Cape Economic Performance and Prospect Bulletin – January 2024

Highlights

- *Price pressures expected to remain heightened and remain above pandemic levels as tightening efforts continue to crystalise.*
- *Nigeria's Q4 2023 output growth expected to be lower than Q3 2023 but remain positive at 2.11 per cent.*
- ***Forecast shows that inflationary pressure in Nigeria heightened in December 2023, with headline inflation rising to 29.69 per cent**.*

Global Economic Update

The year 2023 was characterised by shifting narratives. The year started with a high recession risk, subsequently, conversations shifted to "higher for longer"—meaning higher inflation and higher interest rates for longer than initially expected then "cooling inflation" and finally calls for a "soft landing" amidst growing anticipation for rate cuts in 2024. The changing narratives reflected the heightened geopolitical tensions, rising cost of living, tight monetary stance, and high-level uncertainty accompanied by the risk of a recession. The global economy averted a recession with a moderate performance, due largely to a pick-up in US aggregate demand and normalisation of consumption in China, which offset the underperformance in Europe.

Following the backdrop of the COVID-19 pandemic, global price levels peaked in 2023, reaching record levels of inflation. Consequently, several central banks across advanced and emerging markets embarked on series of policy rate hikes to tighten monetary conditions as policymakers across both advanced and emerging economies continue to prioritise price stability over output growth.

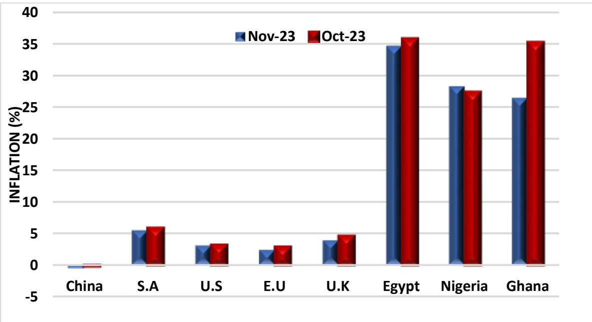
Divergent growth prospects across regions remained a challenge to global full recovery to pre-pandemic levels. In the advanced economies, despite the tight monetary policy stance, several economies showed significant resilience and circumvented a hitherto anticipated recession, albeit with an abysmal growth performance. In emerging economies, concerns about China's capacity to boost its economy dampened growth prospects despite the significant level of resilience posed by several individual countries.

Although, the global economy has surprisingly proven resilient in 2023, the various headwinds from 2023 are expected to subsist for 2024 economic outlook.

Geopolitical fragmentation, weak consumer demand, full impact of tight monetary and financial conditions in 2023 across different regions of the world due to sustained high interest rates would dampen economic prospects in 2024, but a recession may once again be averted.

Inflation in several advanced and emerging economies has turned the curve, however, the pressure on many households remains acute and the cost of living remains high, albeit at a reduced level of intensity, particularly in most advanced economies. Upside risk to inflation remains the Israel-Hamas conflict and Russia's war in Ukraine which could affect prices for commodities, such as oil and grains.

Figure 1: Year-on-Year Inflation in Selected Economies (October 2023 – November 2023) in per cent



Source: Various National Statistics Offices

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, in line with projections from our December 2023 publication, the Federal Reserves at its final meeting for the year 2023 on December 12-13, 2023 kept its benchmark overnight interest rate unchanged (5.25%-5.50%).

This marks the third consecutive meeting where the central bank has chosen to hold off on monetary policy changes. It also signalled it would cut rates three times in 2024 in projections released after officials' two-day meeting as we have anticipated. We anticipate that these rate cuts may begin around the end of second quarter 2024.

As we previously noted, we anticipate that several other central banks would maintain a hold or tight stance at least for the first half of 2024, 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 a gradual return to a loose stance as the year goes by into 2025. 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.

While, inflation might have commenced moderation 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 sustained its growth trajectory path in December 2023 following improvement in previous month. The year ended on a nine-week run of gains, up 15.85% (last seen in January 1994, up 10.26%). The S&P 500® was up 4.42% in December, bringing its one-year return to 24.23%. The Dow Jones Industrial Average® rose 4.84% for the month and was up 13.70% in 2023. The market is expected to be active in January 2024, as the U.S. Congress returns and has to address issues on Ukraine, Israel and the U.S. border, while a potential government shutdown looms if a new budget (or stopgap bill) is not reached by Jan. 19, 2024. Adding to the market's activities is earnings season, starting on Friday, Jan. 12, 2024, with the big banks.

