Cape Economic Performance and Prospect Bulletin – November 2023

Highlights

- *Price pressures expected to remain heightened and remain above pandemic levels as tightening efforts continue to crystalise.*
- *Nigeria's Q3 and Q4 2023 output growth expected to be lower than Q2 2023 but remain positive at 1.73 and 1.54 percent.*
- ***Forecast shows that inflationary pressure in Nigeria heightened in October 2023, with headline inflation rising to 27.71 percent****.*

Global Economic Update

The challenges faced by the global economy have continued to mount pressure on global growth prospects, as the cumulative impact of monetary policy tightening and several other headwinds, including heightening geopolitical tensions remain.

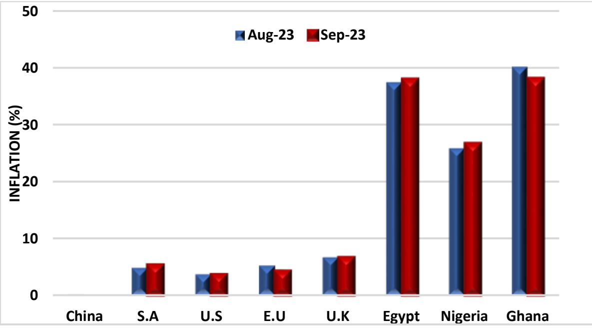
Although, most advanced economies have so far circumvented the recessions that were hitherto anticipated, however, divergent growth prospects across regions remain a challenge to global full recovery to pre-pandemic levels. Equally, concerns about China's capacity to boost its economy, beclouds growth prospects in the group of emerging economies despite significant level of resilience posed by several individual countries.

More so, additional headwinds to output growth and upside risk to inflation are increasing the risk of global economic fragmentation cum the continued war in Ukraine, the Israel-Palestine war, and rising geo-political tensions between the global West and East. In essence, growth prospects although improving, remain troubled by heightened uncertainty around geopolitical tensions, financial stability, and the pace and extent of monetary tightening to tame inflation.

Policy rates in advanced economies have either reached their peak or are about to in this cycle as central banks see increasing evidence that tighter financing conditions are starting to bite. For example, the Federal Reserve kept its benchmark overnight interest rate unchanged (5.25%-5.50%) at its recent FOMC policy meeting, October 31-November 1, 2023. This is the second meeting in a row where the rates have remained unchanged. The pause on interest rate hikes is due to a number of factors, including cooling 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 continues to moderate across several economies, although, core inflation moderates slightly, it remains largely 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.

Figure 1: Year-on-Year Inflation in Selected Economies (August 2023 – September 2023) in percent



Source: Various National Statistics Offices

Central banks will maintain a hold or 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. We anticipate some rate hikes across some advanced and emerging economies in the remainder of the year before a gradual return to a hold stance as seen in the United States and ultimately loosening. The return to loosening is precipitated on the risk of further rate hikes dampening inflationary pressure but heightening financial system instability and dragging economies into recession.

The resilience shown by the economy continues to give the central bank's policy headroom to sustain a tight monetary policy stance, although financial conditions are largely suboptimal, and the debt burdens are worsening particularly for emerging economies.

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

In the financial markets, stocks declined for the third straight month, with the Dow Jones Industrial Average falling 1.3%, the S&P 500 slipping 2.1%, and the NASDAQ giving up 2.8%. Mortgage rates continued to shoot higher as the 15-year Mortgage Rate breached 7% for the first time since 2000, while the 30-year Mortgage Rate approached 8%. Housing prices took a hit as a result; the Median Sales Price of Existing Homes fell for the third straight month and was below US$400,000 for the first time since May.

In the currency market, the U.S. dollar has surged in recent months, gaining more than 6% relative to the currencies of other major trading partners since mid-July 2023. The rally has reversed the dollar's decline from the start of the year. The dollar benefited from the "higher for longer" U.S. interest rates that helped to drive the recent rally. The dollar also benefited from strong foreign direct investment inflows, largely from close trading partners. Investment in manufacturing facilities has accounted for much of the increase as companies shift production to the U.S. market amid trade disputes and growing global fragmentation and polarisation.

