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Vetiva Research

Riding the seesaw

2023 Macroeconomic Outlook

December 2022

Executive Summary

Riding the seesaw

December 2022

From a full-fledged pandemic to a war amongst key commodity producers, the world has endured so much in just three years. While the war in Europe trudges on, a trade deal to protect food exports doused additional supply chain pressures, contributing to lower inflation in the United States of America. Surging inflation in both advanced and emerging economies has pushed central banks to respond adequately. At this pace, central banks could be hiking their way into recession come 2023. With OPEC+ rolling out supply curbs in response to hawkish moves by the US Fed, the state of the Russia-Ukraine war remains a dealbreaker. A truce could ease supply chain pressures and reduce commodity prices. However, escalation could send the world into a frenzy of high inflation, painful recessions, and financial market volatility.

Africa could remain on the precipice as high fuel prices and restricted access to the international debt market exposes fragile economies. While net-oil exporters benefit from the surge in commodity prices, net-oil importers could continually reel under the inflationary passthrough, tight financing conditions, and balance of payment deficits.

In Nigeria, the race to choose the next president heats up, especially as the incumbent completes his constitutional term limit. Notwithstanding, the timeline for implementing a critical fiscal reform has been extended to the handover month of the outgoing administration. Should subsidies be removed as planned, inflation could remain elevated, calling for more tightening by the apex bank. Overall, this singular decision could improve external receipts and enable the apex bank to intervene in the foreign exchange market.

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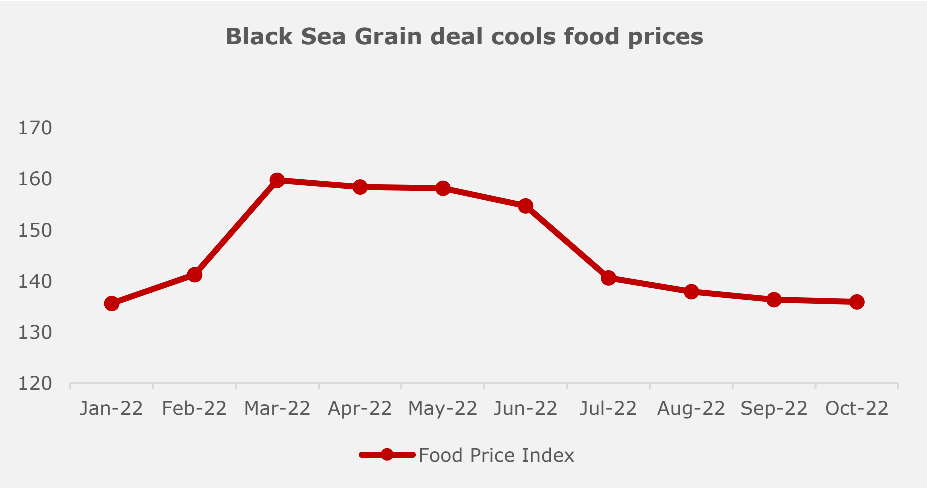
Global Economy

Geopolitics: Skipping downhill

In 2023, policymakers will continue to play the balancing act as they try to stabilize the economy tipped downwards by the war in Eastern Europe. Contractionary policies used to combat record high inflation have brought many economies to the verge of recession. To counter Russia's aggression, the West imposed sanctions on the Russian economy and aristocrats. While Russia has avoided some sanctions through capital controls and strengthened ties with China, it has challenges on the battlefield as Ukraine continues to resist. Ukraine reclaimed some of its territory in the northeast, east, and south through counter-offensive attacks.

To force a ceasefire, the West continues to adopt economic tools to cripple the Kremlin economy. In addition to the European Union (EU) gradually banning Russian oil, the G7 (top seven most powerful economies) recently capped Russian oil prices to prevent them from benefiting from high oil prices. Currently, Russia sells its crude at a discount, which countries like India and China have taken advantage of. To force the EU to lift its economic sanctions against Russia, the Kremlin recently cut its gas supply to the EU.

Aside from energy prices, food prices were also affected by the war since both warring states are key exporters of food commodities. Facilitated by the United Nations, Russia and Ukraine signed an agreement on July 27 in Istanbul. Through this agreement, Ukraine and Russia are able to resume exports of grain and fertilizer from three key Black Sea ports - Odesa, Chornomorsk, and Yuzhny. The initiative has contributed to drop in food prices, which have declined 14.6% since their peak in March. In October, the Food and Agriculture Organization (FAO) observed that food prices moderated for the sixth consecutive month due to improved production prospects in North America and Russia, as well as the resumption of exports from Ukrainian Black Sea ports.

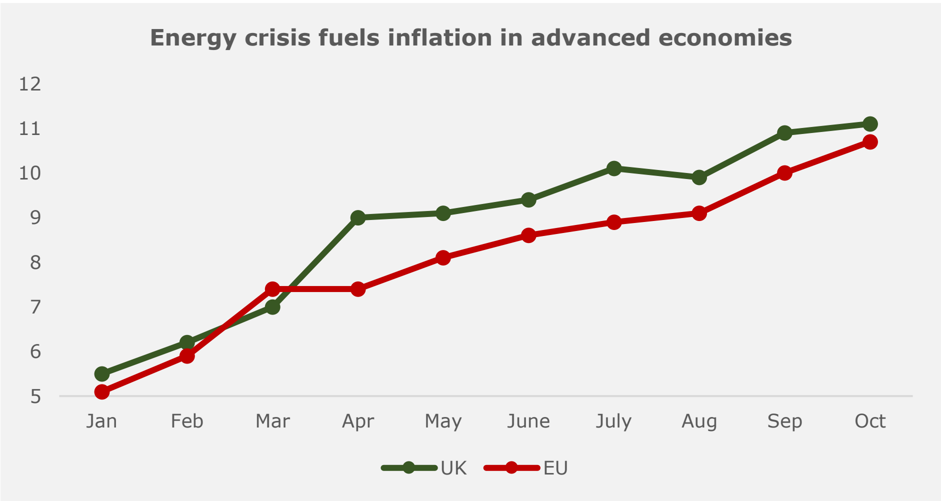


Source: FAO, Vetiva Research

Advanced Economies: A double-edged sword

Recession fears have become more acute as policy makers implement hawkish measures to bring down inflation. The International Monetary Fund (IMF) downgraded its growth expectations in major economies, while inflation remains stubbornly high. The situation in advanced economies remains difficult. Monetary policy mistakes (i.e., premature easing/over-tightening) may aggravate inflation/depress growth.

Starting in the West, the Eurozone remained resilient due to sustained fiscal support and growth in tourism-dependent southern European economies. However, the growth recorded was at a slower pace due to the energy crisis that is weighing on economic activity. The region grew by 2.1% y/y in Q3'22, down from 4.1% y/y in Q2'22. The removal of COVID-19 restrictions across the bloc, combined with lax fiscal policy, has aided the labour market, with employment levels and wages rising. A key risk for the Eurozone is a 20% reduction in Russia's gas supply, which could fuel already high inflation. In November, inflation eased to 10.0% y/y, down from the 10.7% y/y recorded in October. With inflation above desired levels, the European Central Bank (ECB) hopped on the hawkish train and delivered three consecutive rate hikes since July, the most recent being a 75-basis point increase to 1.5%. The ECB has reiterated its determination to combat inflation, so future hikes are possible, even in the face of a possible deep winter recession and gas-rationing.



Source: Trading Economics, Vetiva Research

Similarly, the Bank of England (BOE) has continued to battle record inflation levels despite its successive rate hikes. So far, the BOE has raised the benchmark interest rate eight consecutive times, to 3.0%, its highest level since 2008. Amid high inflation, the UK continues to face severe labour shortages due to the Brexit-induced exodus of its labour force. With a shrinking labour force, UK businesses struggle to expand, and a demand for higher wages by available workers could fuel inflationary pressures.

In September, Liz Truss was installed as the new prime minister. Upon resumption on the job, she outlined her plans to "get economy growing and rebuilding Britain through reform." Markets went into panic mode after Truss and her chancellor, Kwasi Kwarteng, announced a series of unfunded tax cuts, including a 5ppt reduction in the top marginal tax rate to 40%. Investors reacted negatively to the news as gilt yields spiked while the value of the Pound sterling plunged to a fresh-record low due to fears of spiralling national debt. To salvage the situation, the Bank of England launched an emergency government bond-buying programme in an attempt to stabilise markets. However, criticism of "Trussonomics" mounted and after 45 days in office, Liz Truss resigned. Upon the resumption of her successor Rishi Sunak, the British pound gained 1% against the U.S. dollar and UK bond yields retreated.

Meanwhile, the United States Federal Reserve has adopted a hawkish stance due to the elevated level of inflation, which stood at 7.7% y/y as of October, well above the desired 2% rate. As a result, the Federal Reserve of the United States has raised interest rates by a total of 300 basis points this year.

FOMC Meeting Date	Rate Change (bps)	Federal Funds Rate
16-Mar-22	+25	0.25% - 0.50%
04-May-22	+50	0.75% - 1.00%
15-Jun-22	+75	1.50% - 1.75%
27-Jul-22	+75	2.25% - 2.50%
21-Sep-22	+75	3.00% - 3.25%
02-Nov-22	+75	3.75% to 4.00%

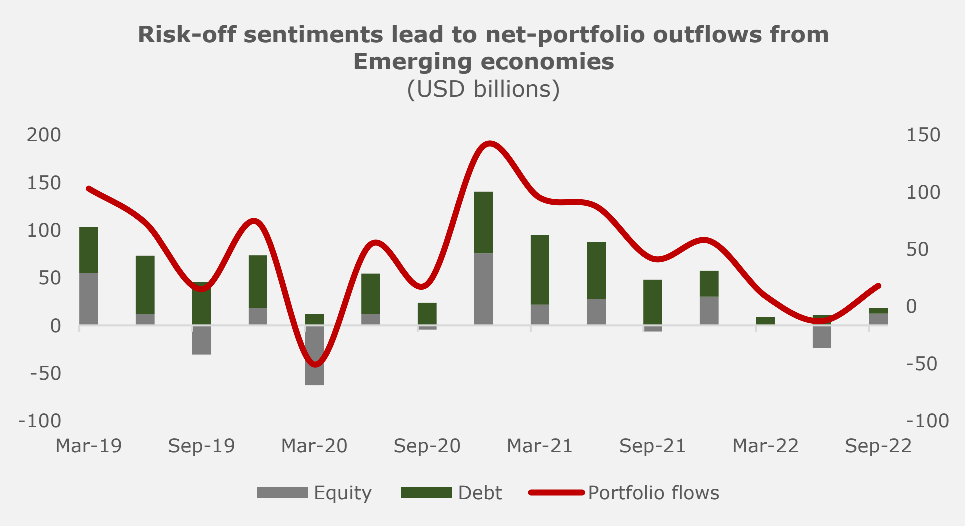
Source: U.S Federal Reserve, Vetiva Research

So far, Jerome Powell, the Chair of the U.S. Federal Reserve, has maintained his determination to stabilise consumer prices. The robust labour market data further supports the action of the Fed as approximately 2.7 million jobs were added since March when rate hikes commenced. In October, 261,000 new jobs were created, while the unemployment rate rose 20 basis points to 3.7%. The strong market shows that economic activities have not been severely hampered by the action of the Fed as companies continue to seek new labour for their expansion needs. Nevertheless, the Fed has signalled slower rate hikes should inflation remain contained.

