Cape Economic Performance and Prospect Bulletin – August 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 July 2023, with headline inflation rising to 23.51 per cent.***

## Global Economic Update

The global economy since the beginning of 2023 has been resilient despite several headwinds, including heightening geopolitical tensions and policy-rate hikes to tame a rather sticky core inflation.

Asia has supported global output as it continues to lead the charge of economic prospect with China's exit from the zero-covid policy. In Europe, a deep recession was averted in the winter period, largely owing to warmer than usual temperatures and to the accelerated switching to alternative energy sources following Russia's decision to turn off gas flows. US consumer spending improved as employers added 187,000 workers to their payrolls. Although, overall job gains slowed, the labour market remains healthy as wages picked up with a 4.4 per cent increase year-on-year (y-o-y) and unemployment rate fell and remains near the lowest in decades. The higher wages suggest the Federal Reserve may need to keep interest rates higher for longer.

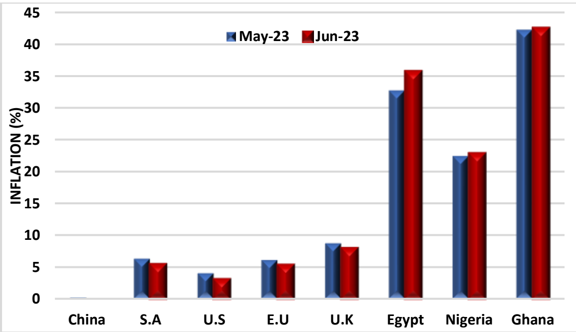
It is important to note that the full effect of monetary tightening across economies have not fully permeated through and as the various tailwinds dwindle and interest rate hikes bite in advanced economies – and the gains from China re-opening fizzles out, the resilience of the global economy may wither.

Additional headwinds to output growth and upside risk to inflation are the continued 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 remains high albeit at a reduced level of intensity particularly in some advanced economies

Central banks will maintain a tightening stance for the remainder of 2023 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 (May 2023 - June 2023) in per cent*




**Source: Various National Statistics Offices**

The European Central Bank (ECB), the US Federal reserves and the Bank of England (BoE) all hiked rates in July.

We at Cape anticipate more rate hikes across several advanced and emerging economies in the remainder of the year before a gradual return to a hold stance and ultimately loosening. The return to loosening is precipitated on the risk of further rate hikes dampening inflationary pressure but heightening the financial system 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.

While inflation is now coming down in the advanced economies, the aggressive monetary policy is anticipated to have significant longer-term impact on debt, financial stability and capital reversals in countries across the world, especially in the emerging economies.

The global financial conditions remain significantly under pressure. In the light of the build-up of financial stability risks, several US and European banks have come under substantial pressures. In the financial markets, the S&P 500 was up 3.11 per cent in July, bringing its year-to-date (y-t-d) return to 19.52 per cent and the Dow Jones Industrial Average increased 3.35 per cent for the month and was up 7.28 per cent y-t-d. This is largely driven by both housing and industrial production that have swung back into positive territory.

In the currency market, year-to-date, the US dollar gained nearly 3 per cent from its lowest in more than a year on July 14, 2023. Renewed strength in the dollar coincided with a dent in the euro's stellar run over the past few weeks - it is still up roughly 2.4 per cent against the dollar for the year. 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 continues to gain 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 rallied in July 2023.

Crude prices are finishing a solid month on a high note as demand prospects remain impressive and expectations are that OPEC+ will keep the market tight. Moreover, oil inventories are beginning to drop elsewhere too, especially in the U.S., where the government has started refilling the Strategic Petroleum Reserve from its lowest level in multiple decades. 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 continue 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

