniques

In order to investigate the determinants of current account in Nigeria and to ascertain the magnitude of impact among the variables under consideration, the study applied Autoregressive Distributed Lag (ADRL) method or bounds testing approach developed by Pesaran and Pesara (1997). The ARDL approach is a dynamic heterogeneous model, which provides the framework for the variables in the model to be lagged and difference. The ARDL model is also applicable in situations where the variables are of I(0) and I(1). The approach also combines the auto-regressive and distributed lag components and assumes that the dependent variable is influenced by both its own past values and past values of the independent variables and it's represented as thus:

$$Y_t = c + \phi_1 y_{t-1} + \ldots + \phi_p y_{t-p} + \beta_1 X_{t-1} + \ldots + \beta_n X_{t-n} + \varepsilon_t$$

4.2 Sources of Data

The study will use annual time series data to analyse current account determinants for Nigeria. Data for the Variables will be sourced from World Development Indicators (WDI).

5. Results

5.1 Unit Roots Test

Table 6.1 Unit root/Stationarity tests (with intercept and Trends)

Variables	*At Level*	*Prob. (5%)*	*1st Difference*	*Prob. (5%)*	*Order*
CA	-3.523623	0.2764	-3.526609	0.0001	I(1)
GDPGR	-3.526609	0.1783	-3.526609	0.0000	I(1)
REER	-3.523623	0.5601	-3.526609	0.0061	I(1)
INV	-3.523623	0.0006	-	-	I(0)
ILR	-3.523623	0.2452	-3.529758	0.0000	I(1)
M2	-3.526609	0.1692	-3.526609	0.0007	I(1)
ADR	-3.557759	0.9843	-3.562882	0.0001	I(1)

***Source: Authors' Computation* (2024)**

The results for the Augmented Dickey Fuller (ADF) statistics show that variables CA, GDPPC, REER, ILR, M2, and ADR achieved stationarity at first difference while INV achieved stationarity at level The result suggest that the series are integrated of order one I(1) and at level, I(0).

5.2 Cointegration Test (Bound Test)

A bound testing for cointegration is being carried out to ascertain the existence of long run relationship amongst the variables, using a lag length of 2 based on the Akaike Information Criterion (AIC). The rationale for the ARDL bound testing approach is to test the null and alternative hypothesis using the F-statistics against the Pesaran values. Thus, if the result of the F-statistics is larger than the upper critical bound values at the 5% level of significance, then we reject the null hypothesis of no cointegration, and confirms the existence of cointegration amongst the variables and vice versa. The F-statistic and critical bounds test values for testing the null of no cointegrating relationship are reported in Table 5.2. The result shows that the F-statistics of 3.600 is greater than the upper and lower bound values at 5% level of significance which confirms the existence of long run relationship among the variables.

Table 5.2 Cointegration (Bounds Test) Result

Test Statistics	*Value*	*Significance*	*I(0)*	*I(1)*
F-Statistic	3.60	10%	1.99	2.94
K	6	5%	2.27	3.28
		1%	2.88	3.99
Sample: n=40				

Source: Author's Computation

5.3 Long Run Analysis

Table 5.3 Long Run Result

Variables	**Coefficient**	**Std. Error**	**t-Statistic**	**P-value**
C	77.78481	19.03816	4.085731	0.0095
ADR	-0.600613	0.157262	-3.819192	0.0124
REER				
M2	-0.017347	0.006525	-2.658506	0.0450
INV	-0.788011	0.210219	-3.748514	0.0133
ILR	0.006627	0.073883	0.089701	0.9320
GDPGR	-2.093746	0.509705	-4.107762	0.0093
	0.557316	0.161562	3.449553	0.0182

