Cape Economic Performance and Prospect Bulletin – July 2023

Highlights

- *Price pressures expected to remain heightened and remain above pandemic levels as tightening efforts continue to crystalise.*
- *Nigeria's Q2 2023 output growth expected to be better than Q1 2023 and remain positive.*
- ***Forecast shows that inflationary pressure in Nigeria heightened in June 2023, with headline inflation rising to 22.47 per cent**.*

Global Economic Update

Global output growth continues to show resilience, away from the gloomy outlook at the start of the year amidst high level of uncertainties, policy rate hikes and stubborn core inflation in the first half of 2023.

Asia continues to lead the charge of economic prospect with a rebound effect from the full reopening of China. Prospects in the United States and Europe remain largely divergent as the fears of a recession remain visibly anticipated following the tight financial conditions and economic imbalances, although the job markets remain resilient.

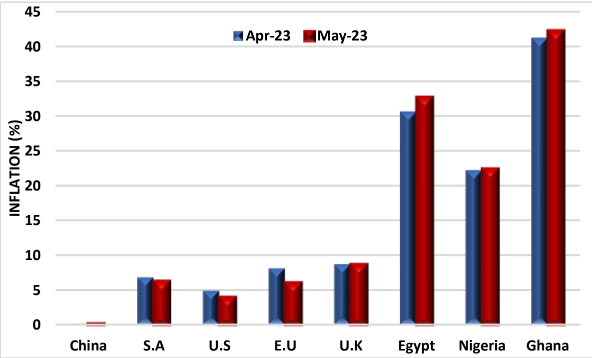
Most advanced economies have so far at best, avoided the recessions that were imminent in the first half of the year or at worst, delayed it. The relative resilience of output is largely propelled by the improvements in economic activities and moderations in the supply and demand imbalances. It is important to note that that the full effect of monetary tightening across economies have not fully permeated through and as the various tailwinds dwindle and interest rate hikes bite in advanced economies – and as gains from China re-opening fizzles out, the resilience of the global economy may wither.

Additional headwinds to output growth and upside risk to inflation are propelled by the war in Ukraine and rising geo-political tensions between the global west and east. In essence, growth prospects, although improving, remain clouded by heightened uncertainty around geopolitical tensions, financial stability and the pace and extent of monetary tightening to tame inflation.

Gains in the widespread policy rate hikes across both advanced and emerging economies to rein-in inflation remain divergent across economies. Specifically, headline inflation has begun moderation in several economies across regions, but core inflation is stickier than anticipated. The pressure on many households remains acute, and the cost of living is expected to remain at crisis levels in several economies for most of the second half of 2023.

Central banks would have to continue their tightening policy in the coming months albeit, at a moderate pace to effectively dampen price pressures, bearing in mind trade-off implications for the fragile output growth and financial system stability.

Figure 1: Year-on-Year Inflation in Selected Economies (April 2023 - May 2023) in per cent



Source: Various National Statistics Offices

Central banks are now faced with a trade-off between managing inflation and maintaining financial sector stability. Hence, they are likely to sustain a tight stance, but at a moderate pace in favour of taming inflation.

Both the European Central Bank (ECB) and the Bank of England (BoE) increased interest rates in June, but the US Fed held rate unchanged to allow earlier hikes permeate the economy. We however anticipate that the Fed may engage in a number of rate hikes in the second half of the year as well as several other central banks before a gradual return to a hold stance and ultimately commence loosening.

There is however a risk that further rate hikes may aggravate the risk of financial sector instability and propel the economy into recession.

Ideally, following series of rate hikes in some economies like the United States, output growth was expected to have slowed significantly to a zero or negative region. However, the resilience showed by the economy continues to give central bank's policy head room to continue to hike although financial conditions are largely suboptimal now and debt burden are worsening particularly in the emerging economies.

In the financial markets, U.S. stock market is up 14% on a year-to-date basis through June 2023 as measured by the S&P 500 index, as both housing and industrial production are swinging back into positive territory at the midpoint of 2023.

In the currency market, year-to-date, the US dollar moderated by almost 5% against the euro in June 2023, as well as against a wider basket of currencies. The sustained dollar correction is largely driven by expectations that the US Federal Reserve is reaching the limit of its policy rate hike programme– an agenda that supported the currency throughout 2022. The recent US banking crisis has also weighed on the dollar. In addition, improving European growth, a possible potential US recession and China's reopening are all putting the pressure on the US dollar.

