Economic Newsletter

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CAPE
Economic Research & Consulting

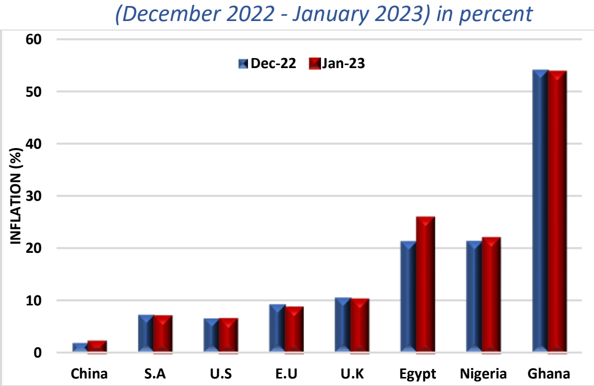
- *Price pressures are expected to sustain moderation but remain above pandemic levels as tightening efforts fully crystalize.*
- ***Forecast shows inflationary pressure in Nigeria in February 2023, with headline inflation slowing to 22.05 percent***.

## Global Economic Update

Prospects for the global economy are improving compared to the doomsday expectations at the start of the year. Although, the year began 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. A shift away from the Zero- Covid policy in China, a resilient job market in the United States, and a mild winter in Europe- moderating energy prices, have improved prospects for the year.

In advanced economies, inflation has maintained a downward trajectory after a series of rate hikes and a moderation in energy prices. However, in emerging markets, supply disruptions, currency depreciations against a strong US dollar, and high levels of deficit financing were factors driving inflation.

*Figure 1: Year-on-Year Inflation in Selected Economies (December 2022 - January 2023) 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, although the US dollar weakened marginally against several advanced economies' currencies between January to February as the yields market improved, however, the US dollar remains significantly strong against the currencies of most emerging economies.

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 February 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.

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.

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## Global Economic Outlook

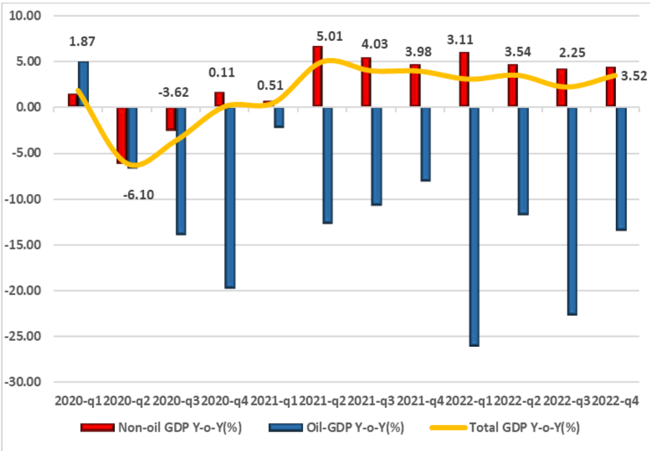
The global economy has shown some resilience in the first two months of 2023. Supply conditions are steadily improving, as the Chinese economy continues to open, while demand conditions remain modest. Near term, risks are upside skewed as the cost-of-living crisis begins to wane in several economies 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 for most of 2023 into 2024 to avert a premature easing of financial conditions and revert the gains in taming inflation. 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

Nigeria's Gross Domestic Product (GDP) outturn in the fourth quarter of 2022 indicated an improvement over the previous quarter and remained in the positive region for the ninth consecutive quarter. In Q4 2022, Nigeria's real GDP grew by 3.52 percent year-on-year relative to the 2.25 percent growth recorded in Q3 2022. However, it declined marginally by 0.46 percentage points relative to the growth rate of 3.98 percent reported in Q4 2021. The overall, Nigeria's annual GDP growth rate in 2022 stood at 3.10 percent, compared to the 3.40 percent reported in 2021, indicating a decline of 0.30 percentage points. The decline was mainly attributed to the decelerated performance of agriculture and industry amid the improved performance of the services sector. In terms of share contribution, the non-oil sector accounted for 95.66 percent while oil sector contributed only 4.34 percent of real GDP growth in Q4 2022 (See figure 3). Non-oil GDP was mainly by ICT, agriculture, financial Institutions, and manufacturing among others.