The commodities market remains characterised by uncertainties and volatilities as geopolitical tensions worsen. Oil prices fell to a three-week low as of end-October 2023. Brent futures fell 39 cents, or 0.5%, to settle at US$84.63 a barrel. U.S. West Texas Intermediate (WTI) crude fell 58 cents, or 0.7%, to US$80.44. As winter kicks in and energy demand surges, it is anticipated that oil prices may hit the US$100 per barrel region. Gold price rose year-to-date by approximately 8.7% to US$1,998.06 per ounce as of end-October 2023.

Upside risks to energy and commodity prices remain increased demand, while the pressure in the financial system and the risk of a recession are downside risks. The rising geopolitical tension including the war in Gaza and 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

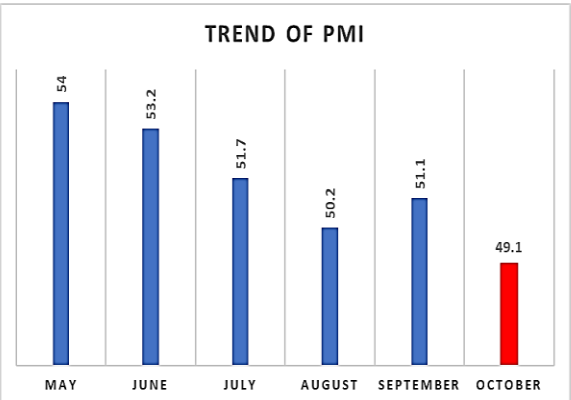
The global economy continues to show resilience in the third quarter, going into the fourth quarter of 2023, despite several headwinds and geopolitical fragmentation. Near-term risks remain mixed. Downside risks remain – as the core inflation remains stubborn and central banks are likely going to maintain either a hold or tight stance in most cases at least for the remainder of the second half of 2023. Others include, heightened geopolitical tensions between the global west and the global east, the persisting Russian-Ukraine war, heightened political tensions in central and West Africa, the war in Gaza, 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, inflationary pressure is expected to continue to moderate, it would however remain above pandemic levels across both advanced and emerging economies. Central banks continue to be faced with a more difficult decision-making process as the cost to financial stability and output growth are becoming more visible in the fourth 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 Gaza and Ukraine lingering effects of the pandemic and changes in climatic conditions.

Nigeria's Output Growth

Nigeria's private sector business activity dipped into negative territory in October 2023, making it the first contraction since March this year. The fourth quarter of 2023, therefore, kicked off on a weak note as the headline Purchasing Managers' Index (PMI) declined by 2.0 index points to 49.1 in October from the 51.1 reported in September. PMI readings above 50.0 signals an improvement in business conditions, while readings below 50.0 indicate a worsening business condition compared to the previous month.

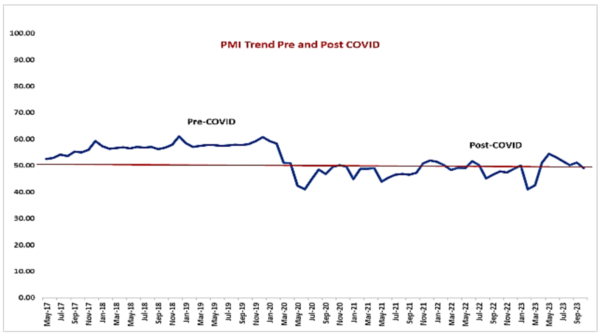
Figure 2: Trend of Nigeria's PMI (May – October 2023)



Source: Stanbic IBTC

The contraction of October 2023 PMI was driven, mainly, by elevated prices of inputs which dampened manufacturers' demand as new order slowed down and consequently, led to depressed output during the period. The rise in the cost of inputs was further exacerbated by the continuous depreciation of the domestic currency coupled with the lingering effects of fuel subsidy removal. Nigeria's PMI has therefore maintained a downward trajectory since May 2023, except for the September print which indicated an uptick of 0.9 index points above the preceding month. This indicates that private sector business activities are yet to be fully restored to their pre-pandemic levels owing to the prevalence of challenging macroeconomic conditions and shocks (figure 3).

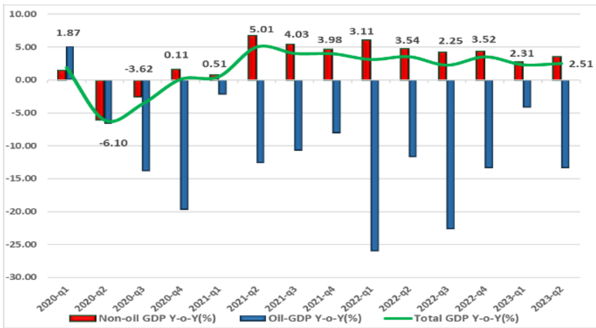
Figure 3: Trend of Nigeria's PMI Pre- and Post-Covid.