Furthermore, the recent campaign to challenge the dominance of the US dollar has gained more momentum, as Russia and Saudi Arabia are contemplating on the use of the Chinese yuan for oil trades. Oil is one of the most important and widely traded commodities in the world, and has traditionally been priced and traded in US dollars, given the US dollar a dominant role in global currency markets as countries that want to purchase oil must first acquire US dollars in order to do so.

The commodities market remains characterised by uncertainties and volatilities as geopolitical tensions worsen. Despite the uncertainties, the price of various commodities (food and energy) sustained moderation in June 2023 after peaking in October 2022. This is largely driven by a seasonal effect on energy demand and improvement in technology. Energy prices are expected to commence a rebound by the end of the third 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.

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

Global Economic Outlook

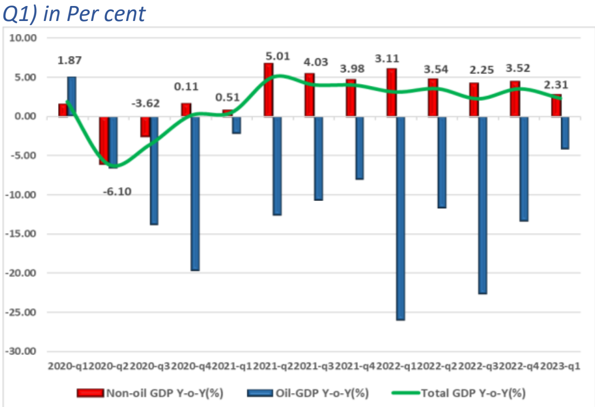
The global economy has shown some resilience in the first half of 2023. Supply conditions are steadily improving as the Chinese economy continues to open, while demand conditions are improving. Near term risk remain mixed as global output growth continues to show resilience. Downside risks however subsists – as the core inflation remains stubborn and central banks are likely going to maintain a tight stance at least for the greater part of the second half of 2023. Others include heightening 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 shadow of Covid-19 pandemic on the global economy.

As highlighted in our previous newsletters, inflation has commenced moderation in several economies, particularly the advanced economies, following series of rate hikes and at a cost to output growth. 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, although are likely to continue to favour moderate rate hikes, they are however faced with a more difficult decision reaching process as the cost to financial stability and output growth are becoming more visible in the second half of 2023. On the one hand, a premature easing of financial condition would revert the gains in taming inflation, on the other hand however, further tightening could worsen financial instability and tilt the economy into a recession. Major upside risks to inflation include supply disruptions due to the war in Ukraine, lingering shadow of the pandemic and change in climatic conditions.

Nigeria's Output Growth

Nigeria's real Gross Domestic Product (GDP) growth remained in the positive region for tenth consecutive quarters after since the last quarter of 2020. However, it slipped to 2.31 per cent (year-on-year) in the first quarter of 2023 from the 3.52 per cent and 3.11 per cent recorded in the preceding quarter and corresponding period of 2022. Specifically, 2023Q1 GDP growth was 1.21 and 0.8 percentage points lower than the outturn recorded in 2022Q4 and the corresponding 2022Q1, respectively. The decline was mainly attributed to the constraining effects of cash crunch in the first quarter triggered by naira redesigned and aggressive implementation of the cashless policy. However, in nominal terms, 2023Q1 GDP grew by 13.07 per cent to N51.2 trillion from N45.3 trillion in the corresponding period of 2022. In terms of sectoral contributions, the non-oil sector accounted for 93.79 per cent of Nigeria's GDP in 2023Q1 while oil sector contributed only 6.21 per cent (See figure 3). Non-oil GDP was mainly driven by ICT, financial institutions, trade, manufacturing and Construction, among others.

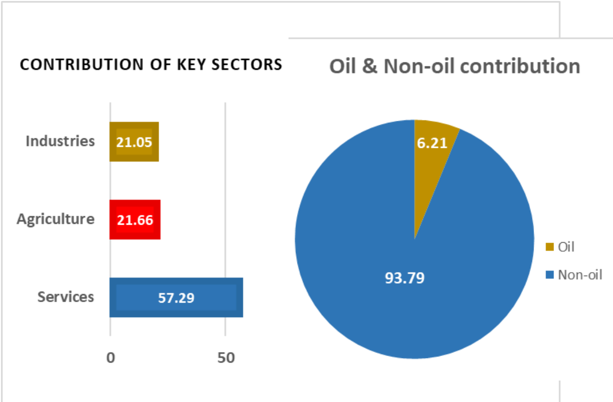
Figure 2: Real GDP Growth Rate in Nigeria (2020 Q1 – 2023 Q1) in Per cent



Source: NBS, June 2023

Further breakdown of aggregate output growth in 2023Q1 indicates that services, agriculture and industrial sectors accounted for 57.29 per cent, 21.66 per cent and 21.05 per cent, respectively (See figure 4).

