Cape Economic Performance and Prospect Bulletin – April 2023

Highlights

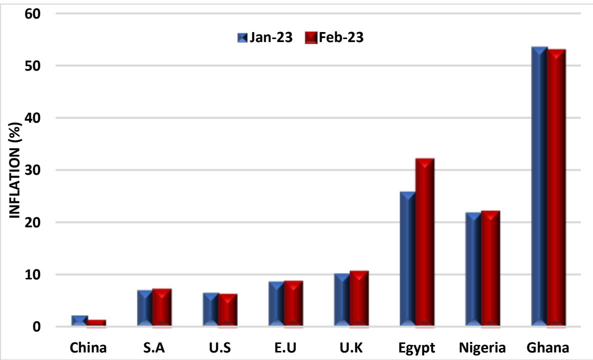
- *Price pressures are expected to sustain moderation but remain above pandemic levels as tightening efforts continue to crystalize.*
- *Nigeria's Q1 2023 output growth expected to be lower than Q4 2023 but remain positive.*
- ***Forecast shows that inflationary pressure in Nigeria moderated in March 2023, with headline inflation slowing to 21.84 percent**.*

Global Economic Update

Global growth data for 2022 slowed to 3.2 percent, largely due to headwinds from the impact of the war in Ukraine, the cost-of-living crisis, and the slowdown in China. The global economy continues to show resilience amidst a high level of uncertainties as the first quarter of 2023 ends. The first quarter of 2023 has shown some prospects of improved performance as China reopens, following the easing of restrictions associated with its Zero-COVID Policy, management of the gas crisis in Europe, and the growth in consumer spending in the United States. The continued war in Ukraine and rising geopolitical tensions between the global West and East however remain major headwinds to a faster recovery of the global economy and upside risk to inflation.

While global inflation is expected to remain above pre-Pandemic levels throughout 2023, evidence of moderation has emerged across advanced and emerging economies. In the advanced economies, inflationary pressure is expected to moderate in 2023 following several interest rate hikes by central banks in this group, inflation is however expected to remain above the long-term objectives of these central banks through 2023.

Figure 1: Year-on-Year Inflation in Selected Economies (January 2023 - February 2023) in percent



Source: Various National Statistics Offices

The moderating impact on prices of the coordinated tight monetary policy stance of several central banks is also expected to contribute to the lowering of inflation in 2023. In Emerging Markets and Developing Economies, the tightening of monetary policy has led to tight financing conditions with a dampening impact on output growth and increased debt burden.

Although inflation has commenced moderation, particularly in several advanced economies, after several rate hikes, it is however expected to remain above target levels for most economies in 2023. Following the commencement of moderation in inflation central banks in the advanced economies have slowed the pace of rate hikes, while those in most emerging economies are still playing catch-up.

The cumulation of several rate hikes across advanced and emerging economies has tightened monetary and financial conditions in a bid to tame rising inflation, at the risk of slowing down output growth in their respective economies and putting a strain on the financial system.

The biggest failure of a US bank since the global financial crisis played out in March 2023 in real-time as a leading lender to the tech industry succumbed to a classic bank run, even as interest rate hike continues.

The sudden collapses of Silicon Valley Bank and Signature Bank in the United States and Credit Suisse in Europe were blamed, in part, on acute hikes in interest rates. This highlights the delicate balance facing central banks as they seek to tame high inflation without putting unnecessary stress on financial institutions. Policymakers are therefore posed with a dilemma on the use of their "reference monetary policy tool – interest rate", trying to rein in inflation on one hand, while keeping credit flowing through the financial system on the other. Ideally, regulators can raise interest rates at just the right margin and pace to bring price levels down without triggering a banking crisis.

The issue for policymakers is that the main tool for suppressing inflation – high-interest rates – is putting added pressure on the financial system. Increased turbulence in the financial system heightens the risk of tipping the global economy. Higher interest rates are a headwind to economic recovery and stabilization as they make it costlier for companies and households to borrow, encouraging firms to cut back on new projects and jobs and consumers to reduce spending.

In the currency market, the US dollar strengthened marginally against several advanced economies' currencies between February to March 2023 reaching a near seven-week high against a basket of other major currencies. This was largely driven by technical considerations as investors herded to US dollar-denominated assets to take advantage of their improved yields despite lingering concerns of a medium-term recession. However, recent geopolitical forces are threatening to weaken its top spot in the currency hierarchy. U.S. sanctions in response to Russia's invasion of Ukraine have pushed some countries to further reduce their reliance on the dollar. There is a concerted effort at creating a multipolar currency order largely pushed by a coalition of countries from the global East and emerging economies. This has also led to a renewed effort at strengthening of the BRICS member states and a recent visit of Moscow to South Africa.

