Economic Newsletter

CAPE
Economic Research & Consulting

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Highlights:

- ***2023 – A not-so-optimistic year after a slow comeback from COVID-19 in 2022.***
- ***Price pressures are expected to moderate significantly in 2023 but remain above pandemic levels as tightening efforts fully crystalize.***
- ***Nigeria's output growth is expected to further slowdown.***
- ***Forecast shows that inflationary pressure in Nigeria would remain heightened in December 2022, with headline inflation rising to 21.6 percent.***

Global Economic Update

The year 2022 was characterized by lingering effects of the COVID-19 pandemic (lockdown in China and several other countries due to Zero-COVID policy), pent-up demand capacity from COVID palliatives, a kinetic war in Ukraine by Russia, distorting energy and food prices, high inflationary pressures and significant levels of monetary tightening across advanced and emerging economies

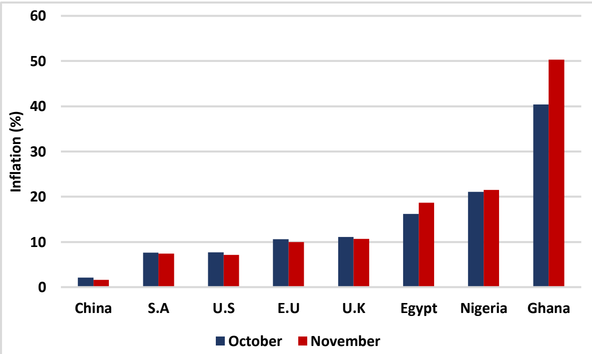
Following the backdrop of the outbreak of COVID-19 in 2020, the year 2022 was meant to be a year of return to normalcy and stabilization. However, the prospects for the year were significantly marred by the Russian war in Ukraine amidst other headwinds including the climate change crisis, record levels of inflation, and debt across advanced and emerging economies.

After the pandemic-induced economic crisis, consumer prices began to soar in 2021, as countries relaxed lockdowns and other restrictions. Several central banks initially maintained that the high price levels would be transitory and fizzle out as economies return to normalcy, but the invasion of Ukraine by Russia exacerbated pressures on food and energy prices.

In advanced economies, pressures from elevated food and energy prices and 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.

Several economies are now faced with an acute cost of living crisis and wages are no longer commensurate to price levels forcing households to make tough spending choices. Central banks have had to play catch-up. For most of the year 2022, central banks have had to play catch-up by tightening monetary conditions. Central banks across advanced and emerging markets raised interest rates several times 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. Inflation has begun to moderate in some of the advanced economies, but the story is not the same in many of the emerging economies.

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



Source: Various National Statistics Offices

In the currency market, the US dollar strengthened significantly against other currencies over the course of the year. As

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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 hawkish monetary policy stance in the US has seen the Federal Reserve raise the federal funds rate from near zero at the beginning of 2022 to a range of 4.25 percent to 4.50 percent at the December FOMC meeting, the highest level in 15 years. Along with the increase came an indication that officials expect to keep rates higher through the year 2023, with no reductions until 2024.

It is of concern that an extremely strong US dollar could lead to significant financial imbalances and instability in emerging markets and other economies across the globe as well as threaten corporate earnings of US companies with overseas operations, reduce US trade and assets competitiveness and increase US trade deficits as highlighted in our previous newsletter.

The commodities market remains characterized by uncertainties. The prices of various commodities (food and energy) sustained moderation in December 2022 after peaking in October and slowing down in November amid a heightened risk of a global recession. Since the outbreak of the war in Ukraine, energy prices have however been most volatile.

Disruption due to the war in Ukraine has led to supply shortages of major staples such as wheat amongst others. As highlighted in our December 2022 newsletter, food prices rose sharply by about 12 to 15 percent across most regions for most of the year 2022, except in East Asia and the Pacific.

Energy prices are projected to decline by about 11 percent in 2023. Headwinds however remain U.S. producer discipline and peak shale productivity, sanctions on Russia, OPEC+ willingness to support prices, and reduced global investment in fossils.

Global Economic Outlook

A global recession is increasingly likely as the cost-of-living soars and expectations for growth are cut back across several regions, according to the latest quarterly report World Economic Forum (WEF). Sentiments expressed by about three-quarters of the key policymakers at the forum suggest that they were gearing up for a recession in 2023. This perhaps makes the 2023 slowdown the most anticipated downturn. With high general price levels and real wages falling, the global cost of living crisis is hitting the most vulnerable hardest and many economies may not be able to avoid a downturn. The worldwide high inflationary pressures and tightening monetary policy could lead to significant financial stress across economies and further increase the risk or trigger a global recession in 2023.