Moving on to the Eastern Hemisphere, the Japanese economy grew by 3.5% y/y in Q2'22, thanks to strong private consumption and business spending. In Q3’22, GDP contracted by 1.2% y/y, as weakness in the currency inflated the country’s import bill. The Japanese Yen has continued to fall due to the Bank of Japan's (BOJ) dovish stance. To boost growth and resolve its low inflation battle, the BOJ implemented a yield-curve control policy in 2016, which caps 10-year government bond yields at around 0%. However, a dovish stance has made investors ditch Japanese securities in search of higher yields elsewhere.

Emerging and Developing Economies: A Case of Catch-22

The emerging world is still dealing with the fallouts of the invasion. With surging inflation and slower growth, the strengthening of the US dollar compounds the problems. The strengthening of US dollar, due to a hawkish Fed, has made imports more expensive for the emerging world and contributed significantly to domestic price pressures. Rising interest rates have also increased the cost of external borrowing for countries in this group. Capital flows, which have dropped significantly, are also yet to recover, and many low-income and developing economies could be on the verge of a debt crisis. However, the impact of the war is uneven across emerging market as commodity exporters stand to gain from the price surge, while the account balances of net-oil importers bleed.



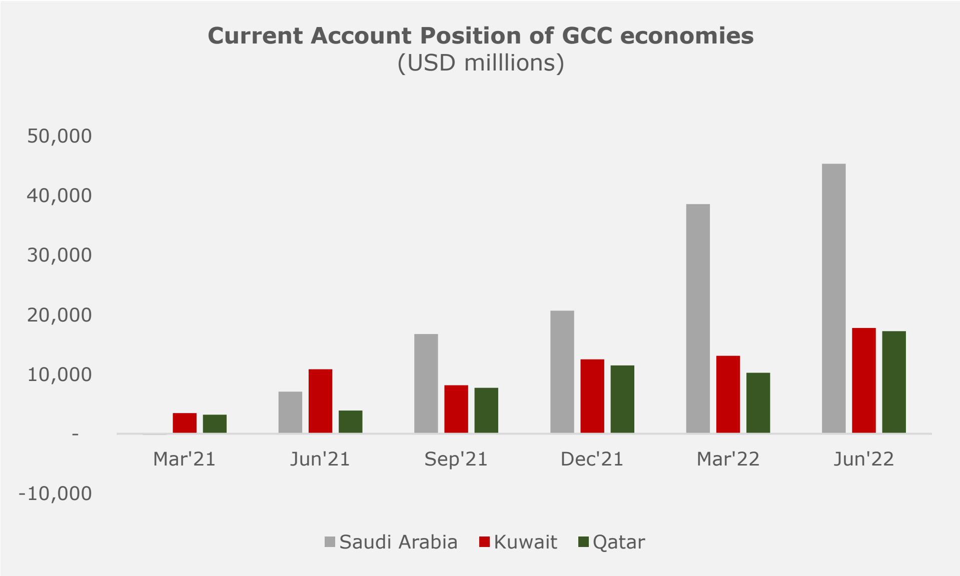
Source: IIF, Vetiva Research

GCC Economies: A Brighter Spot

The Gulf Cooperation Council (GCC) economies, comprising of Saudi Arabia, United Arab Emirates, Kuwait, Bahrain, Qatar, and Oman, demonstrated great resilience. This is primarily due to their statuses as energy exporters, which puts them in a position to benefit from the rise in oil prices.

In comparison to the sharp rise elsewhere, inflation in member countries has remained relatively moderate. Despite their heavy reliance on imported food, GCC economies have been spared from the Russia-Ukraine food crisis due to their food security strategies that were triggered by the 2008 financial crisis. By adopting hydroponic farming, and other planting alternatives, the Gulf states have been able to build up their strategic reserves and local production capacity. Additionally, they buy farmlands in export-oriented developing countries. With these strategies, they have been better prepared to deal with food emergencies.

The high hydrocarbon price has supported growth in the Gulf, as well as bolstered the fiscal position. Gulf states have also seen healthy current account surpluses due to increased oil exports. Refusing to side with either the West or Russia, the region's balancing act positions it to strengthen its global economic and political foothold. Indeed, Russia's sanctions provide an opportunity for the Gulf Cooperation to capture the European oil market as Europe seeks to reduce its reliance on Russian energy. Qatar has confirmed that it will supply Germany with liquefied natural gas by 2024.



Source: IMF, Vetiva Research

BRIC Economies: A mixed bag

In Q2'22, the Chinese economy struggled to recover from the effects of COVID-19 restrictions, growing by only 0.4% y/y, compared to 4.8% y/y in Q1'22. Furthermore, China's property crisis persists, and for a sector that accounts for roughly one-fifth of China's economic activity, this dampens the country's economic outlook. As a result, the job market, particularly for young people, is deteriorating. The Chinese economy grew by 3.9% y/y in Q3'22, driven mainly by the automobile industry (new energy vehicles) and the government's fiscal stimulus. In 2023, the decline in trade, zero-COVID policy, global economic slowdown, and the end of new energy subsidies for automobiles may dampen China's growth. Nonetheless, demand remained relatively strong as demand for China's most popular meat, pork, drove inflation to a 2-year high of 2.8% y/y in September. The People's Bank of China (PBOC) has been relatively dovish to help revitalise the economy, however, with the Yuan taking a dive, the PBOC paused it monetary policy easing in September and maintained its benchmark interest rate at 3.65% to support the Yuan.

Russia’s economy shrank for the second consecutive time in Q3’22 (-4.0% y/y) following the 4.1% y/y contraction in Q2’22. The wave of international sanctions and the decline in consumer expenditure caused the downturn. Due to quick policy responses in Q1’22, Russia was able to avert a downturn in Q1’22. However, Russia posted a current account surplus of $51.9 billion, which was primarily driven by lower imports amid sanctions from the West.

Over in India, the economy expanded by 13.5% y/y in Q2’22, which was 9.4 percentage points faster than the country's performance in the first quarter. The growth was driven by improved consumer spending, investment and reinforced by base effects. Increased household spending and expensive food caused a spike in inflation. With global food prices dropping, Indian consumers may get some relief. In order to stabilise consumer prices, the Reserve Bank of India (RBI) increased its repo rate four times in a row, totalling 190 basis points so far this year.

Brazil's GDP expanded by 3.2% y/y in Q2 of this year, driven by strong household spending and fiscal stimulus by the government. The consumption-induced inflation led Brazil's central bank to raise its key interest rate twelve straight rate times to 13.75%. Despite this, employment in the country grew. In September, Brazil's central bank decided to pause its rate hikes after two consecutive drops in inflation, driven by fuel and energy tax cuts.

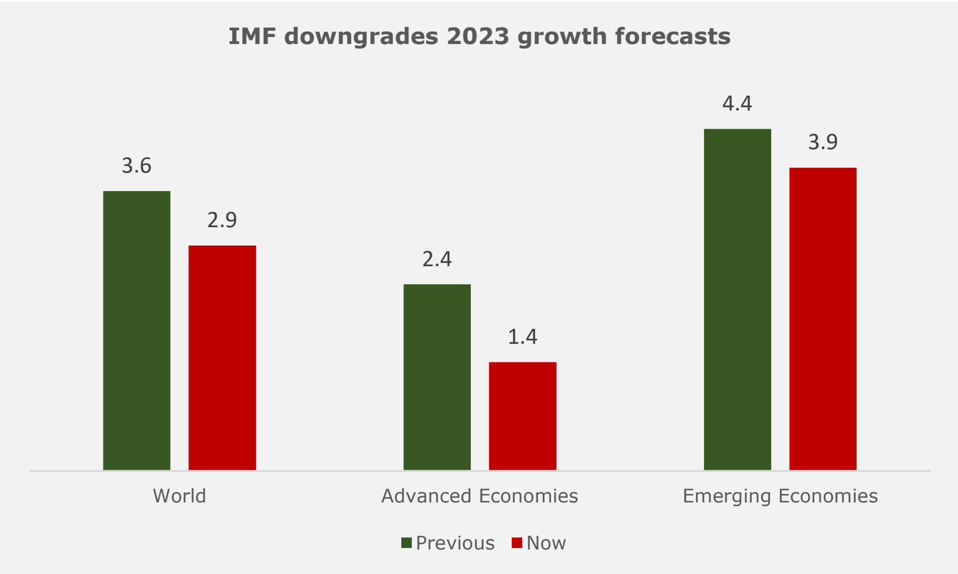
2023 Global Forecasts	GDP (%)	Inflation (%)
World	**2.7**	**6.5**
Advanced Economies	**1.1**	**4.3**
US	1.0	3.5
Euro Area	0.5	5.3
UK	0.3	8.9
Japan	1.6	1.3
EMDEs	**3.7**	**8.0**
China	4.4	2.2
India	6.1	5.1
ASEAN-5	4.9	4.3
Saudi Arabia	3.6	2.2
Russia	-2.2	5.0
SSA	3.7	11.8

Source: IMF, Vetiva Research

Macroeconomic and policy themes in 2023

Global growth slowdown

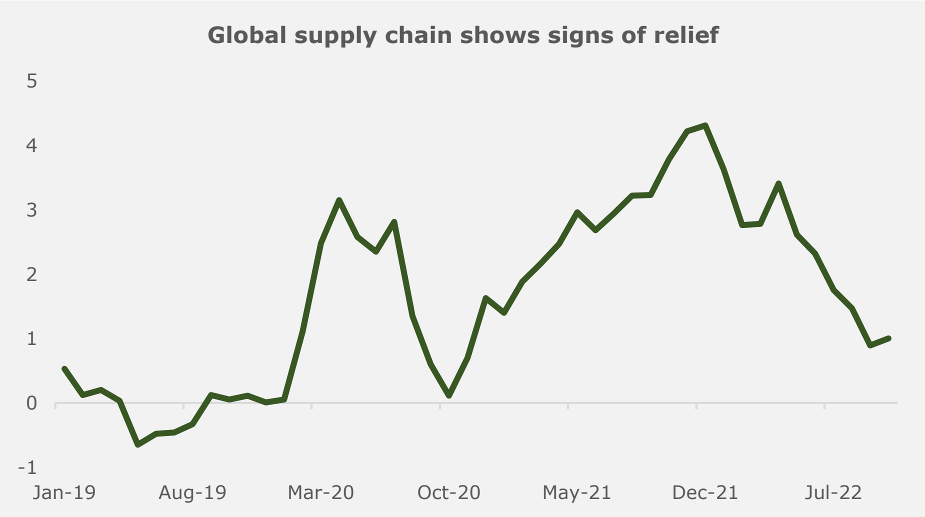
Monetary policy tightening, the energy crisis, and COVID restrictions are all expected to contribute to the 2023 slowdown. Because of these factors, growth in the advanced and emerging economies may slow. While monetary policy tightening may reduce economic output in the United States, the Eurozone's growth may be hampered by the energy crisis. In Asia, China's property crisis and continued COVID controls may dampen real output. Overall, tighter financing conditions could weigh on growth in 2023.



Source: IMF, Vetiva Research

Easing supply constraints

Following the relaxation of strict COVID-related restrictions, supply disruptions have eased, lowering pandemic-related pent-up demand. With the recent Black Sea grain deal between Ukraine and Russia, supply pressures may ease even further. The alleviation of pandemic-related shipping disruptions has resulted in a reduction in shipping costs. This downward trend should continue, especially as more container capacity comes onstream. However, the cancellation of the Black Sea grain deal, as well as continued lockdowns in China, a key trade partner for many economies, could disrupt the supply chain and potentially lead to a food crisis.