***Source: Authors' Computation* (2024)**

From table 5.3 above, findings show that age dependency ratio (ADR), real effective exchange rate (REER), broad money supply (M2), interest lending rate (ILR) and gross domestic product growth rate (GDPGR) are the main long run determinants of current account in Nigeria with

interest lending rate being the main determinant having a higher negative coefficient than the others. The result reveals that age dependency ratio is a negative determinant of current account. Intuitively, a percentage point increase in age dependency ratio leads to a -0.60 percentage point decrease in current account, real effective exchange rate is a negative determinant of current account which implies that an appreciation of the domestic currency will lead to a -0.01 percent decrease in the current account, in the same vein, broad money supply is also a negative determinant of current account such that increase in broad money supply will lead to a -0.78 percent decrease in the current account, interest lending rate is also a negative determinant of current account implying that increase in interest lending rate will lead to a -2.09 percent decrease in current account while gross domestic product annual growth rate is a positive determinant of current account having a coefficient of 0.55 implying that an increase in GDP annual growth rate will lead to a 0.55 percent increase in the current account in the long run.

5.4 Short Run Analysis

Table 6.4 Short Run Result (4, 3, 4, 4, 4, 3, 4)

Variables	*Coefficients*	*Std. Error*	*t-Statistic*	*P-value*
GDPGR	**0.434**	**0.0604**	**7.1961**	**0.0008**
ILR	**-0.309**	**0.1857**	**-1.6643**	**0.1569**
INV	**-0.058**	**0.0662**	**0.0188**	**0.0270**
M2	**0.431**	**0.1037**	**4.1548**	**0.0089**
REER	**0.001**	**0.0046**	**0.3284**	**0.7559**
ADR	**-1.420**	**0.3555**	**-3.9967**	**0.0104**
CointEq.	**-2.116**	**0.1967**	**-10.7546**	**0.0001**
R-squared	**0.9807**			
Adjusted R squared	**0.9405**			
F-Statistic	**12.49183**			
Prob. (F-Statistic)	**0.005125**			
Durbin-Watson Stat.	**1.540244**			

Source: Author's Computation

The result of the short run ARDL model presented in Table 5.4 suggests that the error correction term is negative and statistically significant, which further reinforces the existence of a long-run relation among the variables. The result indicates that for every 1% deviation from equilibrium, the model adjust by -216.6 % speed annually, which depicts a high speed of adjustment. The finding also shows that, the coefficient of gross domestic product growth rate and broad money supply is positive and statistically significant which suggest a positive determinant of current account in the short run while the coefficient of investment and age dependency ratio is negative and statistically significant suggesting a negative determinant of current account in the short run. The diagnostic result suggests that 98% of the variations in current account is explained by the

explanatory variables, while the Durbin Watson value of 1.54 indicates the absence of any first-order serial correlation.

6. Conclusion and Recommendations

The persistence of global current account imbalances has necessitated the study with the objective of investigating the determinants of current account in Nigeria. The study used auto regressive distributed lag (ARDL) approach due to cointegration among the variables, with annual time series data from 1981 to 2022. The result reveals that age dependency ratio, real effective exchange rate, broad money supply, interest lending rate and gross domestic product annual growth rate were the main determinants of current account in the long run. Gross domestic product annual growth rate and broad money supply are positive determinants of current account in the short run while investment and age dependency ratio are negative determinants of current account in the short run. Specifically, the findings showed that investment and gross domestic product annual growth rate are a positive determinant of current account while age dependency ratio, real effective exchange rate, money supply and interest lending rate are negative determinant of current account. The short run result found that any disequilibrium in the model is not corrected but rather worsened, driving the equilibrium farther away at a -216.6 % adjustment speed annually. The diagnostic result suggested that 98% of the variations in current account was explained by the explanatory variables.

The Nigerian government should work with the findings in this study and promote policies that will encourage domestic savings to improve the capital base of the economy, the growing population; if it cannot be controlled should be accompanied with employment and entrepreneurial opportunities. The monetary authority can also ensure appropriate monetary policies that will control the rate at which the home currency is exchanged with other foreign currencies as well as money supplied in the economy and interest landing rates that will encourage investment and savings in order to improve and maintain a favorable balance of payment position.

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