The 10-year U.S. Treasury Bond yield continued to decline (it reached 5.02% in September, last seen 16 years ago), closing at 3.88% for the month, down from last month's 4.34%. The 30-year U.S. Treasury Bond closed at 4.04%, down from last month's 4.50%.

In the currency market, the pound closed at 1.2742, up from 1.2627 last month; the euro closed at 1.1038, up from last month's 1.0889; the yen closed at 141.02 from last month's 148.19; and the yuan closed at 7.1132 from last month's 7.1289.

In the commodity market, oil closed down 5.8% for the month, at US$ 71.31 from last month's US$ 75.67 close and US$ 80.45 at year-end 2022. Since year-end 2020, oil was up 47.3% (US$ 48.42 a barrel at year-end 2020). As winter kicks in and energy demand surges, it is anticipated that oil prices may surge. Gold closed at US$ 2,073.60, up from last month's US$ 2,056.00 and US$ 1,829.80 at the end of 2022. This reflects the commencement of asset switching by investors as an end to interest rate hike starts.

Upside risks to energy and commodity prices remain increased demand and the pressure in the financial system, while the risk of a recession are downside risks. The rising geopolitical tension including the war in Gaza and 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. Additionally, Angola-a major African oil producer, opined it would leave the OPEC cartel after a dispute over oil production quotas.

Global Economic Outlook

The global economy continues to show resilience in the fourth quarter of 2023, despite several headwinds and heightening geopolitical fragmentation – political tensions in Central and West Africa, Russia/Ukraine and Israel/Gaza, while China/Taiwan is still a concern. Additionally, the U.S. faces a presidential election in 2024 that should generate significant attention, but largely inconsequential for markets, going by precedence. Near term risk remain mixed.

Heading into 2024, we are therefore cautiously bullish on the outlook for the global economy buoyed by high consumer spending and strong manufacturing investment. We anticipate sustained economic resilience against a recession; however, we do not expect a robust performance of output growth after the aggressive monetary policy tightening over the past couple of years.

As inflation continues to moderate toward pre-COVID levels, we anticipate that inflation will ease enough for policymakers to halt policy rate hikes and start to cut policy rates between the first and second quarter 2024 across several major advanced and emerging economies.

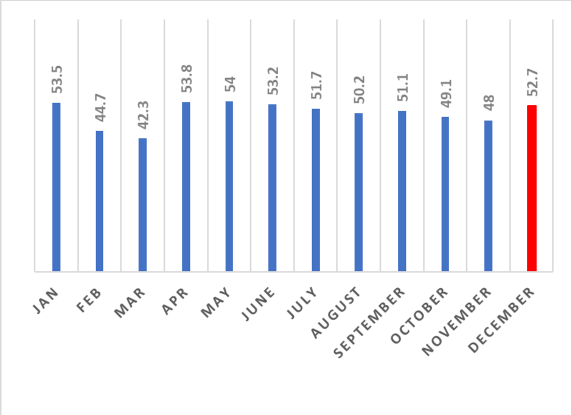
Historically, following numerous rate hikes, there is the tendency for continued preference for near money short-term assets. We anticipate that as policy rates begin to slow down, there might be some gradual portfolio flow gains to emerging markets, where rates are likely to remain higher in the near to medium term, while others may seek haven in commodity assets and bonds as yields are near 20-year high across sectors. Most especially as the U.S. equities are somewhat expensive compared to historical averages, while international equities remain largely neutral. We anticipate long term investors optimising market developments by taking position at the long end of the market.

Major upside risks to inflation remain supply disruptions from the war in Gaza and Ukraine, lingering effects of the pandemic and change in climatic conditions.

Nigeria's Output Growth

Despite the persisting macroeconomic challenges, Nigeria's output growth returned to expansionary path after two months of consecutive decline. The Stanbic-IBTC headline purchasing managers' index (PMI) rose to 52.7 index points in December 2023 from the 48.0 recorded in the previous month, indicating an impressive improvement in the private sector business activity during the period under review. This marked the highest since June 2023.