Source: Federal Reserve Bank of New York, Vetiva Research

Monetary Policy Normalization

To combat persistently high inflation rates, major central banks have aggressively raised their interest rates. So far, the BOE, U.S Fed, and ECB have raised interest rates by 200bps, 300bps and 125bps YTD respectively. Despite this, inflation remains above desired levels. Therefore, we could see more rate hikes until inflation begins to decelerate at a steady pace. We, however, note that escalation of the Russia-Ukraine war could keep commodity prices elevated and warrant further tightening. We note that sustained tightening by the US Fed especially could lead to herding by central banks. Additionally, this could tighten financial conditions and heighten the possibility of a debt distress in emerging markets. On the flip side, we note that geopolitics could dictate the pace of tightening in 2023. Should geopolitically tensions ease, we could see less monetary policy aggression in 2023.

Sub-Saharan Africa

Growth could decelerate in 2023

Following a record 4.7% y/y expansion in 2021, the recovery trajectory in Sub Saharan Africa (SSA) has been impeded in 2022 by a slowdown in global growth, the war in Ukraine, and tight global financial conditions. In 2023, growth in the region hangs largely on the developments in the global economy, as there are uncertainties surrounding (i) the war in Ukraine and (ii) the response of the world's largest central banks to inflation.

First, uncertainties around the Ukraine-Russia war has kept the region on the edge. While the world applauded the Black Sea grain deal (which guaranteed safe exports of grains to address food shortages) in July, Russia pulled out of the deal in October citing drone attacks on its ships. This has significant implications for food prices in Africa as cereals are Africa's top imports from the warring countries. This risk is further heightened by domestic food supply shortages stemming from adverse weather conditions. Thus, should the war between Russia and Ukraine escalate, inflation could remain elevated in 2023.

In addition, the sustained hawkish response of central banks in advanced economies could incite further risk aversion, lack of sovereign access to the international debt market, and limited fiscal space. As regional and domestic central banks sustain the tightening path, fiscal consolidation could drag government expenditure while high interest rates impede investments. Thus, growth in the region is expected to slow to 3.6% y/y in 2022 and 3.7% y/y in 2023 (IMF).

Inflation to trail global development

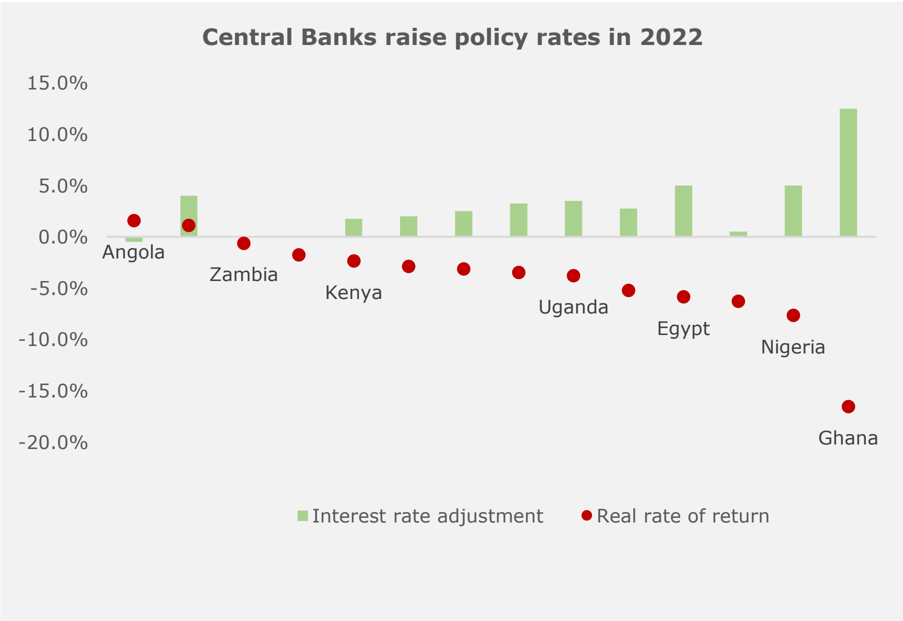
According to the International Monetary Fund, median inflation in Sub Saharan Africa has risen from a pre-COVID level of 5% to more than 9% today. In contrast to developed economies, more pressure has been unleashed on the food basket than the core basket. The Russia-Ukraine war has raised food prices, energy costs, and exchange rate volatility. This position could worsen especially as adverse weather conditions pose significant threat to domestic food cultivation, while the strengthening of the dollar and the ongoing war raises the cost of food imports.

In 2023, we still see the ongoing geopolitical tensions being a key determinant of inflation in Africa. Should tensions ease, this could support a widespread deceleration in inflation. On the other hand, further escalation of the crisis could keep oil prices elevated and keep inflation elevated across the region. Irrespective, oil-rich economies like Angola could continue to consolidate gains from the oil rally, with inflation slipping further the mid-teens to the single-digit region. Nigeria could be on the brink of another upsurge should the new administration effectively expunge fuel subsidies.

Monetary policy: Fed pivot could provide a breather for African central banks

As a result of rising inflation, most Central banks raised their benchmark rates in 2022. However, African central banks were quite cautious as the rate hikes were less aggressive as the pick-up in headline inflation. Ghana (+1,250bps YTD) has been the most aggressive thus far amid acute inflationary pressures and heightened capital flow reversals. Egypt (+500bps YTD) follows closely, as the apex bank raced to reduce the negative real rate of return in the face of balance of payment pressures. In Nigeria (+500bps YTD), the apex bank sustained a hawkish posture throughout the year amid elevated inflationary pressures and electioneering activities. On the other side of the spectrum, Angola (-50bps YTD) reduced its benchmark rate to 19.5% on the back of a stronger currency, deceleration in inflation, and windfall from high oil prices.

In 2023, we see a possible pivot in the US Fed's policy stance influencing an easier monetary policy stance in Sub-Saharan Africa. Initial expectation is that a substantial decline in US inflation could trigger a pivot in monetary policy. On the contrary, should geopolitical tensions spike further, this could extend the timeline of hawkish monetary policy into the coming year.



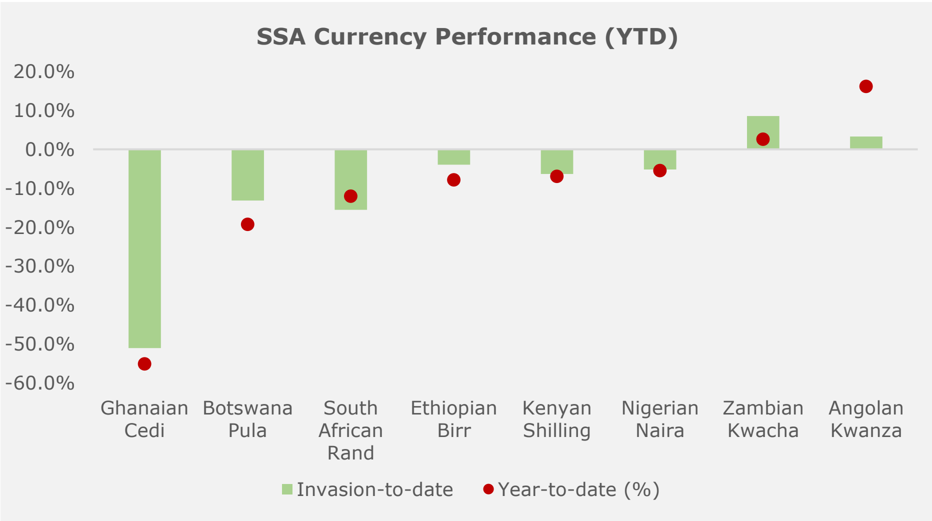
Source: Trading Economics, Vetiva Research

SSA Currencies: High oil prices could remain a dent

In 2022, African currencies were driven majorly by the geopolitical tensions and rising interest rates in major economies of the world. On an absolute basis, Africa's trade exposure to Russia and Ukraine is low (3.6%), yet the commodities imported are demand-inelastic and as a result, exposes the continent to price shocks. Cereals and mineral fuels are the most imported items from the warring countries. Currencies that rallied post-invasion of Ukraine were oil-exporters (Angolan Kwanza) or alternative producers of Russian/Ukrainian exports. However, some of these gains were given away

(South African Rand) as the Fed's rate hikes stepped up capital flow reversals and flight to safe havens. This had a more dire impact on economies with huge exposure to portfolio investors and the international debt market (Ghanaian Cedi), as both events (war and rate hikes) spurred domestic sell-offs, capital repatriations, credit ratings downgrades, and lack of access to the international debt market.

In 2023, while high oil prices could dent SSA currencies further, we expect three key factors to ease pressures on SSA currencies - a lenient monetary policy stance by the US Fed, easing geopolitical tensions, and the relaxation of China's zero COVID policies.



Source: Bloomberg, Vetiva Research

South Africa: Flooding stalls growth

The post-pandemic recovery path in South Africa has been rather sluggish. Following a 6.3% slump in 2020, the South African economy grew by just 4.9% y/y in 2021, as recovery was held back by slow reform implementation and a series of shocks. While COVID-19 variants and domestic riots held back the economy in 2021, the economy was held back by flooding and power cuts in 2022. For context, torrents of rains in KwaZulu province, a major manufacturing hub in the economy, contributed to the economic slowdown in Q2'22. In addition, the economy has been plagued with inadequate electricity supply as load shedding has persisted over the past 15 years. Combining these factors, economic growth slowed to 0.2% y/y in Q2'22, a sharp drop from the 19.5% y/y expansion a year earlier, leaving the South African economy beneath pre-pandemic levels. With legacy concerns surrounding its power industry contributing to reduced economic activity, we anticpate a further slowdown in output growth to 1.7% y/y in 2023 from 1.9% y/y in 2022.

Amid the daunting challenges, revenue prospects improved for the fiscal authorities as a result of high commodity prices. In the 2022/23 fiscal year, revenue collection improved across major income lines - personal income (+8.2%) and companies' income (+62.8%). The government expects this trend to persist into the 2023, as it expects revenue to improve to 1.8 trillion rand - $104 billion (2022/23: R1.6 trillion - $92 billion). While this translates to a 3.6% y/y expansion in revenues, expenses are expected to grow by 1.2% in 2023/24. The government intends using 65% of projected additional revenues to improve its primary balance (revenue less non-interest expenditure). The consolidated budget deficit is projected to narrow to 4.1% of GDP in 2023/2024 (2022/23: 4.9%). Its budget projections are, however, threatened by the escalation of the Russia-Ukraine war, power cuts, and clamour for wage increases.

In 2022, the Russia-Ukraine war resulted in elevated energy prices and higher inflation levels. Inflation surged from 4.5% y/y in 2021 to 6.7% y/y in 2022. In the coming year, the baseline scenario is premised on the easing of supply chains and lower commodity prices. With the additional provision of fuel levy reliefs, this could further contain inflationary pressures in the South African economy. However, inflation could remain above the target of the South Africa Reserve Bank (SARB) till H1'23. Thus, inflation is projected to decline to 5.1% y/y in 2023.

Monetary policy was largely hawkish in 2022, following a cumulative 250 basis points adjustment to 6.25% thus far. Its recent Quarterly Projection Model presumes further hawkish decisions in 2023 (6.36%). However, its monetary policy stance would be reinforced by evolving global developments as a de-escalation of the war could provide leeway for monetary policy accommodation.

On the external scene, the truce in a Ukraine-Russia war is a two-edged sword, as lower commodity prices (precious metals) reduce export receipts while lower oil prices make imported petroleum products cheaper. With South Africa being a net-importer of petroleum products, higher oil imports coupled with lower export prices could slow down net-merchandise exports. Beyond exports, in Q2'22, global risk aversion contributed to a weakness in the income segment of its current account as South Africa recorded the biggest dividend repatriation exercise in 15 years. Although South Africa recorded a decent goods account surplus, its merchandise surplus was weakened by unfavourable terms of trade (higher import relative to export prices), occasioned by elevated oil prices. As a result, the country's current account balance is expected to decline from a surplus of 0.2% of GDP to a deficit of 1.0% in 2023.

