Economic Newsletter

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CAPE
Economic Research & Consulting

Highlights

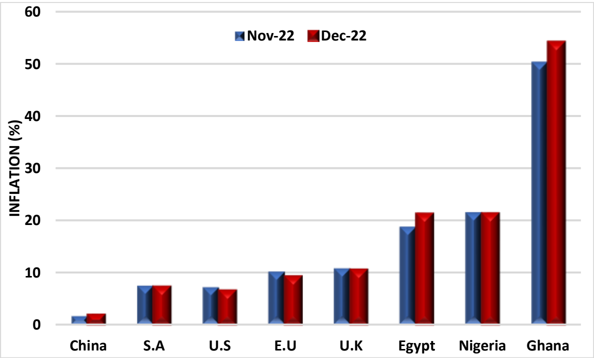
- *Price pressures are expected to sustain moderation but remain above pandemic levels as tightening efforts fully crystalise.*
- *Nigeria's Q4 2022 output growth expected to be lower than Q3 2022 but remain positive.*
- ***Forecast shows that inflationary pressure in Nigeria further moderated in January 2023, with headline inflation slowing to 21.28 percent.***

Global Economic Update

The year 2023 commenced amidst persisting series of severe and mutually reinforcing shocks to the economy – the lingering impact of the COVID-19 pandemic, the ongoing Russian war in Ukraine and resulting food and energy crises, surging high general price and debt levels, tightening monetary and financial conditions, and a climate emergency.

In advanced economies, pressures from elevated food and energy prices due to the Russian war in Ukraine and the lingering COVID-19 pandemic-induced supply shortages put upward pressure on prices. In the emerging markets, supply disruptions, energy and commodity market pressures, and currency depreciations against a strong US dollar were factors driving inflation.

Figure 1: Year-on-Year Inflation in Selected Economies (November - December 2022) in percent



Source: Various National Statistics Offices

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, since a rise in the cost of borrowing would moderate economic activities.

In the currency market, the US dollar remains significantly strong against other currencies. As highlighted in our previous newsletters, most currencies traded at historically low levels against the US dollar. This was mainly driven by the flight to safety in the US dollar as various investors find the dollar to be a haven in times of volatility and the second being the continued rate hikes by the Federal Reserve to tame the inflationary pressure.

The commodities market remains characterized by uncertainties and volatilities as geopolitical tensions worsen. The price of various commodities (food and energy) sustained moderation in January 2023 after peaking in October 2022.

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.

Energy prices are expected to commence a rebound by the end of the first quarter into the second quarter of 2023. Tailwinds to energy prices remain increased demand as China ditches the zero-Covid policy.

Global Economic Outlook

The prospects for the global economy remain blurred, considering the emerging cost of living crisis fuelled by the fallouts of the Russian war in Ukraine on food and energy and several forecast of a looming recession in several countries across both advanced and emerging economies. The global cost of living crisis is hitting the most vulnerable hardest and many economies may not be able to avoid a downturn. The global high inflationary pressures and tightening monetary policy could lead to significant financial stress across economies and heighten the risk of an economic slowdown. However, the global economy has shown a significant level of resilience majorly driven by the relaxation of the zero-Covid policy.

As forecasted in our January 2023 newsletter, Inflation has commenced moderation in several economies, particularly the advanced economies, following several 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. Major upside risks to inflation remain supply disruptions due to the war in Ukraine lingering effects of the pandemic and change in climatic conditions.

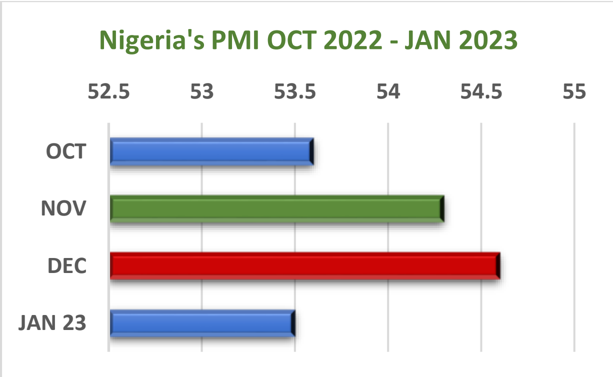
In the advanced economies, the hawkish stance of the monetary policy has started yielding results in moderating inflation but trading off expansion in investment and output. Exports are expected to slow down on the backdrop of waning external demand, a strong US dollar, and energy shortages in Europe. However, labour market resilience would sustain retail activities and improve market confidence as inflation decelerates, particularly in the United States.