Figure 2: Trend of Nigeria's PMI (Jan – Dec. 2023)



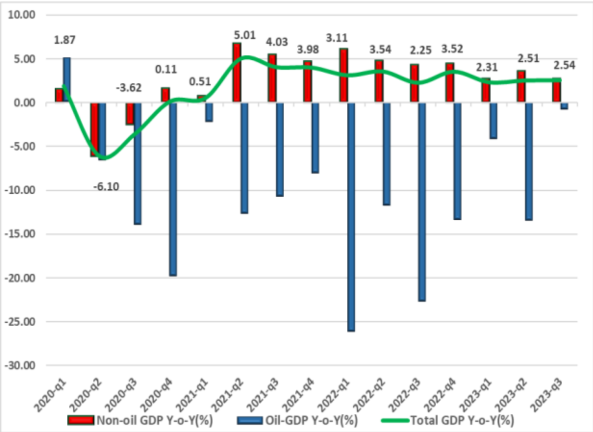
Source: Stanbic IBTC

The rebound was driven by the recovery in aggregate demand associated with the end of year festive period, leading to increase in new orders and output. Consequently, job opportunities continued to rise for the eighth consecutive month, and work backlogs increased for the third time in the past four months. Additionally, there was expansion in both purchasing activity and inventory holdings. However, sectoral data indicated continuous decline in wholesale and retail activities. As a guide, a PMI reading surpassing 50.0 signifies an enhancement in business conditions, whereas readings below 50.0 suggest a deterioration in business conditions compared to the previous month. A PMI reading of 50.0 denotes a situation where there is no change in output growth.

Nigeria's real GDP growth remained sluggish and fragile at an average of 2.45 per cent in the first three quarters of 2023 without much improvement expected in the fourth quarter despite improved PMI in December 2023. This is due to the harsh business environment which has led to the exit or planned exit of major multinationals such as GlaxoSmithKline (GSK), Unilever Nigeria (Home and Skin Care Category), Sanofi-Aventis, Procter & Gamble and more recently Jubilee Syringe Manufacturing. The exit of these companies would not only dampen output growth in the near to medium term, but also erode investors' confidence in the Nigerian economy, regardless of the numerous efforts of the current administration in attracting foreign investment into the country. Consequently, the ills of unemployment and poverty may continue to bite harder in 2024.

In the overall analysis, the anticipated annual real GDP growth for Nigeria in 2023 hovers around 2.5 per cent (figure 3). This rate falls considerably short of being deemed sufficient for enhancing the well-being of citizens, particularly in an economy characterised by an annual population growth of about 3.0 per cent.

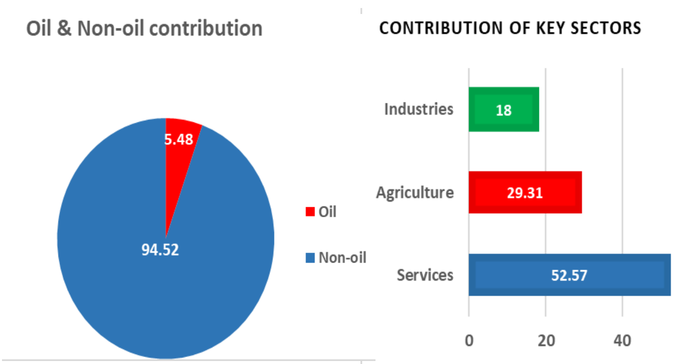
Figure 3: Real GDP Growth Rate in Nigeria (2020Q1 – 2023 Q3) in Per cent



Source: National Bureau of Statistics (NBS)

Non-oil sector remained dominant in its contribution to real GDP in 2023. This was well reflected in the breakdown of sectoral contribution in Q3 2023 which indicated that the non-oil sector accounted for 94.52 per cent of the nation's total GDP, while oil sector contributed only 5.48 per cent.