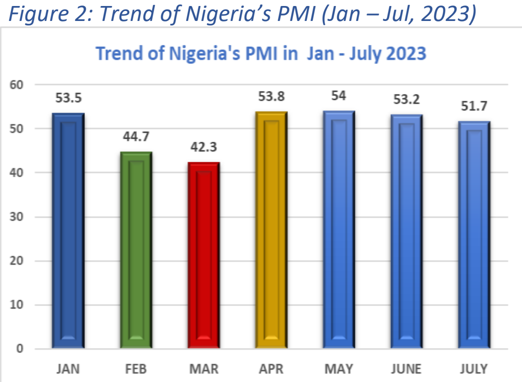
The global economy continues to show resilience in the third quarter of 2023. Supply conditions are steadily improving, as the Chinese economy continues to open, while demand conditions are improving. Near term risk remain mixed as global output growth continues to show resilience. Downside risks however remain – 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, heightening political tensions in central and West Africa, tight financial conditions, weak export demand and the lingering impacts of the Covid-19.

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 third 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, 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

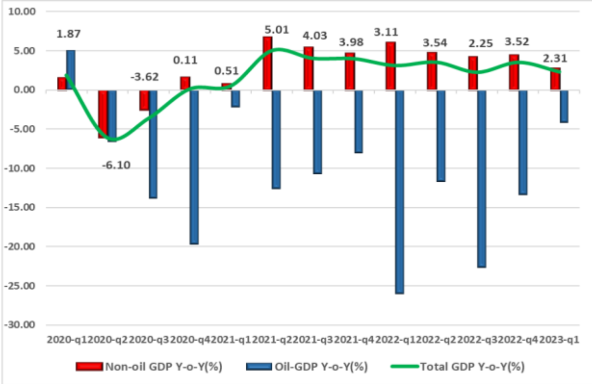
While Nigeria's real gross domestic product (GDP) for 2023Q2 is expected to remain in the positive region, 2023Q3 started on a weaker note following a dip in July 2023 PMI. The Stanbic IBTC Bank Nigeria PMI was pruned to 51.7 in July from 53.2 in the previous month, as business confidence weakened to an over nine-and-a-half-year low (see figure 2). The growth rates of both output and new orders decelerated to the lowest levels since their respective returns to the path of recovery after the naira scarcity at the beginning of the year. As the effects of subsidy removal permeates into the economy, coupled with the depreciation effect of the recent exchange rate policy, inflationary pressure became elevated and consequently dampened aggregate demand. On the supply side, cost of production became heightened as input prices, including wages, rose significantly, thereby slowing down production. However, as government begins to roll out palliatives to alleviate the impact of its recent policies on the poor and most vulnerable in the society, aggregate demand as well as output is expected to respond positively.

*Figure 2: Trend of Nigeria's PMI (Jan – Jul, 2023)*




Source: Stanbic IBTC, 2022

*Figure 3: Real GDP Growth Rate in Nigeria (2020 Q1 – 2023 Q1) in Per cent*

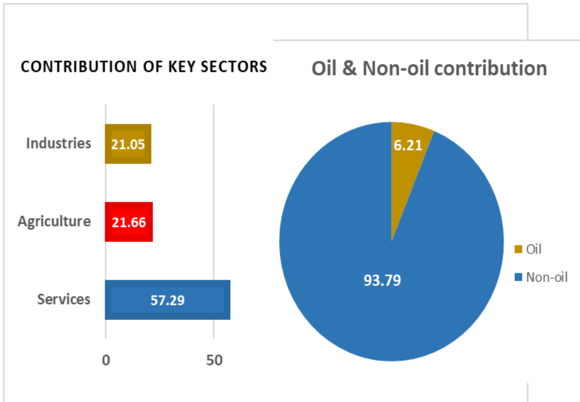



Source: NBS, June 2023

## Nigeria's Output Growth Outlook

The lingering effect of subsidy removal and exchange rate unification will be sustained until households and firms fully adjust to the new normal. Deployment of necessary palliatives would strengthen the resilience of the economy and as such, ***output growth is expected to remain within the positive region in 2023Q3.***