China and Russia are openly taking steps to raise the attractiveness of alternative currencies for international economic and reserve purposes, building multinational financial infrastructure to promote trade and investment in renminbi and rubles.

The commodities market remains characterized by uncertainties and volatilities as geopolitical tensions worsen. Despite the uncertainties, the price of various commodities (food and energy) sustained moderation in March 2023 after peaking in October 2022. This is largely driven by a relatively mild winter season, improvement in technology, slowdown in energy demand, and economic activities.

The war between Russia and Ukraine continues to disrupt supply and cause shortages of major staples such as wheat amongst others and exerts significant pressure on food prices across countries.

The Black Sea Grain agreement brokered by the United Nations and Turkey played a major part in moderating global grain prices through increased supply, however, the initiative expired on March 18, 2023. There is a need for all the parties involved to re-negotiate and further extend the initiative due to its gains to global food security and commodity prices, but concerns abound that Russia may renege from renewing it due to NATOs increased military support to Ukraine and recent NATO membership status granted to Finland.

Energy prices are expected to commence a rebound by the end of the first quarter into the second quarter of 2023. Upside risks to energy prices remain increased demand as China ditches the zero-Covid policy, while the pressure in the financial system and the risk of a recession are downside risks.

Global Economic Outlook

The global economy has shown some resilience in the first quarter of 2023. Supply conditions are steadily improving, as the Chinese economy continues to open, while demand conditions remain modest. The near-term risk is upside skewed as the cost-of-living crisis begins to wane in several economies owing to the mild winter, modest resilience in economic activities, the relaxation of the zero-COVID policy in China, and moderation in energy prices. Downside risks however remain – rising geopolitical tensions between the global West and the global East, the persisting Russian war in Ukraine, tight financial conditions, weak export demand, and the lingering impacts of the pandemic.

As highlighted in our previous newsletters, inflation has commenced moderation in several economies, particularly the advanced economies, following a series of rate hikes. Although inflation is expected to continue to decelerate significantly in 2023, it would however remain above pandemic levels across both advanced and emerging economies. Central Banks would, however, continue to favor higher policy rates but with less aggression for most of 2023 to on the one hand avert a premature easing of financial condition and revert the gains in taming inflation and on the other hand avoid a financial crisis. Major upside risks to inflation remain supply disruptions due to the war in Ukraine lingering effects of the pandemic and change in climatic conditions.

Nigeria's Output Growth

According to the latest Purchasing Managers' Index, business activities in the Nigerian economy dipped for the second consecutive month in over two years owing to the subsisting scarcity of cash – a condition that prevailed for the most part of Q1 2023. The Stanbic IBTC headline PMI for the month of March indicated a further decline to 42.3 from the 44.7 recorded in February 2023. As a rule, PMI readings above 50.0 signal an improvement in business conditions, while readings below 50.0 show deterioration.

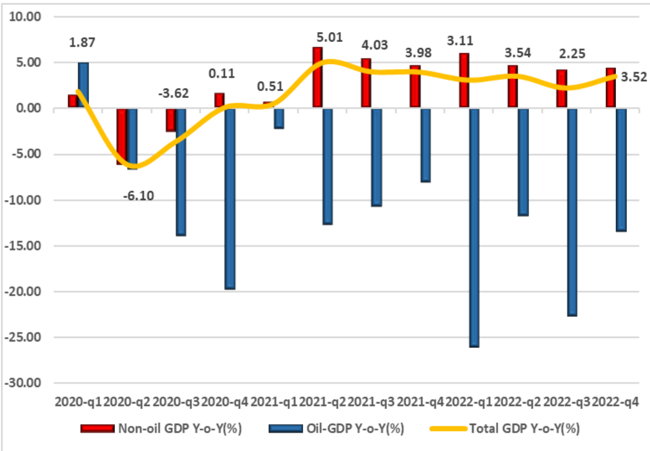
During the month of March, companies reported that customers' spending commitments were constrained by the unavailability of the Naira, leading to a substantial dip in new business transactions consummated.

Figure 2: Trend of Nigeria's *PMI in Q1 2023*

Source: Stanbic IBTC, 2022

In light of the above, Nigeria's real GDP growth in Q1 2023 is expected to be frail, albeit, it would remain within the positive region like the previous nine quarters (See figure 4 below).

Figure 3: Real GDP Growth Rate in Nigeria (2020 Q1 – 2022 Q4) in Percent **Source:**



National Bureau of Statistics (NBS), 2023

Nigeria's Output Growth Outlook

Though the cash crunch that prevailed for the most part of Q1 2023 has begun to ease off, more significantly after the threat nationwide-wide strike by the Nigerian Labour Congress, economic activities were largely suppressed in the first quarter of 2023. This development coupled with other subsisting headwinds such as high energy prices, the rising cost of production, infrastructural deficit, etc, are expected to further weaken output growth in the first quarter of 2023.