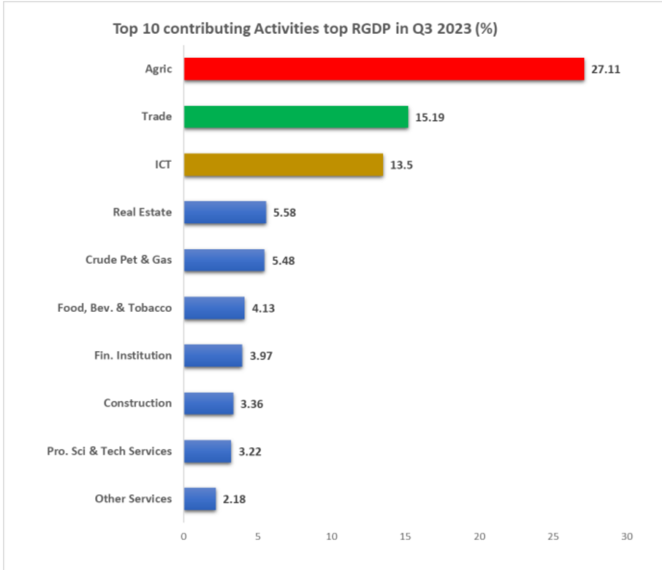
Figure 4: Sectoral Contribution to GDP in Q3 2023



Source: National Bureau of Statistics (NBS)

Top ten economic activities driving real GDP in 2023, particularly in Q3 2023 include agriculture, trade, information and communication (ICT), real estate, among others.

Figure 5: Top 10 Economic activities that drove Nigeria's RGDP (2023 Q3) in Per cent



Source: National Bureau of Statistics (NBS)

Output Growth Outlook

Output growth continues to be resilient despite several headwinds confronting it. High energy prices, exchange rate volatility arising from foreign exchange supply shortage, insecurity, infrastructural deficit, structural bottlenecks, and elevated cost of production continue to weigh on output growth and expected to further slowdown albeit remain positive in 2023Q4. Moreover, several multinationals have abandoned domestic production in 2023Q3 and 2023Q4 due to rising cost of production and challenges with repatriation of profit with implications for output growth and employment. Our medium-term forecast show that output growth would moderate to 2.11 per cent in 2023Q4. We however anticipate an improvement in output growth going into 2024Q1, as seasonal benefits in the agricultural sector kicks and the gains from improvement in the industrial sector with the coming on stream of companies such as the Dangote refinery by 2024Q2.

Table 1: Medium-term Macroeconomic Forecast in Per Cent

	2022q3	2022q4	2023q1	2023q2	2023q3	2023q4	2024q1	2024q2	2024q3
Output (year % change)									
Real GDP	2.25	3.52	2.31	2.51	2.54	2.11	2.74	2.72	2.34
Manufacturing	-1.9	2.8	1.6	2.2	1.5	0	-0.1	4	2.4
Agriculture	1.34	2.05	-0.9	1.5	1.53	0.13	3.69	0.33	0.68
Trade	5.08	4.54	1.31	2.41	2.08	0.62	3.37	2.42	2.53
Information & Comm.	10.1	11.2	11.7	9.7	9.9	6	14.2	7.4	8.8
Inflation (yr % ch.)									
Headline	20.3	21.3	21.9	22.5	25.5	27.5	27.8	27.6	27
Food	22.8	23.9	24.4	24.9	29	31.6	31.9	31.4	28.9
Core	17	18.2	19.3	20.2	21.5	22.9	22.6	22.2	21.2

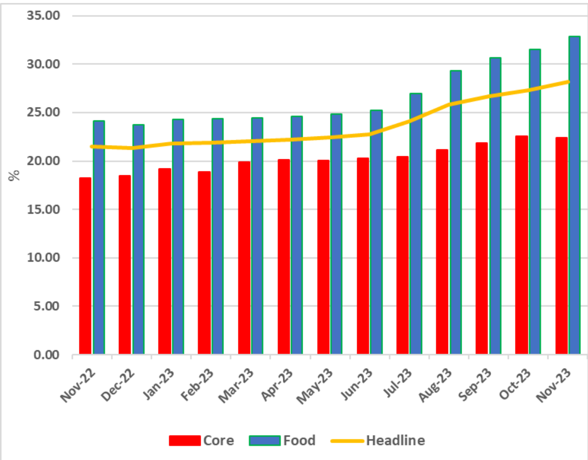
Source: CAPE Economic Research and Consulting, 2023

CAPE Economic Research & Consulting

Price Update

In alignment with our earlier forecast, Nigeria's headline and food inflation ascended further in November 2023, reaching 28.2 and 32.82 per cent respectively, compared with 27.33 and 31.52 per cent printed in the previous month. This trajectory is expected to be sustained in December 2023 amid the continuous depreciation of the naira, higher energy prices, build-up of aggregate demand ahead of the yuletide season and other bottlenecks that characterise the Nigerian economy. Core inflation was however, marginally trimmed by 0.2 percentage points, as it declined to 22.38 per cent from the 22.58 per cent in October 2023.