Figure 3: Sectoral Contributions to GDP 2023Q1

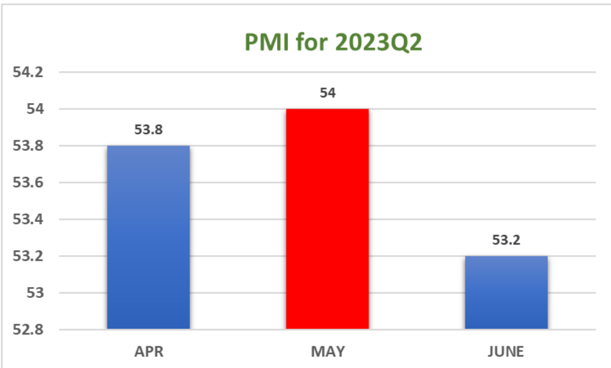


Source: NBS, 2023

Nigeria's Output Growth Outlook

Following the removal of fuel subsidy and exchange rate unification by the new government, energy prices and cost of production are expected to rise sharply thereby slowing output expansion as reflected by the purchasing managers' index (PMI) for June 2023. The Stanbic IBTC's purchasing PMI for June indicated a dip to 53.2 from 54.0 recorded in April 2023 (see figure 5). ***Nevertheless, output growth is expected to remain within the positive region in 2023Q2 as businesses and households adapt to the new economic realities.***

Figure 4: *PMI for 2023Q2*



Source: Stanbic IBTC, 2022

Price Update

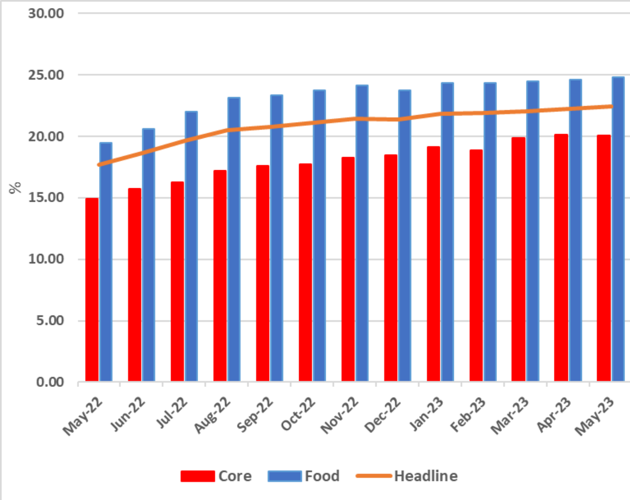
Nigeria's headline inflation further inched up to a record-high of 22.41 per cent in May 2023 compared to the 22.22 per cent recorded in the previous month. May headline inflation indicated an increase of 0.19 percentage points relative to April 2023. On a year-on-year basis headline inflation rose by 4.70 percentage points above the 17.71 per cent recorded in May 2022. Similarly, on a month-on-month basis, headline inflation was elevated to 1.87 per cent compared to the 1.71 per cent recorded in January 2023, indicating a 0.15 per cent rise in in headline inflation month-on-month.

In the same vein, on a month-on-month basis, the All-Items Index in May 2023 rose to 1.94 per cent from the 1.91 per cent recorded in April. This implies an increase in general price level in May by 0.03 per cent compared to April 2023.

The Food inflation rate, on a year-on-year basis, rose to 24.82 percent in May 2023, which was 5.3 percentage points higher than the 19.50 recorded in May 2022. The rise in the food inflation on year-on-year basis was mainly driven by the prices of Oil and fat, Yam and other tubers, Bread and cereals, Fish, Potatoes, Fruits, Meat, Vegetable, Spirit (NBS, 2023).