In most emerging markets, prevailing global economic realities with a tightening global financial condition, a strong US dollar, the construction sector crisis in China, rising energy and food prices, and weakening global demand remain the major headwind to output growth prospects in 2023. However, the relaxation of the zero-COVID policy in China is expected to support economic growth and provide resilience.

Nigeria's Output Growth

While Nigeria's real GDP in 2022Q4 is expected to remain in its positive region, private sector business activities in 2023Q1 kicked off on a dampened note, which may not be unconnected to the start-of-year effect. This is as indicated by the Stanbic IBTC purchasing managers' index (PMI) from October 2022 to January 2023 (See figure 1). The headline PMI dipped to 53.5 in January 2023 from 54.6 in December 2022. The momentum of growth recorded in January was the weakest since August 22. This was attributed to moderation in customer numbers reported by some firms, despite increased demand in the period.

Figure 2a: Purchasing Managers Index from October 2022 – January 2023

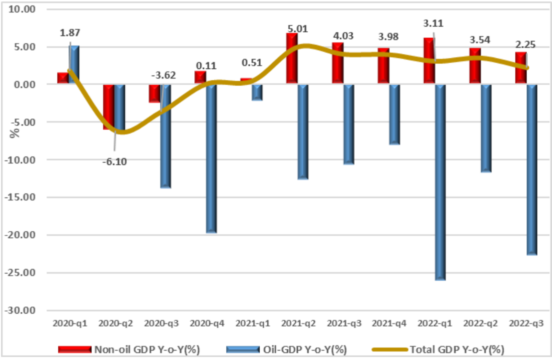


Source: Stanbic IBTC, 2023

Despite the dip, a PMI of 53.5 still signals a solid monthly improvement in the private sector business activities, as Readings above 50.0 signal an expansion in business conditions, while readings below 50.0 show a deterioration.

The dynamics of the real GDP growth rate from Q1 2020 to Q3 2022 are summarised in the figures below

Figure 2b: Quarterly Real GDP Growth Rate in Nigeria (Q1-2020 – Q3 2022) in percent



Source: National Bureau of Statistics (NBS), 2022

Output Growth Outlook

Despite multiple headwinds including high energy prices and fuel scarcity, large-scale flooding, deteriorating foreign exchange rate, infrastructural deficit, structural bottlenecks, and elevated cost of production, output growth is expected to further slow down albeit remain positive in 2022Q4 and 2023Q1. This expectation is anchored on the likely expansion of aggregate demand as election-related spending reaches its peak in 2023Q1. This is expected to offset the weak demand associated with post festivity period.

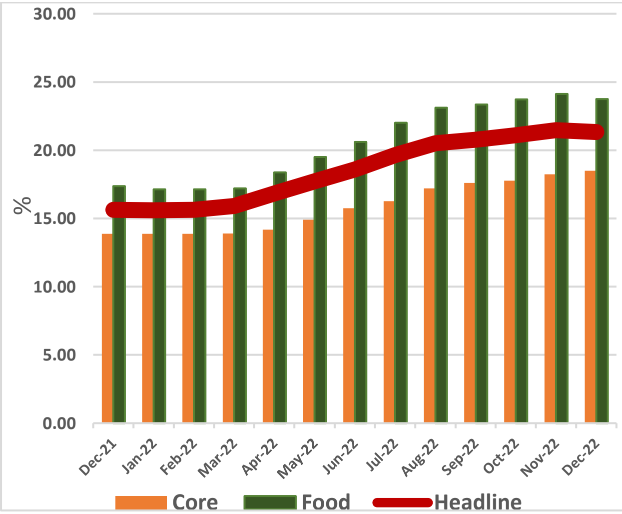
Despite the subsisting challenges which include foreign exchange scarcity, the rising cost of production, inflation, structural bottlenecks, and infrastructural deficit among others output growth is expected to remain within the 2022Q4 and 2023Q1 range. This expectation is anchored on the likely expansion of aggregate demand as election-related spending reaches its peak in 2023Q1. This is expected to offset the weak demand associated with post festivity period.

