Cape Economic Performance and Prospect Bulletin – May 2023

Highlights

- *Price pressures are expected to sustain moderation but remain above pandemic levels as tightening efforts continue to crystalise.*
- *Nigeria's Q1 2023 output growth expected to be lower than Q4 2022 but remain positive.*
- ***Forecast shows that inflationary pressure in Nigeria moderate in April 2023, with headline inflation slowing to 21.87 per cent.***

Global Economic Update

Prospect for global output growth continues to show resilience amidst a high level of uncertainties, in the second quarter of 2023, away from the gloomy outlook at the start of the year.

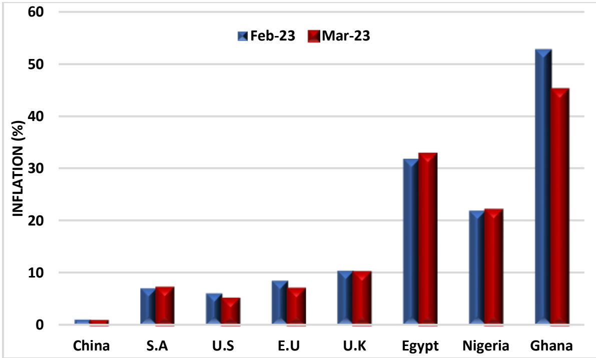
Unsurprisingly, the most prospect of economic activity is expected from Asia, with China's reopening projected to strengthen activity across the continent, as a significant rebound is expected for China this year. Prospects in Europe remain largely gloomy with significant pressures emanating from the financial sector because of the tightening to rein in inflation. In the United States, prospects remain largely divergent as some analysts and economic managers anticipate a recession following the tight financial conditions that have led to the collapse of some banks. Some have argued further that the collapse in the financial sector is only a signal and that the job market resilience is only a smoke screen, as there are serious economic imbalances that would end in an economic crisis.

Additionally, major headwinds to output growth and upside risk to inflation are the continued war in Ukraine and rising geopolitical 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 2023.

The recent crisis in the banking sector across a number of economies in Europe and the United States which is in part linked to the series of policy rate hikes across economies has complicated efforts to deal with runaway prices.

Figure 1: Year-on-Year Inflation in Selected Economies (February 2023 - March 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. While most central banks are likely to maintain a tight stance but at a slower pace in favour of taming inflation, there is however a risk of further rate hikes increasing the risk of deepening the financial sector instability and unnecessarily pushing the economy into recession. Ideally, following the several 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 shown by the economy continues to give the central bank's policy room to continue to hike.

Central banks therefore need to carefully "balance the risk of not doing enough and not getting inflation under control against the risk of maybe slowing down economic activity too much" as recently argued by Jerome Powell the Federal Reserve chair in defence of its latest policy rate hike in May 2023.

It is, however, important to note that the tight monetary policy stance of several central banks particularly in emerging economies is having a moderating impact on prices and has led to tight financing conditions with a dampening impact on output growth and increased debt burden, particularly in emerging economies.

In the currency market, the US dollar has already dropped 10% from its peak in 2022 as it hit its lowest level in a year against the euro in April 2023, as well as against a wider basket of currencies. More specifically, the dollar was impressively bullish for about 18 months, with gains hitting a two-decade high against a plethora of currencies in September 2022.

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 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 the use of the Chinese yuan for oil trade. Oil is one of the most important and widely traded commodities in the world and has traditionally been priced and traded in US dollars, giving the US dollar a dominant role in global financial markets as countries that want to purchase oil must first acquire US dollars to do so. If oil trading were to shift away from the US dollar, it would dramatically reduce the demand for US dollars, which would lead to a decrease in the value of the US currency. This could have several ripple effects throughout the global economy, including hugely increased inflation in the US and potentially destabilising effects on financial markets. With the recent developments, therefore investors need to commence re-evaluating their portfolios to seize the opportunities in a new cycle and hedge against losses.

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 April 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. 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.

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.

Global Economic Outlook

The global economy has shown some resilience in the first quarter of 2023 and continues to show the same in the second quarter of 2023. Supply conditions are steadily improving, as the Chinese economy continues to open, while demand conditions remain modest. Near-term risks remain upside skewed as the cost-of-living crisis commences moderation 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 – 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 impacts of Covid-19.

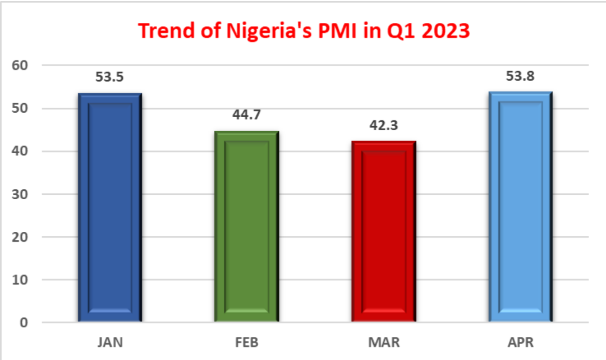
As highlighted in our previous newsletters, inflation has commenced moderation in several economies, particularly the advanced economies, following a series of rate hikes and at a cost to output growth. Although inflation is expected to continue to decelerate significantly in 2023, it would however remain above pandemic levels across both advanced and emerging economies. Central banks, although 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 quarter of 2023. On the one hand, a premature easing of financial condition would revert the gains in taming inflation, on the other hand, however, a further tightening could worsen financial instability and tilt the economy into a recession. 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