Source: Stanbic IBTC

As highlighted in our previous edition, we reiterate that output growth in the third quarter of 2023 would be weak, but positive. However, if the current macroeconomic conditions persist, then, output growth in the fourth quarter may be much weaker than the third quarter of 2023, though also positive.

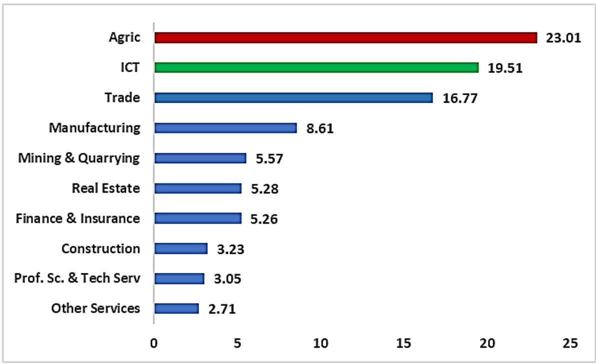
Figure 4: Real GDP Growth Rate in Nigeria (2020 Q1 – 2023 Q2) in percent



Source: National Bureau of Statistics (NBS), 2023

Based on sectoral contribution in 2023Q2, we still expect the services sectors (combined) and agricultural sector to maintain their lead in the 2023Q3 growth outturn.

Figure 5: Top 10 Sectors by Contribution to GDP 2023Q2



Source: National Bureau of Statistics (NBS), 2023

Output Growth Outlook

Headwinds to output growth continue to persist. High energy prices, exchange rate volatility arising from foreign exchange supply shortage, insecurity, infrastructural deficit, structural bottlenecks, and elevated cost of production are weighing on output growth and are expected to further slowdown albeit remain positive in 2023Q3. Our medium-term forecast shows that output growth would moderate to 1.73 percent in 2023Q3 and further down by 0.02 percentage points to 1.54 percent in 2023Q4.

Table 1: Medium-term Macroeconomic Forecast in Percent

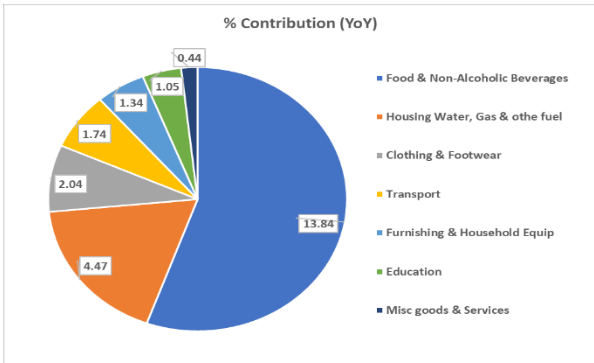
			Q4/Q4			
Output (year % change)	**2023q1**	**2023q2**	**2023q3**	**2023q4**	**2024q1**	**2024q2**
Real GDP	2.31	2.51	1.73	1.54	2.11	1.34
Agriculture	-0.9	1.5	1.45	0.57	3.11	0.44
Manufacturing	1.61	2.2	1.54	-0.04	-0.11	3.96
Information & Communication	10.32	8.6	10.9	5.62	11.46	6.79
Crude Oil	-4.21	-13.43	-2.57	-1.58	-2.21	-0.08
Inflation (year % change)						
Headline	22.04	22.79	23.55	24.19	23.57	22.38
Core	19.63	20.06	19.49	21.17	22.35	23.05
Food	24.45	25.25	26.02	26.63	24.96	23.08

Source: CAPE Economic Research and Consulting, 2023

Price Update

Nigeria's headline inflation maintained its upward trajectory soaring to 26.72 percent in September 2023 from the August print of 25.80 percent. The 0.92 percentage uptick pushed headline inflation to its highest level over the last 20 years. The increase is 0.92 percentage points higher than the 25.80 percent recorded in August 2023. On a year-on-year basis, the headline inflation rate was 5.94 percentage points higher relative to the 20.77 percent recorded in September 2022, making it the ninth streak of rising inflation since December 2022 which has resulted in a year-to-date average of 23.31 percent. However, on a month-on-month basis, headline inflation fell by 1.08 percentage points to 2.10 percent from the 3.18 percent recorded in August 2023. This implies that the rate of increase in the average price level slowed down in September 2023. The major drivers of the headline index include Food & Non-Alcoholic Beverages, Housing Water, Electricity, Gas & Other Fuel, Clothing & Footwear among others. Food & non-alcoholic beverages remained the most important driver.