Inflation is expected to peak in most economies across the globe where moderation has not yet commenced within the first quarter of 2023, after which a deceleration would commence. Although inflation is expected 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 changes 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, labor market resilience would sustain retail activities and improve market confidence as inflation decelerates, particularly in the United States.

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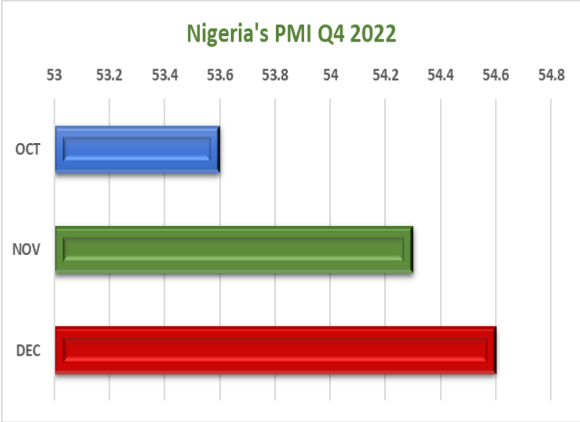
In most emerging markets, prevailing global economic realities with a tightening global financial condition, a strong US dollar, rising energy and food prices, and weakening global demand remain the major headwind to output growth prospects in 2023. China is expected to record positive output growth, albeit at a slower rate, as growth prospect remains encumbered by the pandemic resurge and the zero-COVID policy, and weakening global demand. Prospects for the gulf countries remain strong as they optimize gains from energy exports.

The cost-of-living crisis and a higher risk of recession remain the major concern for businesses and households in 2023.

Nigeria's Output Growth

Nigeria's real GDP in Q4 2022 is expected to remain in its positive region based on the Stanbic IBTC purchasing managers' index (PMI) which suggests a robust growth in the private sector business activities in the quarter. As shown in figure 1, Nigeria's headline PMI rose to 54.6 in December 2022 from 53.6 in October, making it the highest since April 2022. The upward the trajectory of PMI in Q4 2022 indicates a sustained improvement in business conditions as output and new orders expanded faster due to higher customer demands in spite of persistent inflationary pressures. Increased demand is not unconnected with end-of-year festivities.

Figure 2a: Purchasing Managers Index from October – December 2022



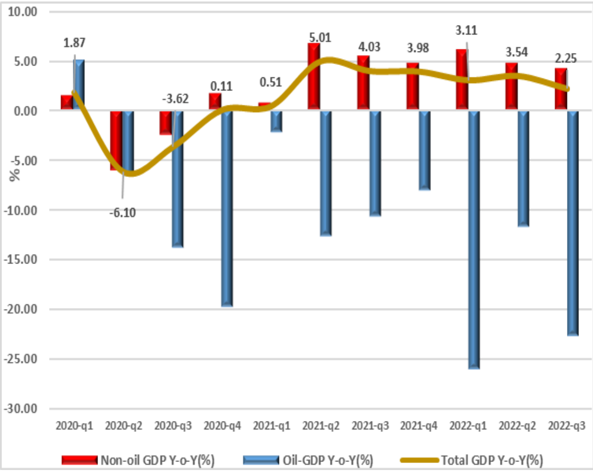
Source: Stanbic IBTC, 2022

Resultantly, firms expanded their productive activities and employment across the various sectors of the economy mainly, agriculture, manufacturing, retail, and services.

A month-on-month analysis shows a sharp growth in PMI from 53.6 in October to 54.3 in November 2022. However, a lesser PMI growth was recorded between November and December 2022, indicating a weaker sentiment. Overall, real GDP growth is anticipated to maintain its positive path.

Dynamics of 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

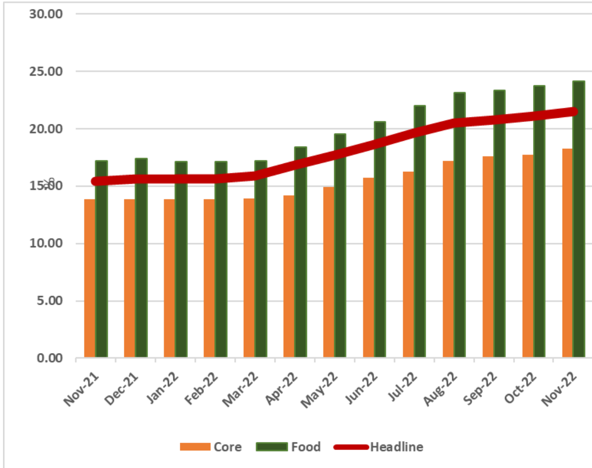
Output Growth Outlook

In spite of the lingering challenges around foreign exchange scarcity, elevated inflationary pressures, structural bottlenecks, infrastructural deficit, and the rising cost of production, output growth is expected to remain on its positive path in Q1 2023. This expectation is anchored on the likely expansion of aggregate demand as election-related spending reaches its peak in Q1 2023. This is expected to offset the weak demand associated with post festivity period.