**Figure 4: Sectoral Contributions to GDP 2023Q1**




Source: NBS, 2023

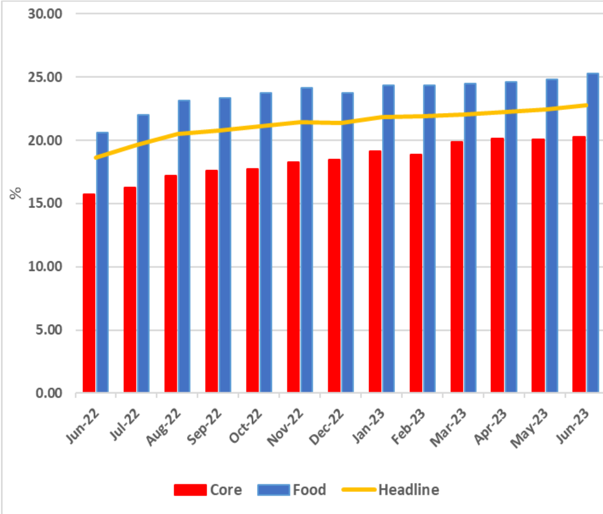
## Price Update

In line with expectation, Nigeria's headline inflation further accelerated to a record-high of 22.79 in June 2023, up from 22.41 per cent recorded in the previous month. On a year-on-year basis headline inflation rose by 4.19 percent points above the 18.60 per cent recorded a year ago and 0.72 percent above the headline inflation in June 2023. Similarly, on a month-on-month basis, headline inflation was elevated by 2.13 percent compared to the 1.94 per cent recorded in June 2023.

Food inflation rate, on a year-on-year basis, rose to 25.25 per cent in June 2023 from 20.60 per cent recorded in June 2022. This was 4.65 percentage points higher than the June 2022 figure. The rise in the food inflation on year-on-year basis was mainly driven by the prices of Oil and fat, Bread and cereals, Fish, Potatoes, Yam and other tubers, Fruits, Meat, Vegetable, Milk, Cheese, and Eggs. (NBS, 2023).

Core inflation, year-on-year, inched up to 20.27 per cent in June 2023 from the 15.75 per cent recorded in June 2022 indicating an increase of 4.53 percentage points. On a month-on-month basis, the Core inflation rate was 1.74 per cent in June, compared to the 1.81 per cent recorded in May 2023. Core inflation was mainly driven by prices of Passenger Transport by Air, Gas, Vehicles Spare Parts, Liquid Fuel, Fuels and Lubricants for Personal Transport Equipment, Medical Services, Passenger Transport by Road etc. On a month-on-month basis, the Core Inflation rate was 1.74 per cent in June 2023. It stood at 1.81 percentage in May 2023, down by 0.07 per cent.

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




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

## Price Outlook

Inflation is expected to further heighten in July 2023. Our forecast showed that inflationary pressure would heighten as headline food and core inflation are expected to rise to 23.51, 26.41 and 21.34 per cent respectively.

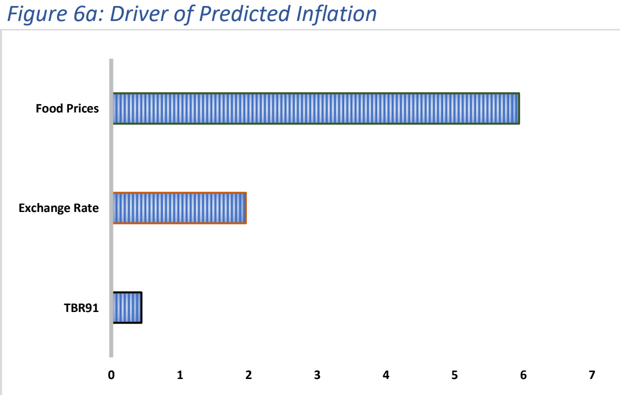
*Table 1: Inflation forecast for June 2023 in Per Cent*

| Headline | Food | Core |
|---|---|---|
| 23.51 | 26.41 | 21.34 |

**Source: CAPE Economic Research and Consulting, 2023**

The key drivers of the headline inflation forecast were, food prices, exchange rate, short term assets which contribute 5.94 per cent, 1.96 per cent, and 0.44 per cent respectively.