Ghana: Negotiating an IMF package amid a BOP crisis

The Ghanaian economy wiggled through 2022 facing a myriad of challenges, triggered by the Russia-Ukraine war, global risk-off sentiments and pre-existing fiscal sustainability challenges. Amid these challenges, Ghana's real sector has been somewhat resilient as economic activities grew at a faster pace in H1'22 (4.2% y/y) than in H1'21 (3.9% y/y). This outperformance was driven by the recovery in the industrial sector (mining especially) amid modest expansion in the agricultural sector and slower growth in the services sector. Leading real sector indicators point to constrained private consumption and investment as both the Consumer Confidence Index and Business Confidence Index have declined on account of rising inflation, currency depreciation and weakening consumer demand. This informs our benign real output growth expectation of 4.3% y/y in FY'22 (FY'21: 5.4% y/y).

According to provisional data, Ghana recorded a cash deficit of 6.4% of GDP (budget: 5.0% of GDP) in the first nine months of the year, driven by a lesser receipt outcome of GH¢51.49 billion - $3.7 billion (budget: GH¢60.08 billion - $4.3 billion) amid a 99.5% expenditure outcome (GH¢89.04 billion - $6.3 billion). The ensuing deficit of GH¢37.56 billion ($2.67 billion) with net foreign loan repayments of GH¢89.04 billion ($6.33 billion) created a resource gap of GH¢41.1 billion ($2.92 billion), which was financed from domestic sources and use of resources from the stabilization fund. While expenditure has been in line with budget estimates, revenue outcome has been underwhelming. Due to the prevailing spate of capital flow reversals and uncovered auctions, the Bank of Ghana had to monetize the budget deficit.

In our H2'22 outlook, we noted that Ghana was in a mess due to a confluence of unfavourable events, including (i) weak revenue mobilization, (ii) expensive domestic debt, (iii) large non-resident holdings of domestic debt, and (iv) restricted access to the international debt market. We equally pre-empted a possible visit to the IMF, which has materialized now. However, we noted that despite the short-term volatility implications for Ghanaian currency, a deal with the IMF could help stabilize the sovereign over the medium term

What we know so far is the restructuring deal could entail a restructuring of both local bonds and Eurobonds. For context, Ghana will replace outstanding local currency debt with four new bonds maturing in 2027, 2029, 2032, and 2037. The annual coupon on these new bonds will be set at 0% in 2023, 5% in 2024, and 10% from 2025 onwards. According to the Finance Minister, there will be no haircuts on the principals of domestic bonds, validating the earlier stance of the Ghanaian President. However, there is an implicit reduction in interest payments. Treasury bills were exempted from the restructuring exercise. Details on external debt restructuring is yet to be released officially as of the writing of this report amid earlier revelations that international debt holders could be asked to accept losses of as much as 30% on principal payments.

The fiscal woes of Ghana trickled down into its consumer prices as sustained risk aversion upended the Ghanaian cedi while elevated energy prices toppled both food and core baskets. Inflation has surged by 2780bps YTD to 40.4%. Amid rising inflation, the Bank of Ghana has raised interest rates to 27.0% (2021: 14.5%). While the apex bank expects inflation to peak in Q4'22 and fall thereafter, this points to the possibility of monetary policy accommodation in 2023. This would, however, be heavily dependent on geopolitics and ongoing monetary policy normalization.

On the external scene, Ghana's balance of payments account is undergoing severe strain as the country's current account deficit deepens amid extreme capital flow reversals. For context, current account deficit expanded by 22% y/y in Q2'22 to $0.69 billion (Q2'21: $0.57 billion). The expansion was driven by a wider services account deficit ($1.1 billion), larger net income account deficit ($0.82 billion) amid a lower transfer account surplus (+$0.69 billion) and a wider goods account surplus (+$0.49 billion). Improved gold ($1.6 billion) and crude oil ($1.5 billion) exports expanded the surplus in the goods account, as the war in Ukraine and global uncertainty trigger higher crude and gold prices, respectively. With the current account in a deficit position, the financial and capital account swerved into a deficit position (Q2'22: $0.89 billion) slipping from a huge surplus position a year earlier (Q2'21: $3.3 billion). Sudden portfolio flow reversals and increased repatriation of investment income ensued as both the war in Ukraine and the US Fed's hawkish monetary policy stance incited risk aversion towards riskier emerging market assets, resulting in an unfunded Balance of Payments gap. Ghana's external woes were compounded by high dependence on the commercial debt market, as yields on local and foreign sovereign debt instruments are exceptionally high. As a result, both Ghana's foreign exchange reserves and currency have come under immense pressure.

Going into 2023, we expect the Balance of Payment support from the IMF to support growth in the Ghanaian economy. While the intense tightening by the Bank of Ghana could weigh on investment, softer fuel prices in H2'23 could reduce pressure on private consumption. Thus, we expect the Ghanaian economy to expand by 3.90% y/y in 2023. We expect high base effects to push inflation lower in 2023 to 19.0% y/y (2022: 30.0%). The tightening stance could be relaxed in 2023 should global supply chain disruptions ease and the US Fed adopts an accommodative stance.

Kenya: Consolidating recovery

The Kenyan economy expanded by 7.5% y/y in 2021, driven by recovery in the industrial and service sectors amid a slowdown in agricultural production. Agriculture was adversely affected by harsh climate conditions (especially drought). In H1'22, the Kenyan economy grew by 6.0%. Growth is expected to be resilient in H2'22 as Kenya concluded her general elections peacefully.

In 2022, a first timer and the outgoing Deputy President, William Ruto, defeated a 5-time contender, Raila Odinga, after garnering 50.5% of the total votes cast. Although the election result was contested by the opposition, the Supreme Court upheld Ruto's victory. This subdued the elevated political risk following the violence that greeted the outcome of previous elections (2007, 2012, and 2017). For the broader economy, leading indicators of economic activity show sustained output growth amid robust activity in the transport, trade, construction, information and communication, and accommodation and food services. Economic surveys by chief executives and the private sector revealed strong optimism about the economy amid renewed confidence post-elections. However, headwinds to growth were identified, including high energy costs, poor weather conditions, and the ongoing war in Ukraine.

Amid renewed confidence in the economy, inflation continues to edge up on the back of high transport prices. Inflation surged to 9.6% in October 2022, which is 390bps higher than December 2021 (5.7%) and 260bps above the Bank of Kenya's target. As of September, the Bank of Kenya's Survey of the Agricultural sector revealed that the prices of some food items have declined due to improved weather conditions and the onset of the harvest season. Nevertheless, the underlying impact of high energy prices continues to drive inflation up. Kenya has also removed fuel subsidies amid ailing government finances and high oil prices. As a result of elevated inflation, the Central Bank of Kenya (CBK) raised the benchmark interest rates by 175bps year-to-date to 8.75%, its largest hike in over seven years.

On the fiscal end, the Kenyan Government is implementing a 38-month economic recovery programme that seeks to strengthen Kenya's COVID response, reduce debt vulnerability through a revenue-driven fiscal consolidation and stabilize the growth in public debt. By the end of 2022, Kenya could have access to SDR inflows worth $433 million from the IMF to attend to spending pressures due to the ongoing drought. In 2023/24 fiscal year, the government aims to trim fiscal deficit to 4.3% of GDP (2022/23: 5.8%).

On the external scene, Kenya being a net-importer of petroleum products is bound to record a current account deficit in FY'22 amid elevated oil prices. With respect to its merchandise trade, exports have strengthened by 11% y/y (12 months to August 2022), driven by increased receipts from tea (10.9% y/y) and manufactured goods (20.8% y/y) despite decline in horticultural exports (-12.0% y/y). Imports on the other hand have risen by 21.4% y/y, reflecting oil and intermediate goods. Overall, current account deficit is projected to rise to 5.9% of GDP in 2022 (2021: 5.5%), before moderating to 5.5% in 2023. Amid the sustained deficit, the Kenyan shilling has weakened to an all-time low of Ksh 122/$.

In 2023, legacy issues could reduce Kenya's growth prospects from the combined impact of currency weakness, high cost of credit, and debt vulnerabilities. Thus, we see room for a 4.5% y/y growth in real output. Inflation could moderate to 7.0% in 2023 as base effects push inflation lower and the Balance of Payment support provides succour in the agricultural sector.

Angola: Soaring on high oil prices

In 2022, high oil prices helped further stabilize Angola's economy. In Q2'22, Angola's economy expanded by 3.6% y/y, up from the 2.8% y/y expansion in Q1'22. The surge was driven by the stellar performance of the oil sector while mining activities improved on suitable climate conditions. Real output is expected to grow by 3.3% in 2022 before slowing to 2.5% y/y in 2023.

President Joao Lourenco secured a new 5-year tenure in a tight August 2022 electoral contest. Following re-election, focus has tilted towards fiscal reforms. Angola has stepped up debt repayment efforts amid high oil prices. With most of these debts owed to China, debt repayments could drag its debt-to-GDP to 53% in 2023 (from 85% in 2021).

The fiscal gains from high oil prices translated into consumer prices via the external channel. The appreciation of the Angolan Kwanza has supported sustained deceleration in inflation. Inflation has fallen from 27.0% y/y (Dec'21) to 16.7% y/y in October. The fall in inflation has provided room for monetary policy accommodation as the National Bank of Angola (BNA) reduced interest rates by 50bps to 19.5% at its September MPC meeting.

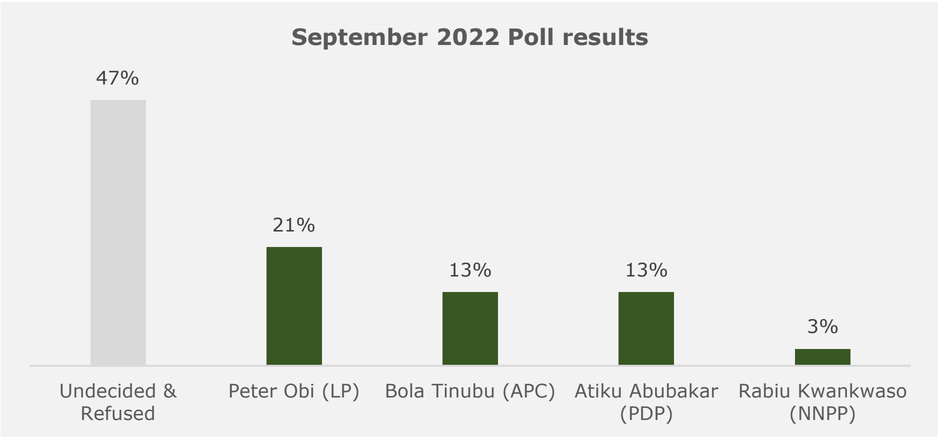
On the external scene, Angola has enjoyed current account surpluses in 6 years. In H1'22, the oil-producing had a current account surplus of $8.3 billion. At this run-rate, the country could double its current account surplus in 2022 to $16.6 billion (2021: $8.4 billion). The huge surplus is driven by oil exports (H1'22: $25.2 billion), which surpasses the deficits in the services account ($4.9 billion), income account ($4.3 billion), and the transfers account ($0.57 million). Angola's current account surplus is complemented by foreign direct investments ($3.2 billion), which masks the foreign portfolio outflows ($1.7 billion). As a result of this positive account balance, the Angolan currency, the Kwanza, appreciated by 31.9% in H1'23. However, the Kwanza depreciated by 16.6% in Q4'22 due to lower oil production.