Price Development

The tempo of all inflation components has continued to rise in Nigeria regardless of the recent interest rate hikes by the monetary authority. Nigeria's headline inflation leaps to 21.47 percent year-on-year in November 2022 from 21.09 percent in the previous month. Again, this brings headline inflation to its highest level since September 2005 and the 10th consecutive monthly increase in 2022. November 2022 headline inflation rate was higher than the 15.4 percent recorded in the corresponding month of 2021 by 6.07 percent. On a month-on-month basis, the November 2022 headline inflation was 1.39 percent, this was 0.15 percent higher than the 1.24 percent reported in October 2022 reflecting a build-up of inflationary pressure (See figure 3).

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



Source: National Bureau of Statistics (NBS), 2022

Similarly, food inflation inched up to 24.13 percent in November 2022 from 23.72 percent recorded in the previous month. This remained the highest food inflation rate since October 2005. Elevated food inflation was driven by increases in prices of bread and cereals, oil and fat, fish potatoes, yam, food products, and other tubers. Also, the core inflation component recorded a rise of 0.48 percentage points to 18.24 percent in November 2022 from 17.76 percent in the previous month. Core inflation in November 2022 was driven mainly by prices of Gas, Liquid fuel, Passenger transport by Air, Vehicles spare parts, and Solid fuel.

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Nigeria's 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 Q4 2022. This expectation is anchored on the likely expansion of aggregate demand driven by the upscale in election-related spending and activities ahead of the February 2023 general elections, as well as festivities-induced activities and spending.

Price Outlook

Inflation is expected to rise further in December 2022. Our forecast showed that inflationary pressure would remain heightened, but at a moderated speed as headline and food inflation are expected to rise to 21.6, and 24.2 respectively, while core inflation is forecasted to moderate to 17.4 percent.

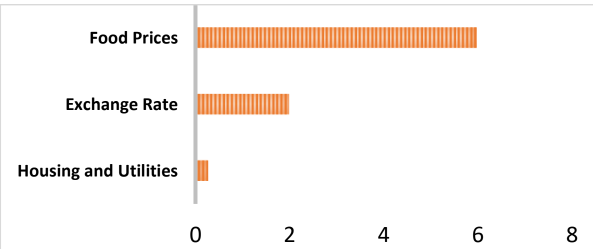
Table 1: Inflation forecast for November 2022 in percent

Headline	Food	Core
21.6	24.2	17.4

Source: CAPE Economic Research and Consulting, 2022

The key drivers of the headline inflation forecast were, food prices, exchange rate, and housing and utilities which contributed 5.98 percent, 1.96 percent, and 0.31 percent, respectively.

Figure 4b: Driver of Predicted Inflation



Source: CAPE Economic Research and Consulting, 2022

Our analysis showed that the magnitude of the impact of food prices on headline inflation persisted, while that of exchange rate and housing and utilities moderated and heightened respectively in December 2022 when compared with November 2022. The moderation in the speed of 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 core private sector, and credit to other sectors which contributed 0.93, 0.54, 0.46, and 0.35 percent respectively in moderating the speed of inflation in December 2022. In addition, our analysis showed some overlapping interrelationships between headline and core inflation through monetary factors. We found that money supply (M2) contributed 0.93 and 0.01 percent in moderating headline and core inflation respectively.

The key drivers of the core inflation forecast were education, clothing and footwear, and transportation which contributed 1.73, 1.72, and 1.67 percent respectively. However, the factors responsible for the moderation in our core inflation forecast are largely monetary factors: money supply (M2) and treasury bills. The rise in our food inflation forecast, despite seasonal harvest factors, was the bread and cereal component followed by meat, fish, and food drinks. The bulk of wheat used in making flour for bread production in Nigeria is imported. The supply disruptions as a result of the war in Ukraine and the strong US dollar driving exchange rate pressure feed into more expensive raw materials for processed food and other goods. Rising prices of commodities (food and energy) at the global level is fuelling food prices and utilities in Nigeria through imported food (raw and processed) and refined energy products.

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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.

When compared with November 2022, the money supply (narrow and broad) increasingly contributed to moderate inflationary pressure in December 2022. This attests to the presence of some monetary elements in inflation and the potency of monetary policy instruments, to some extent, in addressing inflation in Nigeria. However, the push impact continues to outweigh the pull impact, hence, the marginal increase in our inflation forecast.