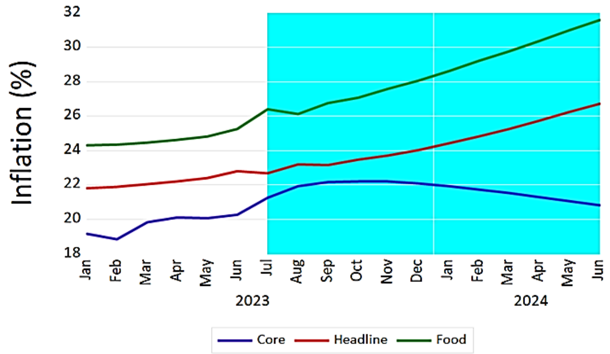
*Figure 6a: Driver of Predicted Inflation*




**Source: CAPE Economic Research and Consulting, 2023**

Our analysis showed a robust impact of food prices and exchange rate on headline inflation in July 2023 when compared with the previous month. It also suggests that impact of increase in energy prices and exchange rate has began to permeate into the economy but would reflect over a 12 month 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 continue to remain dominant in driving inflation in Nigeria.

Our analysis also suggest 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 had over the years blunted the policy rate potency.

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 ₦907.05 billion among the three tiers of government in the month of July 2023. The amount distributed was significantly higher than the ₦786.16 billion shared in June 2023 by ₦120.89 billion representing a increase of 15.4 per cent.

Further breakdown shows that Federal Government received ₦337.03 billion; States, ₦291.62 billion; Local Government, ₦214.73 billion. Thirteen per cent derivation fund shared among oil-producing states amounted to ₦63.68 billion (See Table 2 below). Revenue allocation to all the three tiers of government generally increased in July 2023 due to the increase in non-oil receipts, particularly, companies Income Tax (CIT) and Value Added Tax (VAT),

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

| | July | June | % Change |
|---|---|---|---|
| *Fed.* | *337.03* | *301.89* | *11.6* |
| *State* | *291.62* | *265.88* | *9.7* |
| *LG* | *214.73* | *195.54* | *9.8* |
| *Deriv* | *63.68* | *22.85* | *178.7* |
| **Total** | **907.05** | **786.16** | ***15.4*** |

Source: FAAC, June 2023

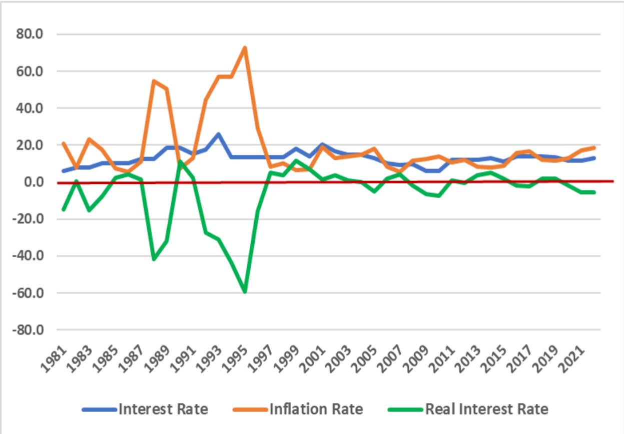
***Following the stoppage of fuel subsidy payments coupled with the proceeds from exchange rate gains, a distributable sum of N1.959 trillion was generated in June, out of which N907.05 was shared while N790 billion was saved in the Infrastructure Support Fund (ISF).*** *The ISF was established to enable the states to intervene and invest in the critical areas of transportation, including farm to market road improvements; agriculture, encompassing livestock and ranching solutions; health, with a focus on basic healthcare; education, especially basic education; power and water resources, that will improve economic competitiveness, create jobs and deliver economic prosperity for Nigerians.*

CAPE
Economic Research & Consulting

# The Impact of Negative Real Interest Rate in Nigeria

Negative real interest rate is said to occur when nominal interest rate is outweighed by the prevailing inflation rate in an economy. It is a macroeconomic condition that portends significant disincentive for investment. Unfortunately, this unfavourable situation has remained persistent in the Nigeria economy, given its multiple episodes from1960 to date. Figure 7 shows these various episodes of negative real interest rate.