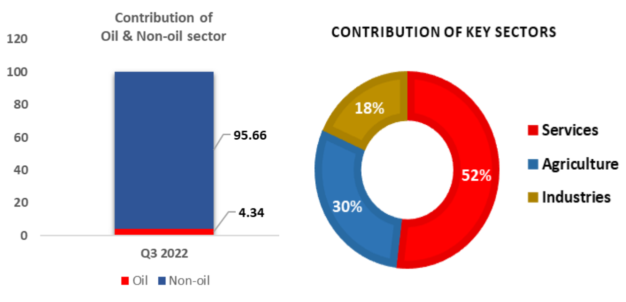
*Figure 3: Real GDP Growth Rate in Nigeria (2020 Q1 – 2022 Q4) in Percent*




**Source: National Bureau of Statistics (NBS), 2023**

Further breakdown of aggregate output growth in Q4 2022 indicates that services, agriculture, and industrial sectors accounted for 56.27 percent, 26.46 percent, and 17.27 percent, respectively (See figure 4).

Figure 4: Sectoral Contributions to GDP Q4 2022




17.1333

Source: NBS, 2023

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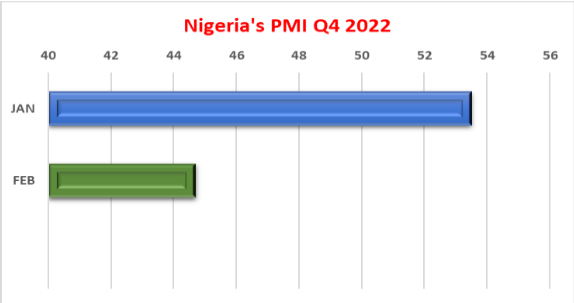
## Nigeria's Output Growth Outlook

Owing to the dampening effect of cash shortages across the country coupled with subsisting multiple headwinds including high energy prices, the rising cost of production, and infrastructural deficit, among others, output growth is expected to slow down, albeit remain positive in Q1 2023. The Stanbic IBTC's purchasing managers' index (PMI) for February indicated substantial declines in both output and new orders, as the headline, PMI dropped below 50.0 points. A PMI lower than 50 suggests a contraction of private sector activity. As shown in figure 5, February 2023 PMI shrank to 44.7 from 53.5 in the previous month.

Figure 4: *PMI for January and February 2023*




Source: Stanbic IBTC, 2022

The expectation of slow output growth in Q1 2023 is anchored on the likely contraction of aggregate demand as election spending was constrained by the implementation of a cashless policy amid weak financial infrastructure.

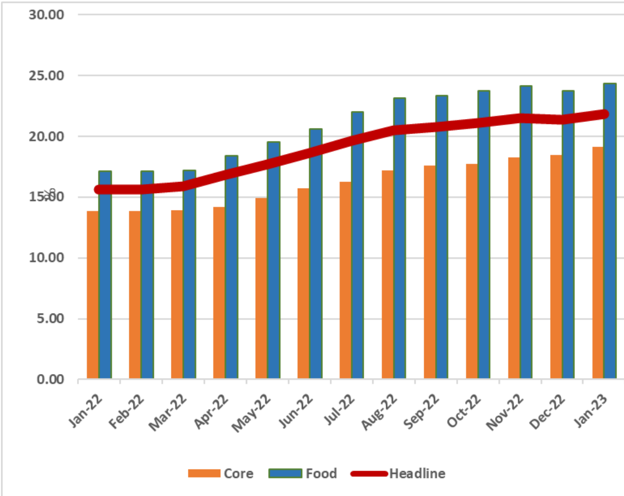
## Price Update

Nigeria's headline inflation hit a record high of 21.82 percent year-on-year, as it returned to its upward trajectory in January 2023. Relative to the 15.60 percent recorded in January 2022, headline inflation in January 2023 was higher by 6.22 percentage points. Headline inflation rose by 0.47 percentage points in January 2023 when compared to the 21.34 percent recorded in December 2022. Similarly, on a month-on-month basis, headline inflation was elevated by 1.87 percent compared to the 1.71 percent recorded in January 2023, indicating a 0.15 percent rise in headline inflation month-on-month.