In 2023, we expect OPEC+ production cuts and accommodative monetary policy to buoy growth in the Angolan economy. Inflation is expected to decline further in 2023 to 13.0% (2022: 22.0%) as high oil prices and improved production alleviates exchange rate pressures. Given the favourable outlook for inflation, the National Bank of Angola is expected to cut interest rates further in 2023 to 16.0%, providing further leeway for growth.

Domestic Economy

Elections and Enumerations

With the incumbent President Muhammadu Buhari signing out in 2023, the upcoming elections could shape the Nigerian economy for the next four (to eight years). Developments leading up to the election reveal one clear fact – the election is too close to call and makes policy outlook hazy. According to the Independent National Electoral Commission, 14 candidates are contesting the presidential elections. Following the conduct of its opinion polls via multi-lingual nationwide telephone calls, NOI Polls streamlined the number of popular candidates to four - Peter Obi of the Labour Party (LP), Asiwaju Bola Ahmed Tinubu of the All Progressives Congress (APC), Atiku Abubakar of the People's Democratic Party (PDP), and Rabiu Kwankwaso of the New Nigeria People Party (NNPP). The poll was, however, unable to predict a clear frontrunner as the undecided respondents and those who preferred not to reveal their candidate summed up to 47% of respondents (2019 polls: 38%). With most of the leading candidates in favour of pro-market policies, this could induce the implementation of the needed reforms to steer the economy in the right direction.



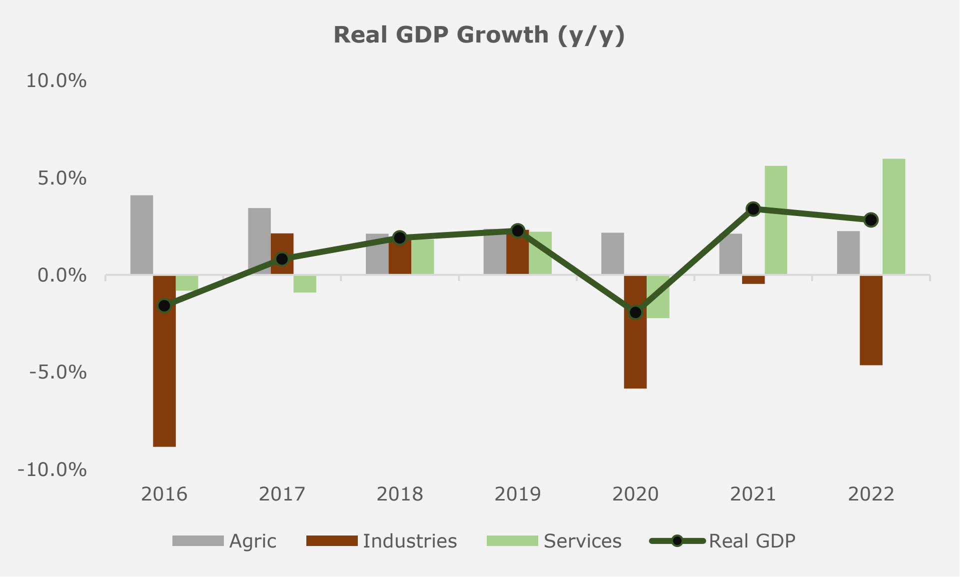
Source; ANAP, NOIPolls

2023 Census

Shortly after the elections, Nigeria will conduct her first census in 16 years. Slated for April 2023, the enumeration exercise would be the first digital census in the nation. According to the National Population Commission, the Population and Housing census would provide reliable data on the size, structure, distribution, socioeconomic and demographic characteristics of a country's population, which is required for policy intervention and monitoring of development goals. In addition to the questionnaire used in earlier editions, more questions will be introduced to provide data on literacy, dual-nationality status, employment capacity, and internet access.

Real Sector outlook: Still on the verge of growth

Within the first nine months of 2022 (9M'22), the Nigerian economy expanded by 2.9% y/y (9M'21: 3.2% y/y). Growth was largely anchored on expansion in two broad sectors; the services (9M'22: +7.1% y/y) and the agricultural (9M'22: +1.8% y/y) sectors amid the sustained slump in the industrial sector (9M'22: -5.8% y/y).



Source; NBS, Vetiva Research

The expansion in the services sector was driven by the Trade and Information & Communication (ICT) sectors, which jointly contribute c60% to services GDP. The expansion in the Trade sector (9M'22: +5.4% y/y) comes on the back of the reopening of additional land borders and sustained post-COVID recovery in supply chains. We expect sustained growth in the trade sector as more ports are built and borders are reopened to support wholesale trade. The ICT sector (9M'22: +9.5% y/y) expanded on the back of growth in SIM registrations, especially as the NIN-SIM related restrictions have been lifted. Thus, sustained growth in the ICT sector is anticipated, amid the rollout of 5G network and increased mobile penetration. Other key sectors such as the Real Estate and Financial Services sector rode on the back of increased economic activities. Despite the +500bps increase in the benchmark interest rate in 9M'22, the Financial services sector expanded by 18.3% y/y, its fastest expansion since 2013. In a similar manner, the Real estate sector recorded its largest expansion (9M'22: 4.5% y/y) since 2015.

The expansion in agriculture has remained steady due to sustained intervention of the CBN in the sector, with the Anchor Borrowers' Programme (ABP) being a key source of funding for agricultural activities.

The industrial sector remained in a 3-year long recession due to the sustained slump in the mining sector, which has masked the expansion in other sub-sectors (Manufacturing, Construction, Power, and Utilities). The slump in the mining sector is driven by a decline in crude production. For context, Nigeria's crude production has been marred by pipeline disruptions and massive crude thefts. This situation has led to force-majeures, especially on the Forcados Oil Terminal. Mid-October 2022, repairs on the terminal were completed setting the pace for increased oil production. As a result, crude production recovered by 8% m/m in October. Our outlook for the oil sector remains broadly positive in 2023, with the adoption of local intelligence in pipeline surveillance yielding positive results – discovery of illegal pipelines and clampdown on oil thieves.

Away from oil, the manufacturing sector contracted in Q3'22, its first contraction since Q4'20. We attribute the decline to elevated energy prices, constrained FX supply, and contractionary fiscal policy. For context, the imposition of excise taxes on non-alcoholic drinks increased the burden on beverage industry players. This was compounded by successive challenges – the surge in diesel prices. The food, beverage, and tobacco sector, which was grossly affected, was quite immune to past economic shocks. Should PMS subsidies be fully removed as planned in 2023, this could ease the woes of the manufacturing sector as improved foreign exchange receipts boosts FX supply and reduces the cost of production, although higher fuel prices may suppress margins in the near term. The outlook for construction is quite mixed given the reduction in proposed capital expenditure by the Federal Government and the fiscal burden from subsidies. Thus, private consumption could be relied upon to spur growth in the sector.

GDP Outlook: Nigeria is tipped to grow by 3.0% y/y in 2023

In 2023, we expect the overall economy to expand by 3.0% y/y. This positive outlook is hinged on sustained recovery in the oil sector amid a moderation in non-oil growth. The oil sector, which has been in a three-year recession, is expected to rebound in 2023. We base our optimism on effective pipeline surveillance and the clampdown on illegal connections to the Trans-Forcados terminal. We also see consolidated gains from the newly commissioned Amukpe-Escravos Pipeline. Our bull estimate of 3.97% is hinged on the commencement of domestic refining and other oil exploration activities.

GDP Forecast

Scale	Bear	Base	Bull
GDP	1.90%	3.00%	3.97%
Borders	Full closure	Partial reopening	Full reopening
Oil production	1.0 mb/d	1.6 mb/d	1.8 mb/d
Elections	Uncertainty	Smooth transition	Smooth transition
Refinery	Nil	Nil	650kb/d

Source; Vetiva Research

Fiscal outlook: Who will bell the cat?

The fiscal scorecard for the first eight months of the year reveals that the budget assumptions were largely favourable. However, Nigeria was unable to convert the fiscal gains from the surge in oil prices, a higher production quota, and a weaker exchange rate (higher oil revenues and FAAC allocations in Naira terms).

2022 Budget Review

Assumptions	Budget	Actual	Variance
Oil Production (mbpd)	1.6	1.3	-21%
Oil Price (US$ per barrel)	73	110	51%
Exchange Rate (₦/US$)	410.2	424.5	3%
Inflation (%)	13.0	20.8	60%
GDP Growth (%)	4.2	3.5	-16%

Source: Budget Office, Vetiva Research

During the first eight months of the year, the Federal Government achieved 67% of its revenue target in 2022. This underperformance, which was caused by misses in both oil revenue (-73%) and independent revenue (-50%), can be linked to pipeline disruptions in the oil sector. On the non-oil leg, the government overshot its corporate tax income targets by 36%. While improved economic activities boosted Company Income and Value Added Taxes, Customs revenues fell slightly off target as the weakness of the Naira impeded import volumes.

On the expenditure leg, spending outcome trailed the budget as the government curtailed its personnel costs (-5%) and non-debt recurrent expenditure (-22%). However, less was spent on capital projects than planned (-51%). While spending was curtailed across major expense line items, more was incurred on debt service (+33%) than planned due to the payment of interest on ways and means advances, which was not featured in the 2022 spending plan. Overall, spending thus far in 2022 has been financed by domestic borrowing. Less foreign loans were obtained than planned due to the tight global financing conditions. The sole foreign loan acquired was the $1.25 billion Eurobond undertaken in the month of March.

2022 Budget Performance (Jan - Aug 2022)

Line item	Budget	Actual	Variance
REVENUES	₦'billion	₦'billion	
Oil Revenue	1,460	395	-73%
FGN Independent Revenue	1,744	866	-50%
Non-Oil Revenue	1,506	1,550	3%
CIT	606	826	36%
VAT	211	210	0%
Customs Revenues	556	466	-16%
FA levies + EMT levy + Royalties	132	47	-64%
Others	784	856	9%
Total Retained Revenue	**5,494**	**3,667**	**-33%**
EXPENDITURE			
Recurrent Expenditure	7,391	7,237	**-2%**
Non-Debt Recurrent Expenditure	4,739	3,713	-22%
Personnel Costs (MDAs)	2,478	2,358	-5%
Aggregate Capital Expenditure	3,610	1,778	**-51%**
Debt Service	2,652	3,524	**33%**
Domestic Debt	1,708	1,735	2%
Foreign Debt	749	764	2%
Sinking Fund	195	-	NM
Interest on Ways & Means	-	1,025	NM
Statutory Transfers	545	550	**1%**
Total expenditure	**10,588**	**11,312**	**7%**
FINANCING			
Privatization Proceeds	60	-	
Project-tied Loans	771	-	
New Borrowings	4,069	5,331	31%
Domestic Borrowing (including CBN)	2,356	4,821	105%
Foreign Borrowing	1,713	510	-70%
Fiscal balance	**-4,900**	**-5,331**	**9%**

Source; Budget Office, Vetiva Research

2023 Budget Analysis

The 2023 budget was tagged the Budget of Fiscal Consolidation and Transition. Unlike previous budgets, we are comfortable with the underlying assumptions. Since 2020, there has been a steady underperformance of Nigeria's oil production targets despite oil prices exceeding 100% of the initial budget benchmark.