Figure 6a: Year-on-Year Headline, Food and Core Inflation (Nov 2022 – Nov 2023) in per cent



Source: National Bureau of Statistics (NBS), 2023

Price Outlook

Inflation is expected to further heighten in December 2023. Our forecast showed that inflationary pressure would heighten as headline food and core inflation are expected to rise to 29.69, 33.21 and 22.63 per cent respectively.

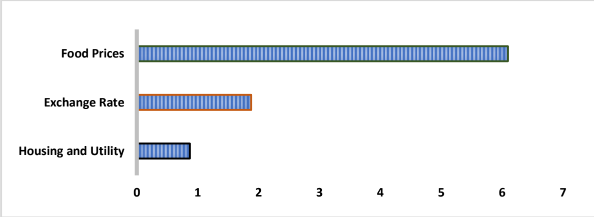
Table 2: Inflation forecast for December 2023 in Per Cent

Headline	Food	Core
29.69	33.21	22.63

Source: CAPE Economic Research and Consulting, 2023

The key drivers of the headline inflation forecast remained, food prices, exchange rate, housing and utility prices which contribute 6.10 per cent, 1.88 per cent, and 0.87 per cent respectively.

Figure 6b: Driver of Predicted Inflation



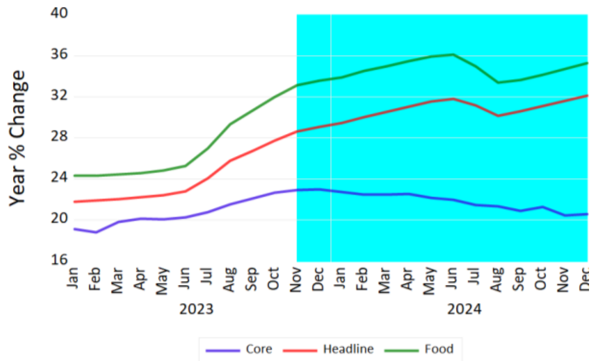
Source: CAPE Economic Research and Consulting, 2023

Our analysis showed a strong impact of food prices and exchange rate on headline inflation. However, housing and utility prices continued to have a robust impact in December 2023. This suggests that the impact of 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 remain 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 December 2023 forecast. Our analysis also established structural factors continue to remain dominant in driving inflation in Nigeria.

Upside risks to inflation remain high fiscal deficit, removal of fuel subsidy and exacerbating exchange rate pressures as well as its pass through to prices. Economic agents remain expectant of actions and policy direction of the new leadership at the Central Bank of Nigeria as it did not hold any Monetary Policy Committee (MPC) meeting in 2023Q4. It is expected that first MPC meeting of the newly appointed Committee of Governors will be in January 2024.

Figure 6c: 12-Month Inflation Projection



Source: CAPE Economic Research and Consulting, 2023

Our revised 12-month inflation projection suggests that inflation would remain elevated, till around mid-2024, when the base effects of the subsidy removal and foreign exchange unification policy would have waned, before it reverts to an upward trend. Additional inference from our 12-month inflation projection however further suggests that core inflation might have maxed out and may commence a moderation, while food inflation continues to drive headline inflation.

Fiscal Operations Update

2024 Budget Update

President Bola Ahmed Tinubu finally signed the 2024 Appropriation Bill to an Act, following a few adjustments by the Nigerian Senate. The approved budget for 2024 was raised to N28.7 trillion from the N27.5 trillion earlier proposed. The benchmark exchange rate was also adjusted to N800 from the initial N750 projected. It is important to note the following:

- Revenue projection of N18 trillion would remain an uphill task amid sub-optimal revenue performance of government.
- Projected capital expenditure amounted N9.9 trillion, representing about 34.7 per cent of the total budget. Hence government is expected to spend more on infrastructural development in 2024. Though this is an improvement over the past, it remained grossly inadequate given the humongous infrastructural deficit facing the Nigerian economy
- In nominal terms, the approved 2024 budget was higher than 2023 by 16 per cent. However, in real terms it was actually lower by 7 per cent. This mirrors the deleterious effect of inflation on citizens' welfare.
- The FGN budget for 2024 represents only 9.7 per cent of GDP. This is a reflection of the size of the government's financial activities relative to the overall economic output. Hence, we cannot overemphasise the need for government to do more.
- At sub-national level, the aggregate budget of all the state governments in Nigeria amounted N16.1 trillion bringing the total national budget to N44.9 trillion.