The food inflation rate, on a year-on-year basis, rose to 24.32 percent in January 2023 relative to the 17.13 percent recorded in January 2022. Food inflation was elevated by 0.57 percentage points above the 23.75 percent reported in December 2022. The rise in food inflation was driven by increases in the prices of Bread and Cereals, Oil and Fat, Potatoes, Yam and Other Tubers, Fish, Vegetables, Fruits, and Meat, among others food products.

Similarly, core inflation rose to 19.16 percent year-on-year in January 2023 from 13.78 percent recorded in January 2022. On a month-on-month basis, the core inflation rate was 1.82 percent in January 2023, up by 0.49 percent points from the 1.33 percent recorded in December 2022. Core inflation in January 2023 was driven by prices of Gas, Liquid Fuel, Passenger Transport by Air, Vehicles Spare Parts, Fuels, and Lubricants for Personal Transport.

*Figure 5: Year-on-Year Headline, Food and Core Inflation (Jan 2022 – January 2023) in percent*




**Source: National Bureau of Statistics (NBS), 2023**

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## Price Outlook

Inflation is expected to rise in February 2023 as currency redesign persists. Our forecast showed that the scarcity of the Naira would further fan commodity prices. Hence, the inflation pressure persists as the headline and food inflation are expected to rise to 22.05, 23 basis point increase, and 20.01, 86 basis point increase, respectively. These forecasts suggest that

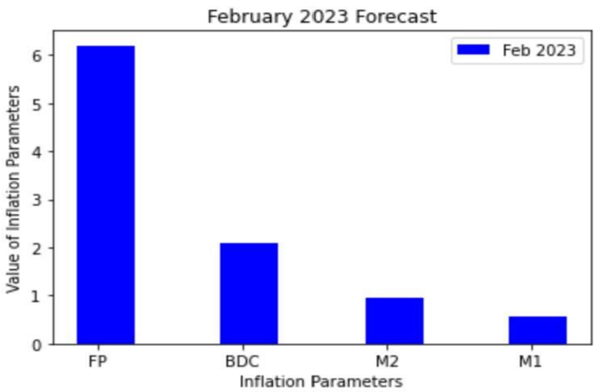
Table 1: Inflation forecast for February 2023 in Percent

| Headline | Food |
|---|---|
| 22.05 | 20.01 |

Source: CAPE Economic Research and Consulting, 2023

The key drivers of the headline inflation forecast were, food prices, parallel market exchange rate, broad money supply, and narrow money supply which contribute 6.2 percent, 2.09 percent, 0.94 percent, and 0.55 percent, respectively, while food prices and parallel market exchange rate are push factors narrow and broad money supply are pulled factors.

Figure 3b: Driver of Predicted Inflation




Source: CAPE Economic Research and Consulting, 2023

Our analysis showed that the magnitude of the listed four main drivers of inflation, food prices, parallel market exchange rate, broad money, and narrow money supply, increased in February. For example, Food prices increase by 20 basis points from the January forecast while the parallel market exchange rate increased marginally by 13 basis points. The monetary instruments still remained the main pull factors in our forecast but their increase further put pressure on inflation in February.