Price Development

For the first time in eleven months, Nigeria's headline inflation rate, on a month-on-month basis, eased to 21.34 percent in December 2022, from 21.47 percent recorded in the previous month. Thus, the headline inflation rate declined by 0.13 percentage points in December compared to November 2022. This was in spite of the inflationary pressure associated with year-end festivities. However, on a year-on-year basis, headline inflation increased by 5.72 percentage points from the 15.63 percent recorded in the corresponding period of last year. The month-on-month increase in headline inflations was mainly driven by factors such as the spike in demand usually experienced during the festive season, the high cost of production due to rising energy costs, and exchange rate depreciation, among others.

Food inflation dropped to 23.75 percent in December 2022 from 24.13 percent reported in the previous month, indicating a decline of 0.38 percentage points This marked the first dip in food inflation since January 2022 (See figure 3). However, compared to December 2021, food inflation was elevated by 6.38 points from 17.37 percent Mainly driven by changes in prices of some food items like Oil and fat, Fish, Potatoes & Tubers, Bread & Cereals, and Fruits etc.

Figure 3a: Year-on-Year Headline, Food and Core Inflation (December 2021 – December 2022) in percent



Source: National Bureau of Statistics (NBS), 2023

On a year-on-year basis, core inflation inched up to 18.49 percent in December 2022 from 13.87 percent in the corresponding month of 2021, representing an increase of 4.62 percentage points. Some of the main drivers of core inflation include prices of Gas, Liquid fuel, Passenger transport by Air, vehicle spare parts, Fuels, and lubricants for personal transport equipment, and Solid fuel.

Price Outlook

Inflation is expected to moderate further in January 2023. Our forecast showed that inflationary pressure would moderate as the headline and food inflation are expected to slow to 21.28 and 23.09 respectively, while, core inflation is forecasted to heighten to 18.58 percent

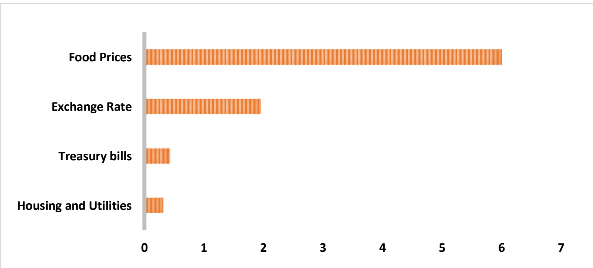
Table 1: Inflation forecast for January 2023 in Per Cent

Headline	Food	Core
21.28	23.09	18.58

Source: CAPE Economic Research and Consulting, 2023

The key drivers of the headline inflation forecast were, food prices, exchange rates treasury bills, and housing and utilities which contribute 6.0 percent, 1.96 percent, 0.43 percent, and 0.32 percent, respectively.

Figure 3b: Driver of Predicted Inflation



Source: CAPE Economic Research and Consulting, 2023

Our analysis showed that the magnitude of the impact of food prices on headline inflation and housing and utilities heightened, while that of exchange rate persisted in January 2023 when compared with December 2022.

The moderation in inflation is due to strong pull factors which are largely monetary factors that are dampening the heightening inflationary pressure. Key pull factors are money supply (M2), narrow money (M1), credit to the ore private sector, and credit to other sectors which contributed 0.91, 0.53, 0.45, and 0.33 percent respectively in moderating the speed of inflation in January 2023.

The key drivers of our core inflation forecast include education, clothing and footwear and transportation which contributed 1.77, 1.69 and 1.64 percent respectively. However, the factors responsible for the moderation in our core inflation forecast are largely monetary factors: money supply (M2). The moderation in our food inflation forecast, despite the lingering impact of flood and the war in Ukraine, was driven by a decline in the price of processed foods and seasonal harvest factors.

Our analysis further 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.

When compared with December 2022 money supply (narrow and broad) decreasingly contributed to moderate inflationary pressure in January 2023. This however attests to the presence of some monetary elements in inflation and the potency of monetary policy to some extent to rein in the monetary elements of inflation in Nigeria.