Core inflation was elevated to 20.06 per cent in May 2023 (year-on-year) up by 5.16 percentage points relative to the 14.90 per cent recorded in May 2022. On a month-on-month basis, the Core inflation rate was 1.81 per cent in May 2023. It stood at 1.46 per cent in April 2023, up by 0.35 per cent. The increase in core inflation was driven mainly by the prices of Gas, Passenger transport by Air, Liquid fuel, Vehicle spare parts, Fuels, and lubricants for personal transport equipment, among others.

Figure 5: Year-on-Year Headline, Food and Core Inflation (Jan 2022 – April 2023) in per cent



Source: National Bureau of Statistics (NBS), 2023

Price Outlook

Inflation is expected to further heighten in June 2023. Our forecast showed that inflationary pressure would heighten as headline food and core inflation are expected to rise to 22.47, 24.92 and 20.12 per cent respectively.

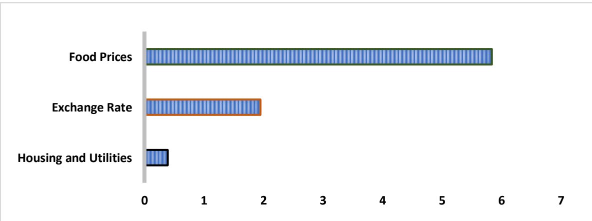
Table 1: Inflation forecast for June 2023 in Per Cent

Headline	Food	Core
22.47	24.92	20.12

Source: CAPE Economic Research and Consulting, 2023

The key drivers of the headline inflation forecast were, food prices, exchange rate, housing and utility prices which contribute 5.84 per cent, 1.95 per cent, and 0.39 per cent respectively.

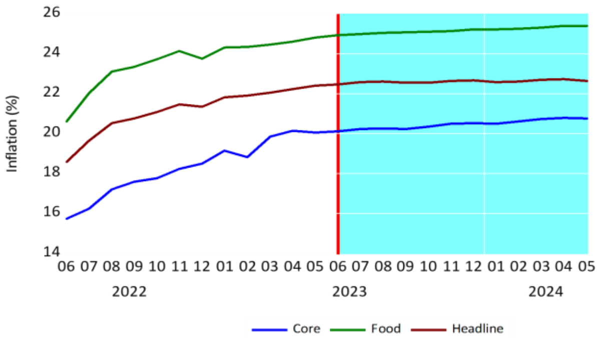
Figure 6a: Driver of Predicted Inflation



Source: CAPE Economic Research and Consulting, 2023

Our analysis showed a significant impact of food prices and exchange rate on headline inflation in June 2023 when compared with the previous month. It also suggests that the effect of increase in energy prices and exchange rate has begun to permeate into the economy, which would reflect over a 12-onth period, through a base effect.

Figure 6b: 12-Month Inflation Projection



Source: CAPE Economic Research and Consulting, 2023

The key drivers of core inflation forecast were clothing and footwear, education, transportation, and alcoholic beverages. Our analysis also established monetary policy instruments as pull factors, suggesting some level of monetary policy instruments potency in anchoring expectations in Nigeria, while, structural factors remained 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 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, as well as the emergence of a multi-tier credit system in Nigeria, which could be blunting the potency of the policy rate.

Upside risks to inflation are the burgeoning fiscal deficit; monetary financing, 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 ₦786.16 billion among the three tiers of government in the month of June 2023. The amount distributed was significantly higher than the ₦685.93 billion shared in May 2023 by ₦100.23 billion representing a increase of 14.6 per cent.

Further breakdown shows that Federal Government received ₦301.89 billion; States, ₦265.88 billion; Local Government, ₦195.54 billion. Thirteen per cent derivation fund shared among oil-producing states amounted to ₦22.85 billion (See Table 2 below). Revenue allocation to all the three tiers of government generally increased in June 2023 due to the increase in both oil and non-oil receipts, particularly, companies Income Tax (CIT), Import and Excise Duties, Value Added Tax (VAT), Petroleum Profit Tax (PPT) and Oil & Gas Royalties.

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

	June	May	% Change
Fed.	*301.89*	*264.61*	*14.1*
State	*265.88*	*226.32*	*17.5*
LG	*195.54*	*166.78*	*17.2*
Deriv	*22.85*	*28.22*	*-19.0*
Total	**786.16**	**685.93**	***14.6***

Source: FAAC, June 2023

Following the alignment of exchange rate and the removal of fuel subsidy, allocations to the three tiers of government are expected to rise significantly in the subsequent months as more funds are freed up for government utilisation.