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 a total sum of N902.05 billion among the three tiers of government in the month of December 2022. The amount distributed was higher than the ₦736.78 billion shared in November 2022 by ₦165.27 billion representing a significant increase of 22.4 percent.

A further breakdown shows that the Federal Government received the sum of ₦358.52 billion; States, ₦270.84 billion; Local governments, ₦204.13 billion. Derivation funds allocated to oil-producing states amounted to N68.57 billion (See Table 2 below). Revenue allocation to all tiers of government increased significantly. Notably, 13 percent derivation fund to oil-producing states increased by a whopping 161.4 percent while allocations to federal, state, and local government rose by 22%, 13.1%, and 15.3% respectively.

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

	December	November	% Change
Fed.	*358.51*	*293.95*	*22.0*
State	*270.84*	*239.51*	*13.1*
LG	*204.13*	*177.09*	*15.3*
Deriv	*68.57*	*26.23*	*161.4*
Total	**902.05**	**736.78**	**22.4**

Source: FAAC, 2022

Improved revenue allocation to all three tiers of government in December 2022 provided the needed buffer for concluding the implementation of the 2022 budget. However, the outbreak of massive floods and their attendant impact in different parts of the country in 2022 necessitated the request for a 2022 Supplementary Budget.

2022 Supplementary Budget

The need to address the devastating effects of multiple foods on farmlands and critical infrastructure in Nigeria motivated the Senate to approve the 2022 Supplementary Budget of N819 billion on the 28th of December 2022. This raises the 2022 budget deficit to N8.17 trillion and the deficit to GDP ratio to N4.43 percent which exceeds the 3% benchmark set by the Fiscal Responsibility Act. The supplementary budget would be financed through additional domestic borrowings thereby worsening the country's debt profile. An important implication is that this would lead to further deterioration of Nigeria's revenue-to-debt service ratio and as such, constrain the government's ability to meet other obligations.

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2023 Budget Highlights

The 2023 Appropriation Act was signed by the president on the 3rd of January 2023. The N21.83 trillion budget was tagged "Budget of Fiscal Consolidation and Transition'' in line with current realities in Nigeria. The major thrust of the 2023 Appropriation is to maintain financial viability and ensure a smooth transition to the incoming Administration. The 2023 budget is unique in some ways. First, it shows that the economy is diversifying away from oil as only 22% of projected revenues is expected from oil sources, while the larger chunk of 78% is to be earned from non-oil sources. Secondly, it is based on the assumption that the petrol subsidy will remain up until June 2023 and as such made a provision of only N3.36 trillion for fuel subsidy. A breakdown of the budget is as presented in Table 3 below.

Table 3: Highlight of the 2023 Budget

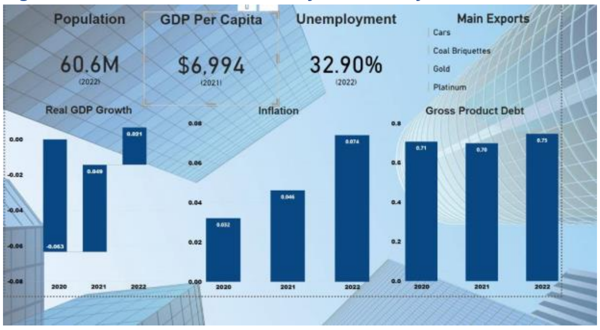
Budget Parameters/Assumptions	***2022***	***2023***
Crude oil production (mbpd)	*1.60*	*1.69*
Benchmark Oil Price (US$ per barrel)	*73*	*75*
Exchange Rate (₦/US$)	*410.15*	*435.57*
GDP Growth Rate	*3.55*	*3.75*
Inflation Rate	*16.11*	*17.16*
Revenue & Expenditure (₦'trillion)		
Aggregate Revenue	**9.97**	**10.49**
Aggregate Expenditure	**18.14**	**21.83**
Non-Debt Recurrent	*7.12*	*8.33*
Debt Service	*3.67*	*6.31*
Sinking Fund	*29*	*0.25*
Capital	*6.68*	*6.45*
Fiscal Deficits	***8.17***	***10.78***

Conclusion

In conclusion, we anticipate a slow start to the year 2023 with a slowdown in the global economy and the risk of a recession more pronounced. 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 in the new year. However, this is coming at a significant cost to output. in moderating prices. In Nigeria, economic prospects for the fourth quarter of 2022 remain resilient, albeit at a moderated level.

Country in Focus – South Africa

Figure 5: Economic Parameters for South Africa



Source: CAPE Economic Research and Consulting, 2022

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