A major challenge for monetary policy instrument potency remains its difficulty in directly impacting demand-side drivers of inflation particularly household consumption patterns.

Other factors that would contribute to the upward inflationary pressure are the burgeoning fiscal deficit; monetary financing, election spending; 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 N990.19 billion among the three tiers of government in the month of January 2023. The amount distributed was higher than the N902.05 billion shared in December 2022 by N88.14 billion representing an increase of 9.8 percent.

A further breakdown shows that Federal Government received N375.306 billion; States, N299.557 billion; Local Government, N221.807 billion. The derivation fund shared among oil-producing states amounted to N93.519 billion. Revenue allocation to all three tiers of government increased in January 2023 (See Table 2 below). Notably, the 13 percent derivation fund increased significantly by 36.4 percent. The balance in the Excess Crude Account (ECA) as at January 17th, 2023 stands at US$473,754.57.

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

	Jan '23	Dec '22	% Change
Fed.	*375.31*	*358.51*	*4.7*
State	*299.56*	*270.84*	*10.6*
LG	*221.81*	*204.13*	*8.7*
Deriv	*93.52*	*68.57*	*36.4*
Total	**990.19**	**902.05**	***9.8***

Source: FAAC, 2023

In the overall analysis, government revenue improved, as it rose to N1,411.54 billion collected in December 2022, from the N1,163.61 billion received in November 2022 by N247.93 billion or 21.3 percent. Thus, providing the fiscal buffer for the kick-starting the implementation of 2023 budget.

MOODY'S DOWNGRADES NIGERIA SOVEREIGN RATING AND ITS IMPLICATIONS

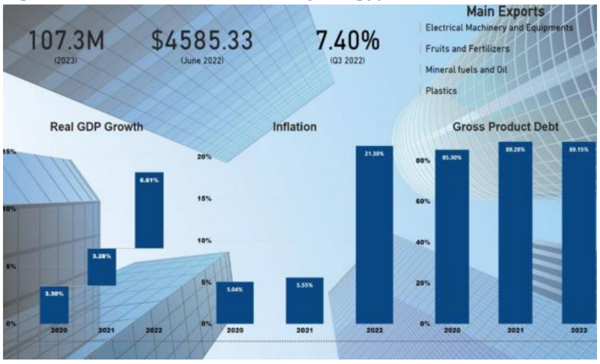
Moody's Investors Service, a globally acclaimed credit rating agency has further downgraded Nigeria's sovereign rating to Caa1 from B3. Specifically, it downgraded Nigeria's long-term foreign-currency and local-currency issuer ratings as well as its foreign currency senior unsecured debt ratings to Caa1, from B3 and changed the outlook to stable. This portends serious fiscal implications for Nigeria as obligations rated Caa1 are generally regarded as having poor standing and very high credit risk, which makes it fall below investment grade. The downgrade signals to investors that Nigeria's capacity to accommodate more debt is at high risk, thus increasing the cost of borrowing for the country as additional debts become more expensive. The rating was based on Moody's conclusion that Nigeria's fiscal position would continue to deteriorate in the medium term.

Moody is particularly of the opinion that Nigeria is under fiscal pressure driven by a sustained fuel subsidy regime, declining oil production, and rising interest rate. It projected that interest payment would gulp more than half of Nigeria's revenue as debt-to-GDP rises to about 45 percent. The rating agency was also concerned about the size of Nigeria's Ways and Means Advance from the central bank. These among other factors culminated in the recent downgrade.

The overall implication of the downgrade is that Nigeria would have to borrow at a higher interest rate to finance its N11.34 trillion budget deficit in 2023. As the country's financing options become narrow, it would be compelled to rely heavily on domestic debt and alternative financing sources.

Country in Focus – EGYPT

Figure 4: Economic Parameters for Egypt



Source: CAPE Economic Research and Consulting, 2023

Conclusion

In conclusion, we anticipate a slow start to the year 2023 with a slowdown in the global economy but with a significant level of resilience. The hawkish 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 is coming at a significant cost to output. The global economy has however started showing signs of resilience largely hinged on recent developments in China. In Nigeria, economic prospects for the fourth quarter of 2022 remain resilient albeit at a moderated level.