Figure 6: Key Drivers of headline Index in September 2023

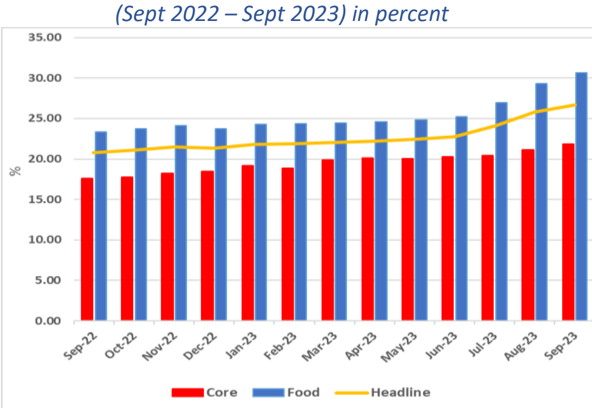


Source: National Bureau of Statistics (NBS), 2023

Nigeria's food inflation rate accelerated to 30.64 percent in September 2023 compared to the 29.34 percent reported in August. On a year-on-year basis, it rose by 7.30 percentage points above the 23.34 percent recorded in September 2022. The increase was driven mainly, by an increase in the prices of Oil and fat, Bread and cereals, potatoes, yam, and other tubers among others. The primary propellers of rising food inflation include insecurity in food-producing states, significant post-harvest losses, and high cost of logistics.

Regardless, core inflation was elevated to 21.84 percent in September 2023 from the 17.49 percent and 21.15 percent in recorded in September 2022 and August 2023, respectively. The main drivers of core inflation were the prices of transport by road, passenger transport by air, medical services, furniture repairs maintenance, and repair of personal transport equipment etc among others.

Figure 7a: Year-on-Year Headline, Food and Core Inflation (Sept 2022 – Sept 2023) in percent



Source: National Bureau of Statistics (NBS), 2023

Price Outlook

Inflation is expected to further heighten in October 2023. Our forecast showed that inflationary pressure would heighten but at a moderated pace compared to the previous month as headline food and core inflation are expected to rise to 27.41, 31.01, and 22.50 percent respectively.

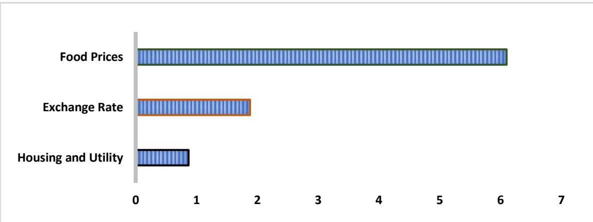
Table 2: Inflation Forecast for October 2023 in Percent

Headline	Food	Core
27.41	31.01	22.50

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 6.1 percent, 1.88 percent, and 0.87 percent respectively.

Figure 7b: Driver of Predicted Inflation



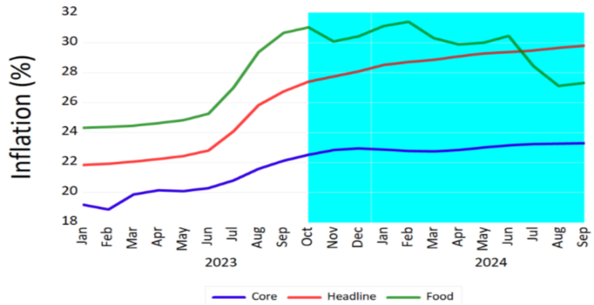
Source: CAPE Economic Research and Consulting, 2023

Our analysis showed a strong impact of food prices and exchange rates on headline inflation. However, housing and utility prices had a more robust impact in October 2023 than in September 2023. This suggests that the impact of an increase in energy prices and exchange rate continues to permeate into the economy and would continue to reflect over a 12-month period at the least, through a base effect.