Price Update

Nigeria's headline inflation hit a 17-year record-high of 21.91 percent year-on-year as it maintained its upward path in February 2023. Relative to the 15.63 percent recorded in February 2022, headline inflation jumped by 6.21 percentage points in February 2023. Compared to the 21.82 percent recorded in January 2023, headline inflation increased by 0.09 percent in February. On a month-on-month basis, headline inflation decelerated to 1.71 percent in February 2023 compared to the 1.87 percent recorded in January 2023, indicating a 0.16 percentage points decline in the general price level.

The food inflation rate, on a year-on-year basis, rose to 24.35 percent in February 2023 compared to the 17.11 percent recorded in February 2022, indicating an increase of 7.24 percentage points. Compared to the previous month, food inflation rose marginally by 0.03 percentage points from the 24.32 recorded in January 2023. The main drivers of food inflation include prices of Bread and cereal, Oil and Fat, Potatoes, Yam and Other Tubers, Fish, and vegetables, among others. However, on a month-on-month basis, the food inflation rate in February 2023 declined to 1.90 percent, compared to the 2.08 percent recorded in January 2023.

Interestingly, core inflation slowed down to 18.84 percent in February 2023 from the 19.16 percent recorded in the previous month. However, on a year-on-year basis, core inflation was elevated by 4.83 percentage points from the 14.01 percent recorded in February 2022. The increase was driven by the prices of Gas, Passenger Transport by Air, Liquid Fuel, Fuels, and Lubricants for Personal Transport Equipment, Vehicles Spare Parts, Solid Fuel, etc.

Figure 4: Year-on-Year Headline, Food and Core Inflation (Jan 2022 – January 2023) in percent

Source: National Bureau of Statistics (NBS), 2023

Price Outlook

Inflation is expected to moderate marginally in March 2023. Our forecast showed that inflationary pressure would moderate as headline food and core inflation are expected to slow to 21.84, 24.21, and 18.78 percent respectively.

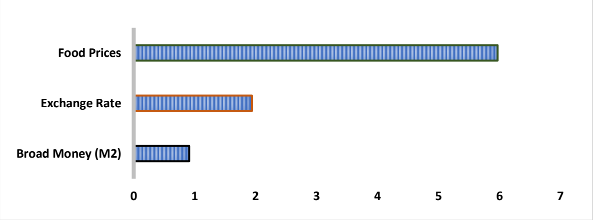
Table 1: Inflation Forecast for March 2023 in Percent

Headline	Food	Core
21.84	24.21	18.78

Source: CAPE Economic Research and Consulting, 2023

The key drivers of the headline inflation forecast were, food prices, exchange rate, and broad money supply (M2) which contribute 5.97 percent, 1.94 percent, and 0.91 percent respectively.

Figure 5 Driver of Predicted Inflation



Source: CAPE Economic Research and Consulting, 2023

Our analysis showed a robust impact of food prices and exchange rates on headline inflation in March 2023 when compared with the previous month.

The moderation in inflation is due to strong pull factors which are largely monetary that are dampening the heightening inflationary pressure. Key pull factors are money supply (M2), narrow money (M1), and credit to the core private sector which contributed 0.91, 0.53, and 0.45 percent respectively in moderating the speed of inflation in March 2023.

The key drivers of the core inflation forecast were education, clothing and footwear, transportation, alcoholic beverages, and health which contributed 1.76, 1.75, 1.60, 042, and 0.17 percent respectively.

The moderation in our food inflation forecast, despite the lingering impact of the flood and the war in Ukraine, was driven by a decline in the price of processed foods and seasonal harvest factors. Additionally, the cash crunch due to the supply constraints of naira notes led to a moderation in demand as consumers had limited access to physical cash for petty consumption transactions and small-scale informal business activities that depend largely on cash transactions. This negatively affected traders in perishables who were willing to sell off produce at a haircut and limit their loss. Also, traders and service providers were willing to sell at lower prices when the customer was offering physical cash.

Our analysis established monetary policy instruments as pull factors, suggesting some level of monetary policy instruments' potency in anchoring expectations and dampening inflation in Nigeria, while, structural factors continue to remain dominant in driving inflation in Nigeria.

Our analysis also suggests that monetary policy in Nigeria might be drawing close to a point of neutrality, where it would have an ignorable impact on affecting economic activities and general price levels in the economy. A major challenge for monetary policy instrument potency remains its difficulty in directly impacting demand-side drivers of inflation, particularly household consumption patterns.