The opening month of Q2 2023 kicked off on a positive note as business activities in the private sector gained momentum following the easing of the cash crunch. The Purchasing Managers' Index for April 2023 signals a significant recovery as the Stanbic IBTC headline PMI jumped to 53.8 from 42.3 recorded in the month of March (See figure 2). As a rule, PMI readings above 50.0 suggests improvement in business conditions, while readings below 50.0 indicate otherwise.

During the month of March, companies reported expansions in new businesses and output amid improved access to funds. Particularly, activities in key sectors, mainly, agriculture, manufacturing, services and wholesale & retail recorded a rebound. However, firms remained cautious with regard to hiring, hence, and employment fell marginally.

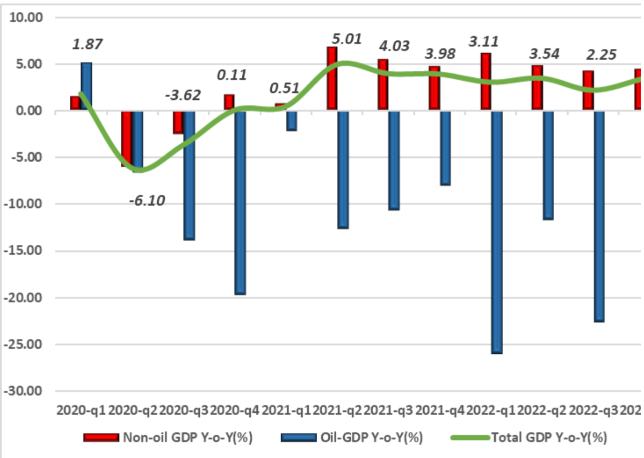
Figure 2: Trend of Nigeria's *PMI in Q1 2023*



Source: Stanbic IBTC, 2023

In light of the above, there is elevated optimism that Nigeria's real GDP growth outturn in Q2 2023 would emerge even stronger in the positive region where it had domiciled in the previous nine quarters (See figure 3 below).

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



Source: National Bureau of Statistics (NBS), 2023

Nigeria's Output Growth Outlook

Amid the increasing availability of cash, we expect a continuous recovery in business activities in the near term. Also, following the peaceful conduct of the 2023 general election and the anticipated inauguration of the new administration in May, investors are likely to become more confident to invest in productive sectors of the economy. However, output growth may be slightly weakened by the uptick in inflationary pressure has continued to fuel the rising cost of production amid high energy prices and persistent infrastructural deficit in the country. Overall, we expect stronger output growth in Q2 2023.

Price Update

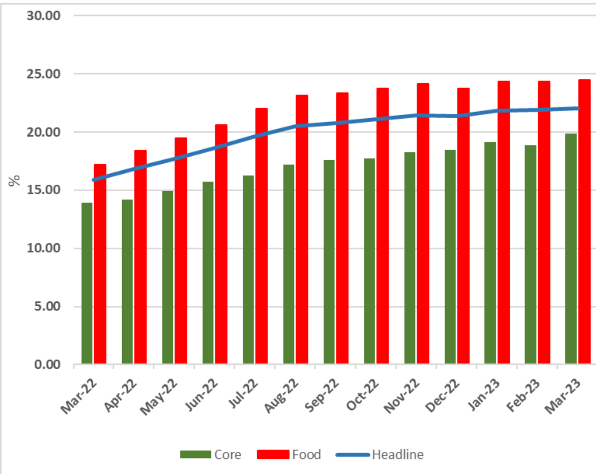
In March 2023, Nigeria's headline inflation climbed higher to 22.04 per cent year-on-year, from the 21.91 per cent recorded in February 2023, making it the highest since 2009. This represents an increase of 0.13 percentage points compared to February 2023. Nigeria's headline inflation rate was 6.13 percentage points higher, compared to the 15.92 per cent recorded in March 2022.

On a month-on-month basis, headline inflation was accelerated to 1.86 per cent in March 2023 compared to the 1.71 per cent recorded in February 2023, indicating a 0.15 percentage points increase in the general price level. The main drivers of headline inflations are food & non-alcoholic beverages, housing, water, electricity, gas & other fuel clothing & footwear, transport, and furnishings, among others.

The food inflation, on a year-on-year basis, rose to 24.45 per cent in March 2023 compared to the 17.20 recorded in March 2022. Relative to the previous month, food inflation rose by 0.10 percentage points from the 24.35 recorded in February 2023. The rise in food inflation on- year on year basis was caused mainly by increases in prices of Oil and fat, Bread and cereals, Potatoes, Yam and other tubers, Fish, Fruits, Meat, Vegetables, and Spirits.