The key drivers of the core inflation forecast were clothing and footwear, education, transportation, and alcoholic beverages. It also showed that the contribution of transportation and alcoholic beverages to core inflation heightened in our October 2023 forecast compared to our September 2023. Our analysis also established that monetary policy instruments continue to be a pull factor, while, structural factors continue to remain dominant in driving inflation in Nigeria.

Upside risks to inflation are the high 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. Economic agents are expectant of actions and policy direction of the new leadership at the Central Bank of Nigeria as it may hold the first Monetary Policy Committee meeting of the newly appointed Committee of Governors in November 2023.

Figure 7c: 12-Month Inflation Projection



Source: CAPE Economic Research and Consulting, 2023

Our revised 12-month inflation projection suggests that inflation would remain elevated, but the pace of elevation would remain moderated as inflation plateaus in 2024. Additional inference from our 12-month inflation projection further suggests that food inflation might have maxed out and may commence a moderation soon which would help dampen inflationary pressure.

Fiscal Operations Update

The Federation Account Allocation Committee (FAAC) distributed the total sum of ₦903.48 billion among the three tiers of government in the month of October 2023 for revenue collected in September 2023. The amount distributed was lower than the ₦923.01 billion shared in September 2023 by ₦19.53 billion representing a decrease of 2.1 per cent.

A further breakdown shows that the Federal Government received ₦320.54.25 billion; States, N287.07 billion Local Government, ₦210.90 billion. Thirteen percent derivation fund distributed among beneficiary states amounted to ₦84.97 billion. Revenue allocation to all the three tiers of government generally declined in October 2023 except for the 13 percent derivation fund. The decline was driven by the shortfall in non-oil receipts, particularly, Companies Income Tax (CIT), Import and Excise Duties, and Value Added Tax (VAT). Collections from Petroleum Profit Tax (PPT), and Oil & Gas Royalties increased during the period.

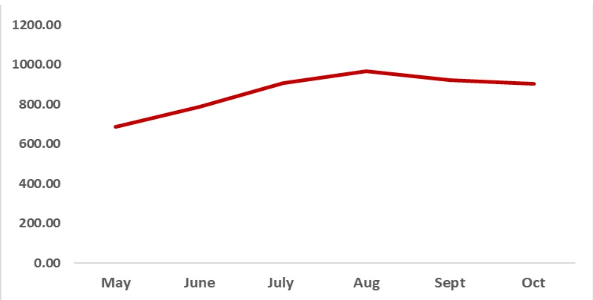
Table 3: Highlight of October FAAC Distr (N'billion)

	Oct	Sept	% Change
Fed.	*320.54*	*337.95*	*-5.2*
State	*287.07*	*313.87*	*-8.5*
LG	*210.90*	*230.06*	*-8.3*
13%	*84.97*	*41.13*	*106.6*
Total	**903.48**	**923.01**	***-2.1***

Source: FAAC, October 2023

The moderation in FAAC distribution in October 2023 may not dampen inflationary pressure significantly.

Figure 8: Trend of FAAC Distribution



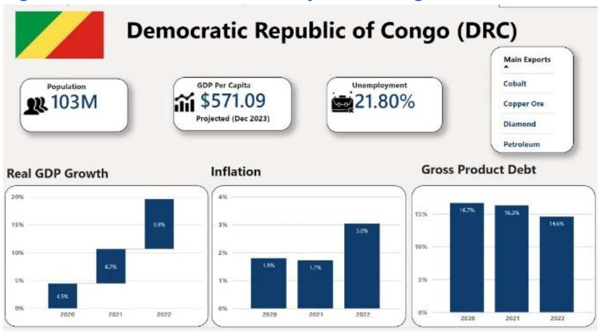
Source: FAAC, October 2023

Conclusion

In conclusion, global growth prospect remains positive but weak. Prospects in Emerging economies is significantly challenged by uncertainty and the weak performance of China. The tightening stance of most central banks across both advanced and emerging markets for most of 2022 and the first three quarters 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 in output and financial stability with a heightened risk of a financial crisis. In Nigeria, economic prospects for the third quarter of 2023 remain resilient, albeit at a moderated level, following bold policy reforms.

Country in Focus – Democratic Republic of Congo

Figure 9: Economic Parameters for DR Congo



Source: CAPE Economic Research and Consulting, 2023