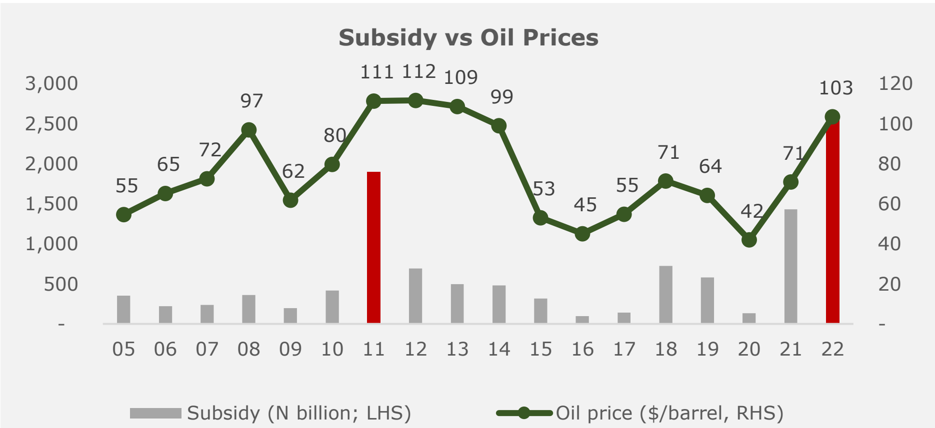
Budget details	2020	2021	2022*	2023*
Oil Production (mbbls/day)				
Budget	1.8	1.9	1.6	1.7
Actual	1.8	1.5	1.3	
Oil Price ($/barrel)				
Budget (Benchmark)	28	40	73	70
Actual	43	71	110	
Revenue (₦ trillion)				
Budget	5.4	8.0	10.1	9.7
Actual	4.0	4.6	5.5	5.8
Expenditure (₦ trillion)				
Budget	9.97	13.6	16.4	20.5
Actual	10.02	11.1	13.6	16.9
Fiscal deficit (₦ trillion)				
Budget	4.6	5.6	6.3	10.8
Actual (full subsidy)	6.0	6.4	8.1	14.0
Fiscal deficit (% of GDP)				
Budget	3.0%	3.2%	3.1%	4.8%
Actual (full subsidy)	3.9%	3.7%	4.1%	6.2%

*2022 Actuals are prorated, 2023 Actuals are forecasts Source: Budget Office, Vetiva Research

The 2023 budget proposal of ₦20.5 trillion is 21% larger than the 2022 appropriation act. The larger budget figure is driven by a higher debt service provision (₦6.6 trillion; +69% y/y) and non-debt recurrent spending plan (₦8.3 trillion; +20% y/y) while allocation to capital projects was lower than the 2022 appropriation act (₦4.9 trillion; -10% y/y).

The government plans to generate ₦9.7 trillion in revenue, leaving a ₦10.8 trillion fiscal deficit. We note that while the government more than doubled its spending plans in 4 years, the government has been unable to retain an annual revenue outcome of ₦6 trillion in any given year. In 2022, however, our annualized estimates show that revenue could hit ₦5.5 trillion at the current run-rate (Jan – Aug: ₦3.7 trillion). While the government reduced its revenue expectations from oil and independent revenues in 2023, the reductions were barely 15% apiece, compared to the more than 50% underperformance across both line items in 2022. While we remain upbeat about oil revenues in 2023 due to effective pipeline surveillance, we believe the revenue targets remain ambitious as they are premised on lower subsidy deductions. Overall deductions from revenue for FY'23 amounted to ₦3.0 trillion, which is lower than the full-year subsidy deduction of ₦6.7 trillion. Thus, the current revenue figure assumes that fuel subsidies will be fully removed in the month of June. On the contrary, we estimate that revenue could amount to just ₦5.8 trillion in 2023, which implies a phased subsidy removal process. In addition, we estimate that actual spending could be trimmed to ₦16.9 trillion amid cost containment. Contrary to the planned fiscal balance, we estimate that FY'23 fiscal balance could rise to ₦14.0 trillion, which translates to a fiscal deficit-to-GDP ratio of 6.2% (Budget: 5.0%).

In 2023, we expect the subsidy removal subject to gain traction, especially as subsidies engulfed NNPC's revenues as of July 2022. Historical evidence shows that the subsidy argument erupted in 2011 when oil prices crossed the $100/barrel psychological line and subsidies, the ₦1 trillion mark. This surge in the subsidy bill was checked in the past by pump price increases as outright subsidy removal was resisted by labour unions. With oil prices projected to remain high in 2023, a substantial increase in the PMS price may be on the cards. While the unprecedented decision to expunge subsidies in 2012 met strong social dissent, the fiscal authorities have openly communicated their timelines in expunging subsidies in recent times. The target date (June 2023) for removal this time, however, doubles as the handover date of the incumbent administration. Given the unpopular but necessary decision to expunge fuel subsidies, this begs the question – who will bell the cat?



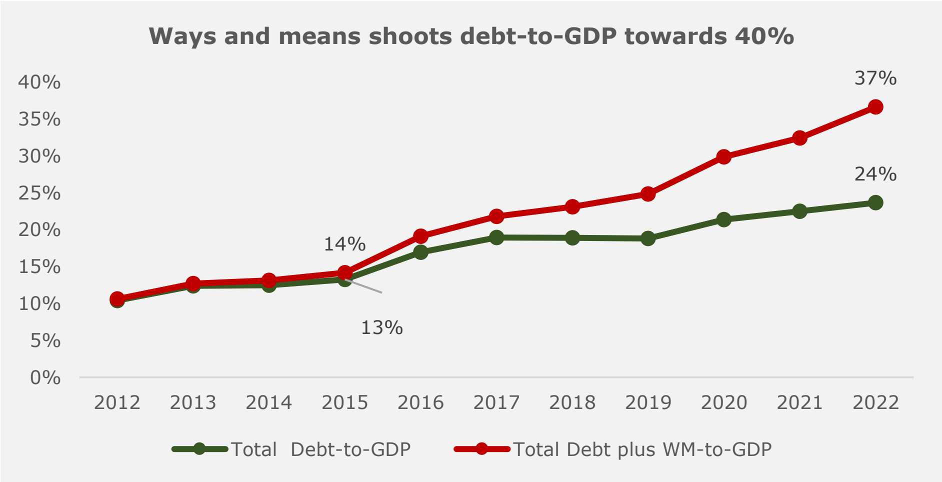
Source: NEITI, Macrotrends, Vetiva Research

Debt Outlook: Ways and Means could spike official debt levels

To plug its planned funding gap (of ₦10.8 trillion), the government will primarily depend on domestic debt (₦7.0 trillion) for 65% of its financing needs. While the government expects external borrowing and project tied loans to plug the rest, unfavourable global macro conditions could inhibit the government's borrowing plan. However, we note that the government could access cheaper multilateral loans should fuel subsidies be removed as planned. The prognosis for external debt largely depends on the ongoing war in Ukraine and the US Fed's monetary policy. Should the war in Ukraine de-escalate and the Fed assume an accommodative posture, financing conditions could ease, paving way for access to the international debt market. On the contrary, the government may have to depend on its domestic debt market to fund its budget.

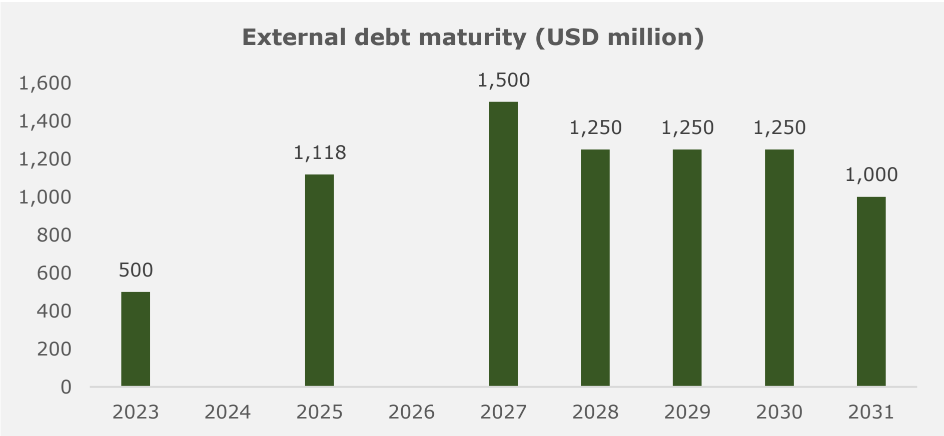
According to Debt Management Office, Nigeria's debt stock increased by 8.3% YTD to ₦42.8 trillion ($103 billion) in the first half of 2022. The uptick was driven majorly by a net accumulation of ₦2.5 trillion from domestic sources and a $1.25 billion Eurobond issuance. Despite increased external borrowings in recent times, the pace of external borrowings eased as tighter financing conditions prevented Nigeria from raising $990 million in the international debt market. Nigeria's debt mix is still tilted towards domestic debt (61% of debt stock) as external constitutes 39% of total debt stock.

Nigeria's Debt-to-GDP ratio has increased to 24%, below the 40% medium-term threshold of the DMO. While the debt-to-GDP ratio is quite modest, the addition of Ways and Means advances from the CBN raises the overall debt-to-GDP to 37%, moving the metric closer to the government's medium-term target. Statements from the current Finance Minister, Zainab Ahmed, points to the securitization of the ways and means advances to a 40-year bond issued at 9%. This has since come under public scrutiny, given extant fiscal laws and the implications for future repayment schedule.



Source: DMO, CBN, Vetiva Research

Overall, Nigeria's external debt maturity profile over the short term remains lean. In 2022, the Government redeemed a $300 million diaspora bond. In 2023, the government has barely $500 million (1.3% of external reserve stock) in external debt redemptions. While there are no redemptions in 2024 and 2026, the government has to repay a total sum of $10.4 billion over the next 10 years.



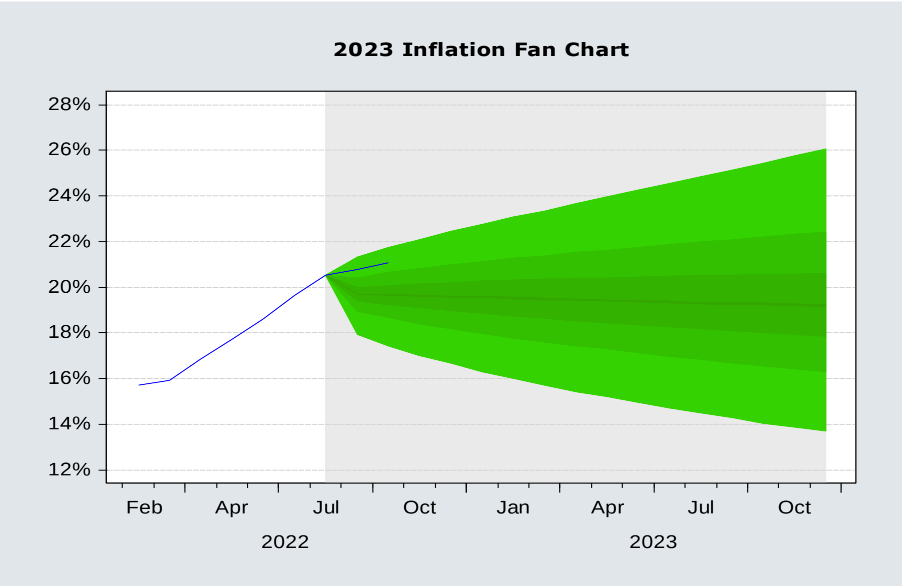
Source: Budget Office, Vetiva Research

Inflation Outlook: Hinged on policy direction

In Nigeria, consumer prices rose virtually throughout the year. Flayed by high energy prices, headline inflation rose to a 17-year high of 21.09% y/y in October 2022 (vs 15.99% y/y in October 2021). Food and core inflation remain at elevated levels of 23.72% y/y and 17.76% y/y respectively, burdened by high energy prices, currency depreciation, flooding, and conflict in food-producing regions.