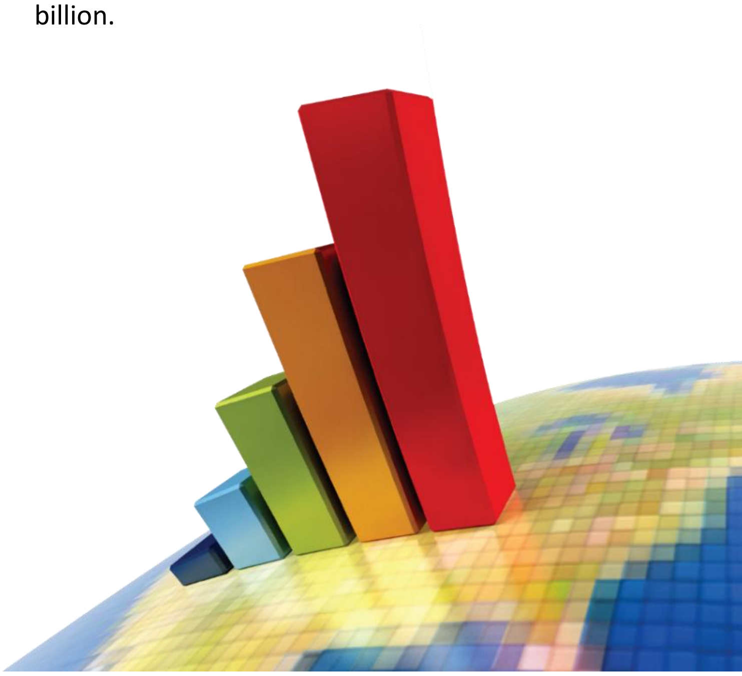
The increase in our food inflation forecast, as the economy recovers from the impact of a flood, was driven by the currency redesign policy. The policy disrupts the entire food supply chain and thus pass-through to food prices, especially staple food such as bread and rice.

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

## Fiscal Operations Update

The Federation Account Allocation Committee (FAAC) distributed the total sum of ₦750.17 billion among the three tiers of government in the month of February 2023. The amount distributed was significantly lower than the ₦990.19 billion shared in January 2023 by ₦240 billion representing a decrease of 24.2 percent.

A further breakdown shows that Federal Government received ₦277.33 billion; States, ₦244.98 billion; Local Government, ₦180.14 billion.



The derivation fund shared among oil-producing states amounted to ₦32.73 billion. Revenue allocation to all three tiers of government decreased in February 2023 (See Table 2 below). The balance in the Excess Crude Account (ECA) as at February 20th, 2023 stood at U$473,754.57

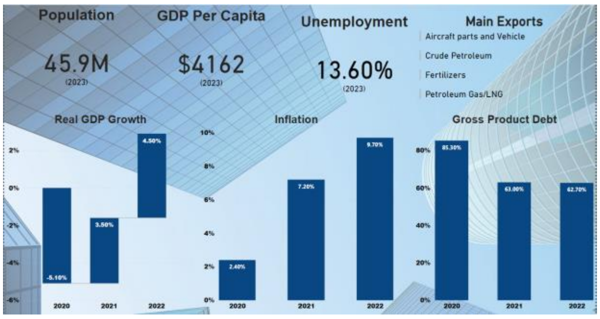
**Table 2: Highlight of FAAC Distribution (N'billion)**

| | February | January | % Change |
|---|---|---|---|
| *Fed.* | *277.33* | *375.31* | *-26.1* |
| *State* | *244.98* | *299.56* | *-18.2* |
| *LG* | *180.14* | *221.81* | *-18.8* |
| *Deriv* | *32.73* | *93.52* | *-65.0* |
| **Total** | **750.17** | **990.19** | ***-24.2*** |

Source: FAAC, February 2023

## Country in Focus – ALGERIA

*Figure 4: Economic Parameters for Algeria*




## Conclusion

In conclusion, we anticipate a bit better-than-anticipated 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 2022 has started yielding results in price moderations in some economies, while others are expected to catch up. However, this has come with a significant moderation in output. In Nigeria, economic prospects for the fourth quarter of 2022 remain resilient, albeit at a moderated level.