The major concern around the effective implementation of 2024 budget is the persisting revenue generation constraints that has lingered for years. Though the removal of subsidy and foreign exchange devaluation are expected to bring more money into government coffers, it is doubtful if the government would be able to generate as much as the N18 trillion it is targeting in revenue. The reliance of sub-national government on FAAC allocations has continued to make many state governments unproductive over the years. Therefore, the way-out for government is to broaden its revenue base by also maximising the potentials of solid mineral resources in the country, as well as the blue economy.

FAAC Distribution for December 2023

The Federation Account Allocation Committee (FAAC) distributed the total sum of ₦1088.78 billion among the three tiers of government in the month of December 2023 for revenue collected in November 2023. The amount distributed was higher than the ₦906.96 billion shared in November 2023 by ₦181.82 billion representing an increase of 20 per cent.

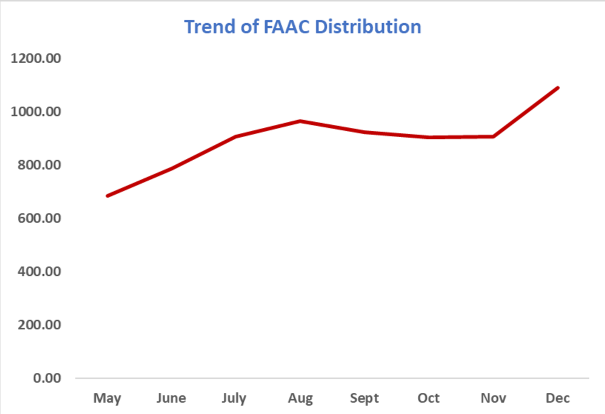
Further breakdown shows that Federal Government received ₦402.87 billion; States, ₦351.70 billion; Local Government, ₦258.81 billion. Thirteen per cent derivation fund distributed among beneficiary states amounted to ₦74.41 billion. Revenue allocation to all the three tiers of government generally increased in November 2023. The increase in FAAC distribution represents a boost to liquidity which may contribute to inflationary build-up in December 2023.

Table 3: Highlight of Dec 2023 FAAC Distribution (N'billion)

	Dec	Nov	% Change
Fed.	*402.87*	*323.36*	*24.6*
State	*351.70*	*307.72*	*14.3*
LG	*258.81*	*225.21*	*14.9*
13%	*74.41*	*50.67*	*48.8*
Total	**1088.79**	**906.96**	***20.0***

Source: FAAC, December 2023

Figure 8: Trend of FAAC Distribution



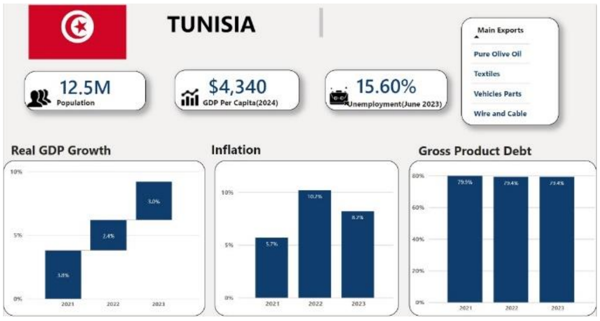
Source: FAAC, December 2023

Conclusion

In conclusion, the global growth prospect remains marginally positive going into 2024. Prospects in emerging economies are significantly challenged by uncertainty and the weak performance of China. The tight stance of most central banks across both advanced and emerging markets for most of 2022 and 2023 has started yielding results in price moderation in most economies. However, this comes with a significant moderation in output and financial stability. In Nigeria, economic prospects for the fourth quarter of 2023 and going into 2024 remain resilient, though at a moderated level, following bold policy reforms.

Country in Focus – Republic of Tunisia

Figure 9: Economic Parameters for Republic of Tunisia



Source: CAPE Economic Research and Consulting, 2023