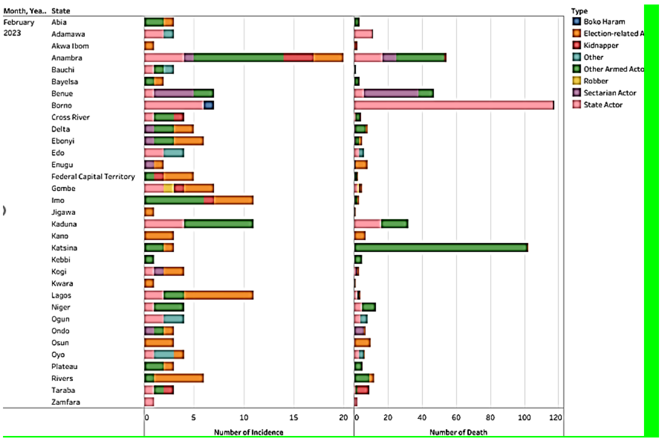
Upside risks to inflation are the burgeoning fiscal deficit; monetary financing, election, and census spending; anticipated removal of fuel subsidy, and the effect of monetary tightening in advanced economies leading to capital outflows and exacerbating exchange rate pressures as well as its pass-through to prices.

Fiscal Operations Update

The Federation Account Allocation Committee (FAAC) distributed the total sum of ₦722.68 billion among the three tiers of government in the month of March 2023. The amount distributed was lower than the ₦750.17 billion shared in February 2023 by ₦27.49 billion representing a decrease of 3.7 percent.

A further breakdown reveals that Federal Government received ₦269.06 billion; States, ₦236.46 billion; Local Government, ₦173.94 billion. The derivation fund shared among oil-producing states amounted to ₦43.21 billion. Revenue allocation to all three tiers of government further decreased in March 2023 (See Table 2 below). The balance in the Excess Crude Account (ECA) as of 2nd March 2023 stood at U$473,754.57

Figure 6: Widespread Election-Related Insecurity Data



Source: CAPE Economic Research and Consulting, 2023

Despite the deployment of over 400,000 security personnel and distribution of 1.240 patrol vehicles to ensure peaceful conduct of the 2023 general elections, the security situation in the country deteriorated in February 2023. Cape Insecurity Data for the month of February indicates an elevated level of insecurity associated with the activities of election-related actors, state actors, and other armed actors, amongst others. While the number of insecurity incidences increased across the 36 states of the federation, Anambra, Lagos, Imo and Kaduna states recorded the highest number of incidences. Significant increases were recorded in election-related violence in Lagos, Rivers, Kano, Osun, FCT, Gombe, and Anambra owing to the stiff rivalry among leading political actors in these states.

In the overall analysis, insecurity was heightened as a result of the 2023 general elections with killings due to nonstate actors highest in Katsina state. Insecurity is likely to increase when courts begin to rule over election petitions before them, following the mixed reactions that have been trailing the presidential election results.

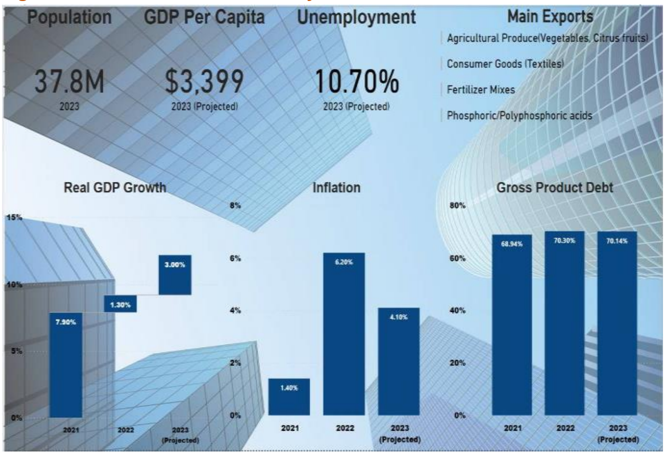
Table 2: Highlight of FAAC Distribution (N'billion)

	March	February	% Change
Fed.	*269.06*	*277.33*	-3.0
State	*236.46*	*244.98*	-3.5
LG	*173.94*	*180.14*	-3.4
Deriv	*43.21*	*32.73*	32.0
Total	**722.68**	**750.17**	**-3.7**

Source: FAAC, March 2023

Country in Focus – Morocco

Figure 7: Economic Parameters for Morocco



Source: CAPE Economic Research and Consulting, 2023

Conclusion

In conclusion, we anticipate a better-than-expected Q1 2023 global economic performance, considering the level of resilience the economy has shown. The tightening stance of most central banks across both advanced and emerging markets for most of 2022 has started yielding results in price moderations in some economies, while others are expected to catch up. However, this has come at a significant moderation to output and financial stability with a heightening risk of a financial crisis. In Nigeria, economic prospects for the first quarter of 2023 remain resilient, albeit at a moderated level.