In 2023, current information suggests inflationary risks are tilted to the upside. While we assign more weight to the impact of floods and other disruptions on inflation, the subsidy removal debate remains a key determinant of the direction of inflation in 2023. Given the high uncertainty around the possibility of full subsidy removal, we adopt a scenario approach to guide our FY'23 inflation expectations. Our baseline scenario assumes the status-quo is maintained, with a substantial increase in the PMS price over the course of the year, however, with fuel subsidies still in place. Our bear case approach assumes full subsidy removal combined with the impact of high food prices, an aftermath of the floods witnessed in 2022. Our bull case assumes the status quo is maintained with stable fuel prices and the full reopening of land borders.

Given this backdrop, the outlook of inflation is split into two halves. Due to the prior year's high base, headline inflation could trend downwards in the first half of the year (H1'23). The outlook for H2'23 is tilted towards the upside, as both subsidy and flooding constraints send consumer price inflation higher. Thus, we expect inflation to average 17.80% y/y in 2023 (2022e: 18.83%). Should subsidy removal and flooding risks fully materialize, we anticipate a bear inflation estimate of 22.14% y/y.



Source: EViews, Vetiva Research

Monetary Outlook: Subsidy removal could guide interest rate direction

Amid the rise in inflation, monetary policy has remained largely contractionary as the apex bank stepped up its inflation-fighting tools in 2022. Just as we predicted in our FY'22 and H2'22 outlook reports, the apex bank would be forced to step down its pro-growth stance, which favoured low interest rates amid interventions in the Nigerian economy. The Russia-Ukraine war incited inflation across the globe, with central banks in advanced economies leading the hawkish ride. The Central Bank of Nigeria had to follow suit despite stating earlier that the country was immune to capital flow reversals from the liquidity glut of 2020. Thus, the apex bank had to raise rates by 500bps to 16.5%, the largest annual rate adjustment in 11 years. In addition, the Cash Reserve Ratio was raised by 500bps to 32.5%.

In 2023, we expect three factors to influence monetary policy; (i) global supply chains in relation to the war in Ukraine, (ii) pace of monetary policy normalization in advanced economies, and (iii) the decision on fuel subsidy. Should the Russia-Ukraine war escalate in 2023, the passthrough of elevated food inputs and imported food items could cause inflation to remain entrenched. While recent data shows global supply chain pressures are easing, an escalation could reverse these gains and keep the hawkish taps on. On the other hand, should inflation decelerate considerably in the United States, the US Fed could slow down its pace of aggressive interest rate increases, paving way for softer global financing conditions and ultimately, reduced pressure on emerging and developing economies as Nigeria to tighten.

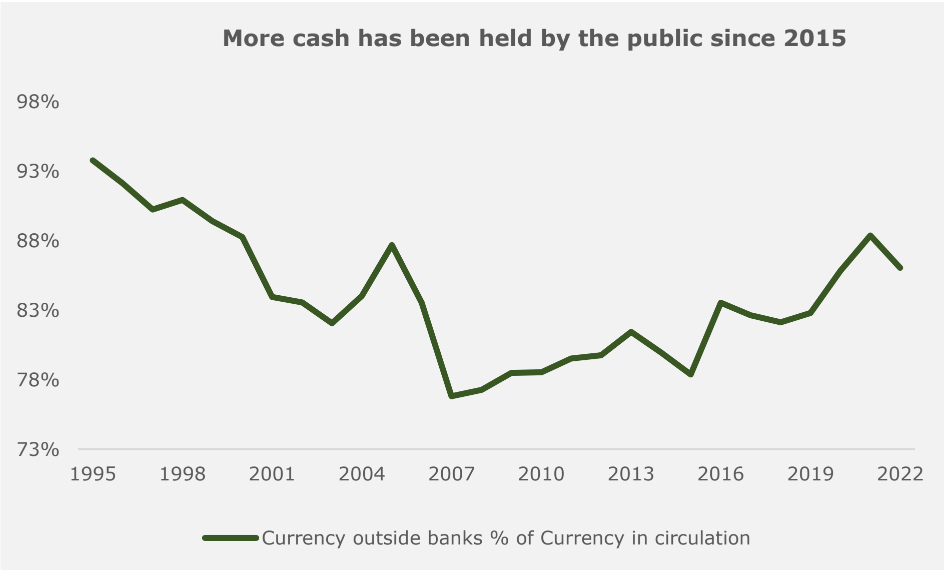
At the November 2022 MPC meeting, the apex bank hinted at reducing its pace of rate increases. This supports our view that milder rate hikes or a return to a HOLD policy could ensue in H1'23. Policy direction on subsidies and food supply from the new administration come June 2023 would dictate the pace of monetary policy in H2'23. A reformist approach to fuel subsidies could result in higher pump prices, improved fiscal receipts, and ultimately higher inflation numbers in the near term. This could necessitate further rate hikes from the apex bank in H2'23.

Indicator	Base	Bull	Bear
Inflation	17.8%	15.0%	22.4%
Energy prices	Higher pump prices	Subsidies remain	Full subsidy removal
Impact of floods	Moderate	Minimal	Severe
MPR	17.5%	13.5%	21.5%
CRR	32.5%	27.5%	35.0%
Asymmetric corridor	+100/-700bps	+200/-500bps	+100/-700bps

Source: Vetiva Research

New Naira Notes

Late into 2022, the CBN decided to re-design the Naira notes to tackle significant hoarding of Naira notes, worsening shortage of clean banknotes, and the increasing ease and risk of counterfeiting. Data from the apex bank shows that currency held by the public (currency in circulation less currency outside the banks) has increased from 78% in 2015 to 88% in 2022 despite numerous policies aimed at driving a cashless economy. The apex bank has said it will introduce stringent measures for withdrawal of large sums of physical cash in banks to ensure its policy objectives are achieved. This could improve the effectiveness of monetary policy transmission and address terrorism financing/money laundering.

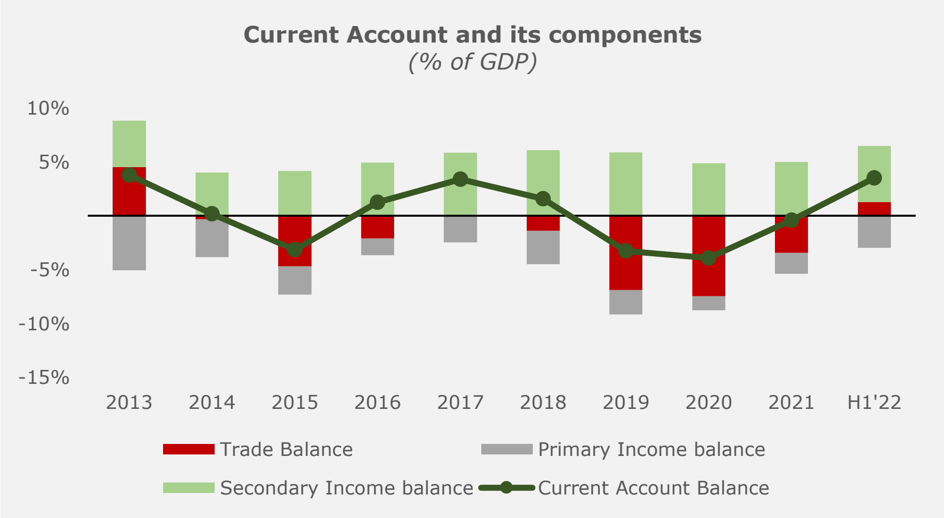


Source: CBN, Vetiva Research

External Outlook: FX Gap widens despite positive net trade flows

Current Account position turns positive in H1'22

In Q2'22, Nigeria's current account position rebounded by 92% q/q to $5.1 billion (4.7% of GDP), its highest point in four years. This improvement was on the back of higher goods account surplus, a thinner net income account deficit and a lower transfer account surplus (remittances). The gains from these sub-accounts surpassed the services account deficit.



Source: CBN, Vetiva Research

Beginning with the goods account, exports surged by 5% q/q to $18.2 billion while imports declined by 10% q/q to $12.5 billion, resulting in a net balance of $5.7 billion. The surge in exports can be attributed to significantly higher prices as oil production fell for a significant portion of the year. The decline in crude production is linked to crude theft. In August 2022, the Federal Government awarded a pipeline surveillance contract to Government Ekpemupolo's (Tompolo) non-state security outfit. The contract yielded positive results within a short timeframe as several illegal connections and pipelines were discovered. The removal of these illegal connections and the completion of repairs on the Trans-Forcados pipeline are triggers for higher oil production over the near term. Thus, we expect higher goods account surpluses.

The net-income balance (-$2.6 billion) has remained in a perpetual deficit position as investment income from foreign business interests in Nigeria exceeds income on Nigerian investments in foreign businesses. While foreign investors earned $3.3 billion in investment income, Nigerian businesses earned barely $624 million in investment income. This is a departure from positive net-income balances in co-oil producing countries, Kuwait ($5.9 billion) and Saudi Arabia ($5.1 billion). The drawdown on Excess Crude Account to $472,513 from c.$4 billion in 2014 underscores the persistent income account deficit in Nigeria.

In the services segment, the deficit was entrenched (Q2'22: $3.6 billion) as Nigerians embraced outbound transport (+49% y/y) and travel services (+32% y/y) despite elevated jet fuel costs, high ticket costs, and the depreciation in the Naira. This also speaks to increased emigration across the country, especially in the health and education sectors. Interestingly, the capital inflows from inward remittances surpassed the deficit in the services account, as Nigerians in diaspora remitted $4.9 billion to the country.

Remittances have remained a resilient source of FX over the years, averaging $20 billion over the past 11 years.

In 2023, we expect further expansion in good exports as effective pipeline surveillance boost crude export prospects. We also highlight the upside from the commencement of domestic refining activities. On services, we note that increased emigration could entrench the deficit in the services account, mainly attributed to the sustained exodus of skilled workers. We expect the income account to remain in the deficit position, as non-residents earn more investment income from their business prospects in Nigeria relative to domestic investors. Thus, we project that the current account balance could rise from an estimated 3.5% of GDP in 2022 to a bull estimate of 4.8% of GDP in 2023 (in the case of domestic refining of petroleum products). Our base case assumes that lower oil prices could counter the impact of higher crude production amid no domestic refining, leading to a narrower current account balance of 2.4% of GDP.

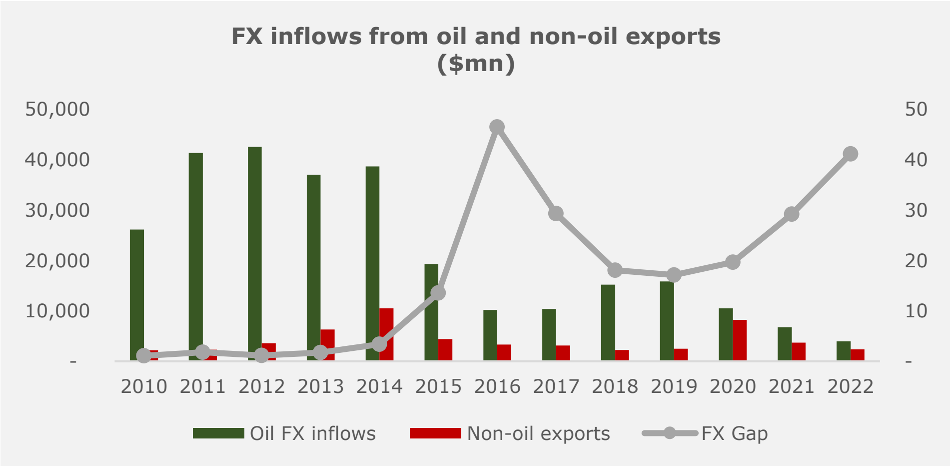
In its financial account, Nigeria recorded a net-incurrence of financial liabilities worth $3.1 billion (Q1'21: $0.88 billion). This was driven by portfolio investment in short-term debt securities ($1.8 billion), as non-resident investors benefit from the rising yield environment while other investments ($3.0 billion) surged on currency deposits and long-term loans to the government. We expect this trend to continue into 2023, as hawkish monetary policy raises the yields on domestic fixed income assets; however, portfolio inflows could be subject to clarification on the apex bank's foreign exchange policy and the outcome of the 2023 general elections.