Similarly, core inflation jumped to 19.86 per cent from 13.91 per cent recorded in March 2022. Relative to the previous month, core inflation rose by 1.02 percentage points from 18.84 per cent in February 2023. The key drivers of core inflation were prices of Gas, Passenger transport by Air, Liquid fuel, Fuels, and Lubricants for personal transport equipment, Vehicles spare parts, Maintenance, and repair of personal transport equipment, Medical services, Passenger transport by road, among others.

Figure 4: Year-on-Year Headline, Food and Core Inflation (March 2022 – March 2023) in per cent



Source: National Bureau of Statistics (NBS), 2023

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Price Outlook

Inflation is expected to moderate marginally in April 2023. Our forecast showed that inflationary pressure would moderate as headline food and core inflation are expected to slow to 21.87, 20.2 and 17.63 per cent respectively.

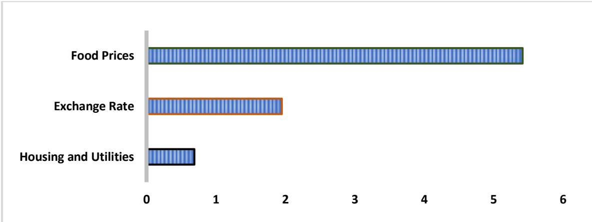
Table 1: Inflation forecast for March 2023 in Per Cent

Headline	Food	Core
21.87	20.2	17.63

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 contributed 5.42 per cent, 1.95 per cent, and 0.92 per cent 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 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) and credit to the core private sector which contributed 0.92 and 0.45 per cent respectively in moderating the speed of inflation in April 2023.

The key drivers of the core inflation forecast were clothing and footwear, education, transportation, and alcoholic beverages which contributed 1.75, 1.74, 1.58, and 0.46 per cent respectively.

The moderation in our food inflation forecast, despite the lingering impact of floods 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 a 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 a total sum of ₦714.63 billion among the three tiers of government in the month of April 2023. The amount distributed was lower than the ₦722.68 billion shared in March 2023 by ₦8.05 billion representing a decrease of 1.1 per cent.

A further breakdown reveals that Federal Government received ₦276.14 billion; States, ₦232.13 billion; Local Government, ₦171.26 billion. The derivation fund shared among oil-producing states amounted to ₦35.10 billion. Revenue allocation to all three tiers of government further decreased in April 2023 (See Table 2 below).

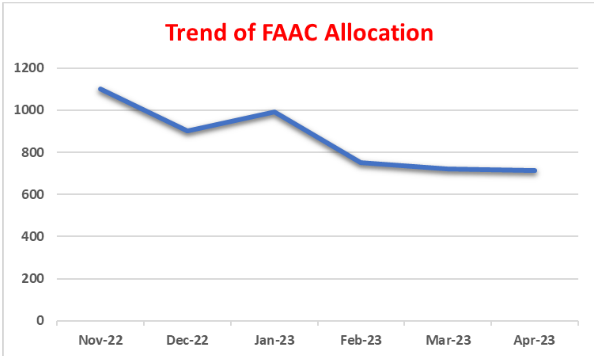
Table 2: Highlight of FAAC Distribution (N'billion)

	April	March	% Change
Fed.	*276.14*	*269.06*	2.6
State	*232.13*	*236.46*	-1.8
LG	*171.26*	*173.94*	-1.5
Deriv	*35.10*	*43.21*	-18.8
Total	**714.63**	**722.68**	**-1.1**

Source: FAAC, April 2023

The trend of revenue allocation has been declining, reflecting persistent revenue challenge of government.

Figure 6: Driver of Predicted Inflation



Source: FAAC Reports

The balance in the Excess Crude Account (ECA) stood at U$473,754.57

SECURITISATION OF N22.7 TRILLION WAYS AND MEANS: IMPLICATIONS FOR NIGERIA

The Senate has approved the securitisation of N22.7 trillion Ways and Means with a 40-year tenor, 37 years repayment period and a moratorium of 3 years on principal repayment. The interest rate on the securitised debt is pegged at 9 per cent per annum.

The benefits of the conversion include transparency in public debt statistics and a reduction in the cost of debt service as the government would now pay a 9 per cent interest rate as against the current 21 per cent (MPR + 3 per cent) it is paying. This would also reduce fiscal deficit due to lower interest rate payments. Despite these gains, there are loads of concerns.

There are worries that it would further worsen Nigeria's debt profile which is now N69 trillion. Yet, there is a higher proclivity that the government would continue to borrow more to fund its budget thereby raising debt sustainability concerns for the country. Also, there are concerns that the securitisation of Ways and Means would further encourage fiscal indiscipline as the government will continue to borrow heavily from the central bank beyond the 5 per cent of the previous year's revenue permissible by law.

Country in Focus – Angola

Figure 7: Economic Parameters for Angola

Source: CAPE Economic Research and Consulting, 2023

Conclusion

In conclusion, we anticipate that the weight of uncertainty may necessitate that broad-based growth remains elusive in 2023. Global growth prprospectsowever is expected to be buoyed by emerging economies' performance specifically China. 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.