*Figure 7: Nominal vs Real Monetary Policy Rate*



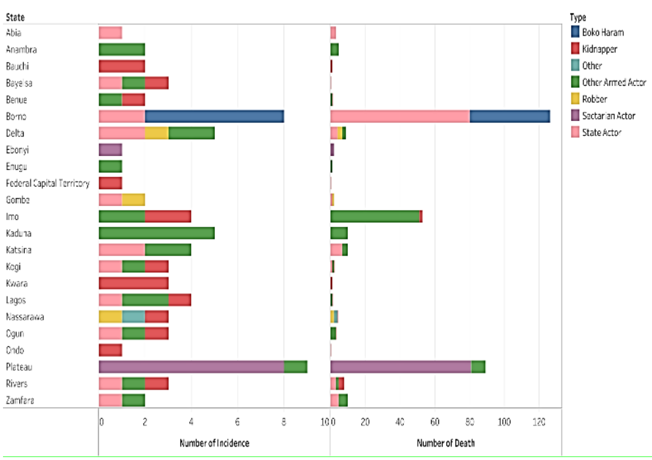

**Source: CAPE Economic Research and Consulting, 2023**

Persistent negative interest has macroeconomic implications for the economy which include the following;

- It depresses savings and investment which are critical for growth.
- It leads to emergence of parallel markets where higher interest rates are applied.
- It distorts efficient allocation of resources and leads to sub-optimal investment efficiency.
- It has been argued that negative real interest could be used to stimulate the economy as it gives consumers and businesses an incentive to spend or invest money rather than leave it in their bank accounts, where the value would be eroded by inflation (IMF, 2020).
- It constrains the ability of government to mobilise resource through issuance of bond. In Nigeria however, government bonds are often over-subscribed, suggesting that investors have preference for safety rather than magnitude of returns.

# UPDATE ON INSECURITY

*Figure 8: Insecurity Tracking in Nigeria*




**Source: CAPE Economic Research and Consulting, 2023**

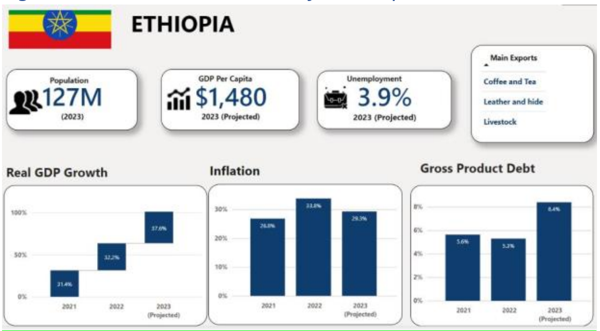
Insecurity remained heightened across Nigeria, as activities of other armed actors have become prevalent across the subnational. Our insecurity data collection dashboard showed that although, insecurity was most rife in Borno, largely driven by activities of Boko Haram. Operations of military personnel and Boko Haram necessitated that killings were most rife in Borno. As we highlighted in the previous newsletter, there also appear to be a resurge of Boko haram related tensions in Borno as number of insecurity incidences and killings surged significantly. Activities of the other armed actors and sectarian actors surged significantly in Plateau Kaduna and Delta.

## 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 comes with a significant moderation to output and financial stability with a heightening risk of a financial crisis. In Nigeria, economic prospects for the third quarter of 2023 remains resilient, albeit at a moderated level, following bold policy reforms.

## Country in Focus – Ethiopia

*Figure 9: Economic Parameters for Ethiopia*




**Source: CAPE Economic Research and Consulting, 2023**