The balance in the Excess Crude Account (ECA) as at February 20th, 2023 stood at U$473,754.57

Fuel Subsidy Removal: The Pains & Gains

The immediate implementation of subsidy removal by the new administration marked the beginning of a defining moments for Nigerians as they grapple with multiple effects of the policy on their livelihood and the economy at large. There are no doubts that, the pains, as well as attendants gains will affect everyone in the short, medium and long-term.

The Pains:

- Rise in the general cost of living as it further aggravates inflations
- Increased in poverty level as purchasing power of consumers are eroded

- Reduced consumption and welfare
- Could trigger social unrest and protest

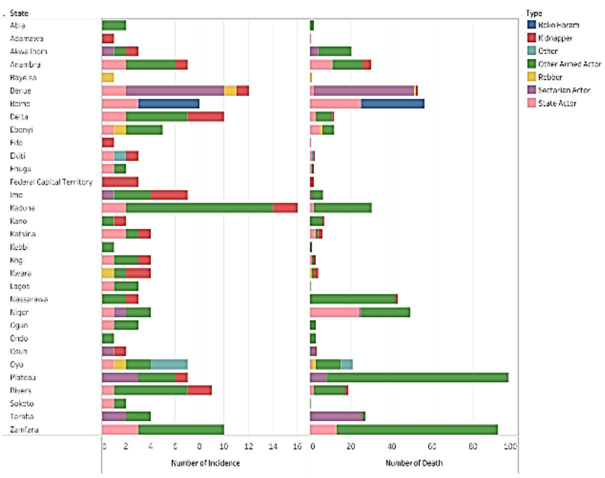
The Gains:

- Make resources available investment in critical infrastructures
- Improvement in the availability of petroleum products
- Reduction in government deficit and borrowing
- Discourage smuggling fuel by large arbitrage
- Increase in private sector investments in downstream sector leading to local refining
- It would help conserve foreign exchange
- Creation of more jobs, increase income and reduced poverty in the long term
- Reduction in environmental pollution

The removal of subsidy is no doubt a step in the right direction as the benefits far outweighs the pains. However, government must quickly provide palliatives to cushion the immediate adverse effects of the policy on the vulnerable poor.

UPDATE ON INSECURITY

Figure 7: Trend of insecurity in Nigeria



Source: CAPE Economic Research and Consulting, 2023

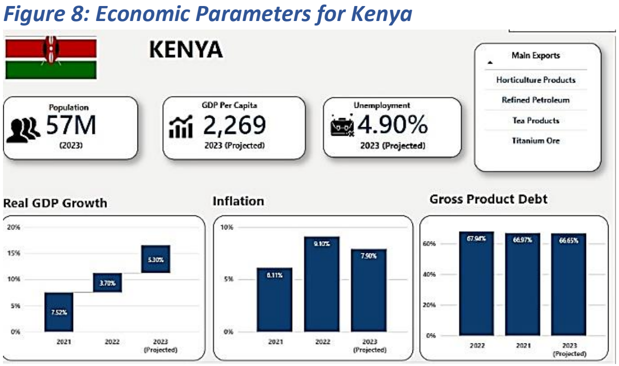
Insecurity remained heightened across Nigeria, as activities of other armed actors have become prevalent across the subnational and geo-political regions. Our insecurity data collection dashboard showed that although, insecurity was most rife in Kaduna, largely driven by other (non-state) armed actors and kidnapping, killings due to nonstate actors was highest in Plateau and Zamfara state. There also appear to be a resurge of Boko haram related tensions in Borno as number of insecurity incidences and killings surged significantly and Kidnapping activities in the FCT appears to be on the rise.

Conclusion

In conclusion, we anticipate that the weight of uncertainty may necessitate that a broad-based growth remains elusive in 2023. Global growth prospect however is expected to be buoyed by emerging economies perofmance specifically China. The tightening stance of most central banks across both advanced and emerging markets for the most of 2022 and first half of 2023 has started yielding results in price moderations in some economies, although core inflation remains largely sticky. However, this as come at a significant moderation to output and financial stability with a heightening risk of a financial crisis. In Nigeria, economic prospects for the second half of 2023 remains resilient, albeit at a moderated level, following bold policy reforms.

Country in Focus – Kenya

Figure 8: Economic Parameters for Kenya



Source: CAPE Economic Research and Consulting, 2023