FX Outlook: Pipeline surveillance could buoy the Naira

Since the descent into a negative current account position in 2019, Nigeria has had less foreign exchange inflows to stabilize its currency. We note that although oil contributed 90% of foreign exchange inflows in 2013, this contribution has dropped steadily to 26% in 2020 and 17% in 2021. Due to the descent, the main contributors to FX inflows are majorly autonomous sources: OTC purchases (27%), domiciliary account deposits (24%), and TSA & third-party funds (13%). Non-oil exports contributed a meagre 6% to total FX inflows in H1'22.

Amid the descent in oil earnings, the apex bank has made moves to de-risk Nigeria's FX inflows from the vagaries of the oil sector. Thus, it introduced the RT200 FX programme, which seeks to improve non-oil export flows into the country. The program aims to raise $200 billion in non-oil FX earnings over the next 3 to 5 years. The program includes a rebate scheme to incentivize non-oil exporters for repatriating FX through the official channel. The apex bank rewards non-oil exporters with ₦65 for every $1 repatriated for third-party use or ₦35 for every $1 repatriated for own use. In a recent summit, the CBN

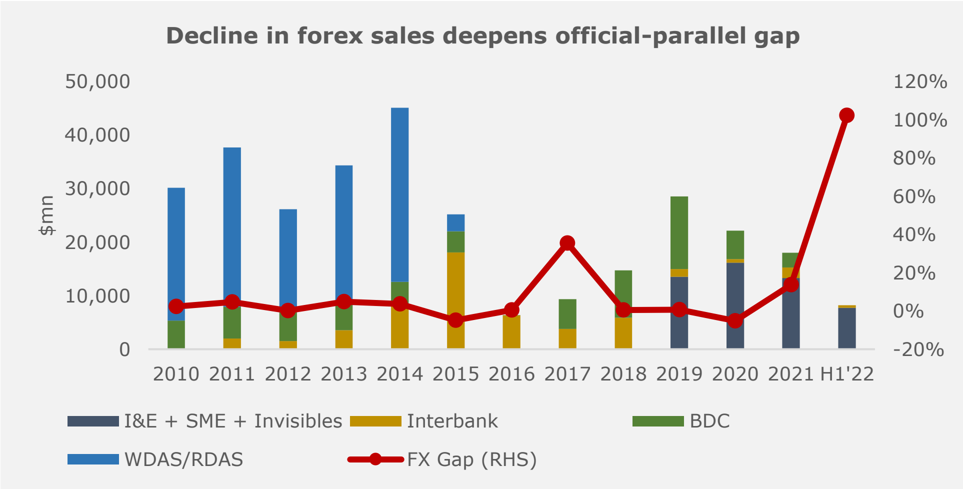
Governor, disclosed that $4.99 billion was repatriated by non-oil exporters in 2022, a 56% y/y improvement from the outcome in 2021 ($3.19 billion). In return, the Bank has paid ₦81 billion in rebates. While this move yields the result over the near term, we understand that the historical contribution of non-oil exports to foreign exchange flows is c.4%.



Source: CBN, Vetiva Research

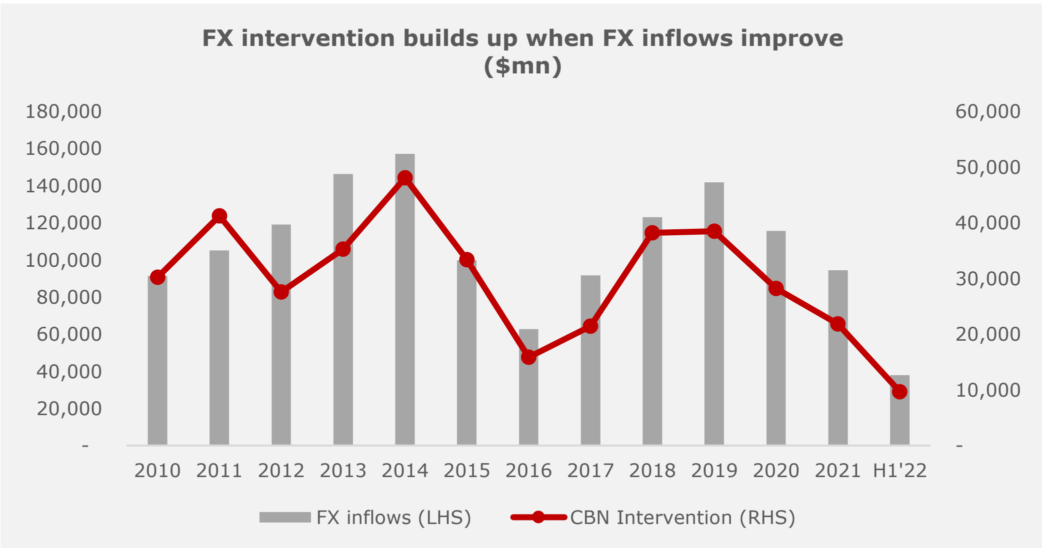
Worse still, the absolute contribution of the oil sector has waned from an annual inflow of $38 billion in 2014 to an annual inflow of $6 billion in 2021. Thus, the magic wand to improve FX flows in the near-term hangs largely on the oil sector. In this regard, we have seen positive signs following the outcome of the pipeline surveillance contract and the resumption of crude exports via the Trans-Forcados terminal in October 2022. With the risk of crude theft minimized by this development, we expect increased crude receipts and higher foreign exchange earnings in 2023. However, we note that a substantial reduction/total elimination of fuel subsidy is necessary to boost FX inflows into the reserves, as subsidies now take up to 100% of oil revenues.

As a result of the decline in FX flows, the Bank has introduced stringent measures of reserve management. In addition to restricting official FX access for some imported items, the bank has reduced its interventions in the foreign exchange market. In July 2021, the bank stopped selling FX to Bureau de Change (BDC) operators. Amid reduced FX supply and increased demand especially in a pre-election year, the FX gap between the official and parallel market widened further. In 2022, the parallel market has weakened by 27% year-to-date, while the official exchange rate is down by barely 7%.



Source: CBN, Vetiva Research

Our prognosis going into 2023 suggests that currency performance hangs largely on higher oil production receipts and improved intervention in the foreign exchange market. Thus, should our baseline scenario of stronger oil production and a reduced subsidy bill play out, we expect increased foreign exchange inflows and a narrower FX gap. We had established in our H2'22 Outlook that the Naira is undervalued in the parallel market, though slightly overvalued in the official market. Thus, while we see the Naira slipping to ₦480/$ in the official window, our base estimate for the parallel market is hinged on an appreciation to ₦665/$ in 2023. Risks to our outlook includes subsidy retention, excessive demand volatility, unrest in the Niger Delta, political upheavals, and a sustained hardliner posture from the apex bank towards retail FX outlets.



Source: CBN, Vetiva Research

Vetiva Exchange Rate Forecast				
Period	Indicator	Forecasts Worst	Base	Best
Mar-23	Reserves ($'mn)	35,564	38,566	40,384
	I&E (₦/$)	490	465	440
	Parallel (₦/$)	865	752	730
Jun-23	Reserves ($'mn)	33,293	39,336	41,698
	I&E (₦/$)	495	470	430
	Parallel (₦/$)	882	728	677
Sep-23	Reserves ($'mn)	31,847	40,166	42,764
	I&E (₦/$)	503	477	400
	Parallel (₦/$)	905	700	628
Dec-23	Reserves ($'mn)	30,038	39,821	42,034
	I&E (₦/$)	512	486	380
	Parallel (₦/$)	934	665	584

Source: Vetiva Research

Forecast Assumptions				
		Bear	Base	Bull
Mar-23	Brent (avg.)	$80/bbl	$90/bbl	$108/bbl
	Imports restriction	Yes	Yes	Yes
	Foreign investors' sentiment	Risk-off	Risk-off	Risk-on
	Crude oil sales	Sustained decline	Moderate recovery	Strong recovery
	Spending limits relaxed	Yes	No	No
Jun-23	Brent (avg.)	$77/bbl	$90/bbl	$95/bbl
	Imports restriction	Yes	Yes	Yes
	Foreign investors' sentiment	Risk-off	Risk-off	Risk-on
	Crude oil sales	Sustained decline	Moderate recovery	Strong recovery
	Spending limits relaxed	Yes	No	No
Sep-23	Brent (avg.)	$70/bbl	$87/bbl	$98/bbl
	Imports restriction	Yes	Yes	Yes
	Foreign investors' sentiment	Risk-off	Risk-off	Risk-on
	Crude oil sales	Sustained decline	Moderate recovery	Strong recovery
	Spending limits relaxed	Yes	No	No
Dec-23	Brent (avg.)	$70/bbl	$85/bbl	$95/bbl
	Imports restriction	Yes	Yes	Yes
	Foreign investors' sentiment	Risk-off	Risk-on	Risk-on
	Crude oil sales	Sustained decline	Moderate recovery	Strong recovery
	Spending limits relaxed	Yes	No	No

Source: Vetiva Research

Risks to the outlook

Health risks

A severe outbreak of the monkeypox disease and a resurgence of the COVID-19 pandemic poses health threats to our outlook. Should a new pandemic occur that necessitates strict lockdowns, this could worsen supply chain bottlenecks that are starting to ease. On the other hand, a decline in demand for contact-intensive services could ease pricing pressures, resulting in a trade-off between inflation and output.

Geopolitics

Escalating tensions in Eastern Europe could exacerbate market volatility, engender a commodity super-cycle and intensify the cost-of-living crisis. The war in Ukraine has already caused market fragmentation, as Russia's invasion resulted in fallout with many countries. New geopolitical tensions elsewhere may result in a more hostile global economy, disrupting trade and eroding the pillars of multilateral cooperation, prompting countries to adopt protectionist policies, and putting globalization at risk. In East Asia, China’s ambition to annex Taiwan has piqued the interest of the US, which has promised to defend its ally. An attack on Taiwan, will have a humanitarian and economic impact, given the importance of Taiwan's computer chips in electronics.

Financial risk

Rising interest rates will weigh on the financing options in emerging market and developing economies. Given the hawkish stance of the US Fed, rising yields has compounded the debt burden and risk aversion of emerging economies. As a result, economies that rely heavily on external financing may face high refinancing risks. Should the current rout in the global financial markets remain in place, this could degenerate into a debt crisis, especially in economies with huge exposure to foreign loans.

Domestic risks

In 2023, three major risks that could thwart our expectations include political instability, climate change, and unrest in the Niger Delta region. As Nigeria approaches her general elections, the risk of political instability remains valid. Our outlook is hinged on smooth political transition, and any black swan event could alter the outcomes. On climate change, we note that insecurity and rising cases of flooding could worsen inflation and erode the real rate of return on local currency investments. Finally, unrest in oil-producing states could thwart our expectations on the fiscal, monetary, and external sectors of the Nigerian economy.

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