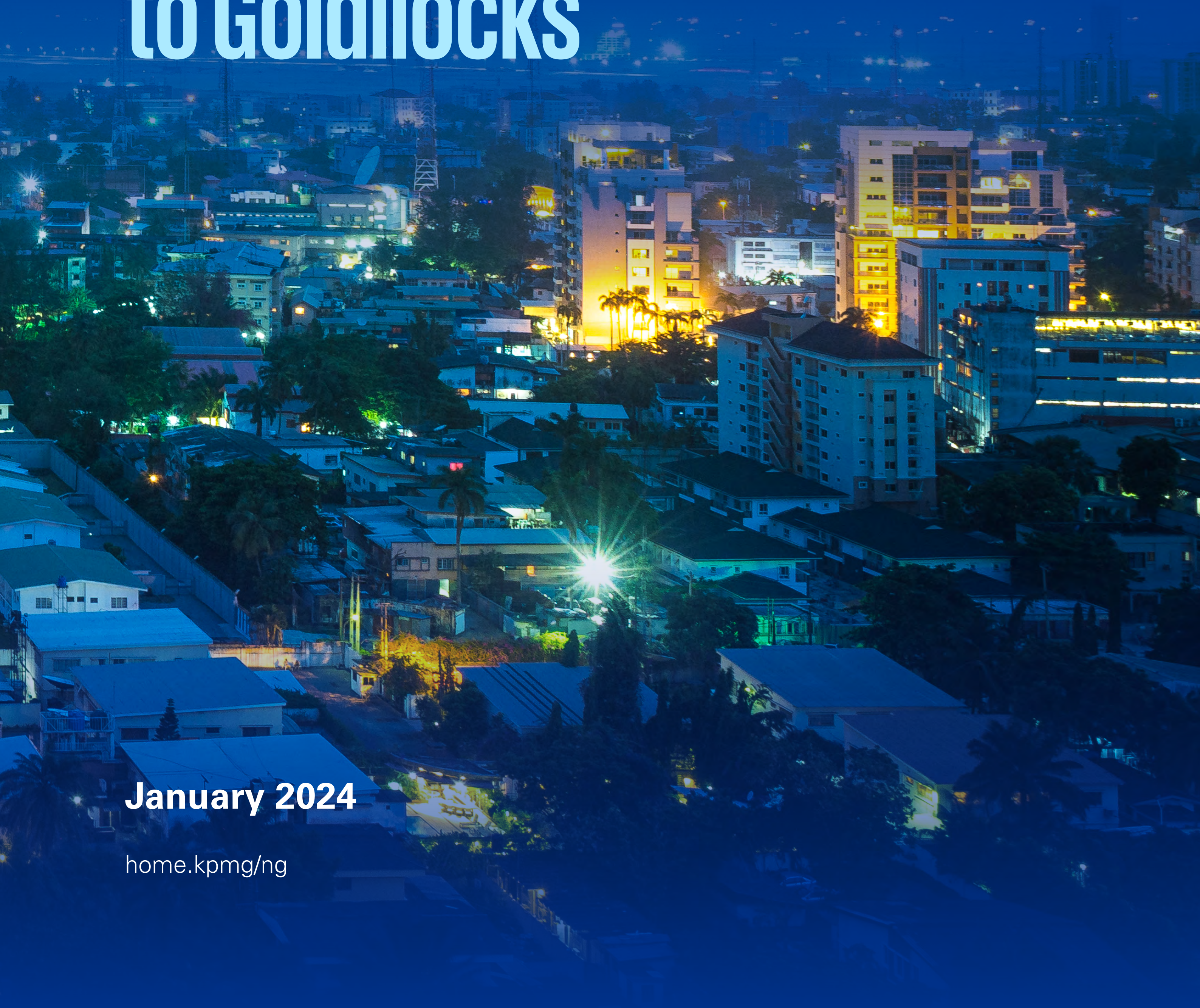
Macroeconomic Review 2023 and Outlook for 2024: The Steep Climb to Goldilocks



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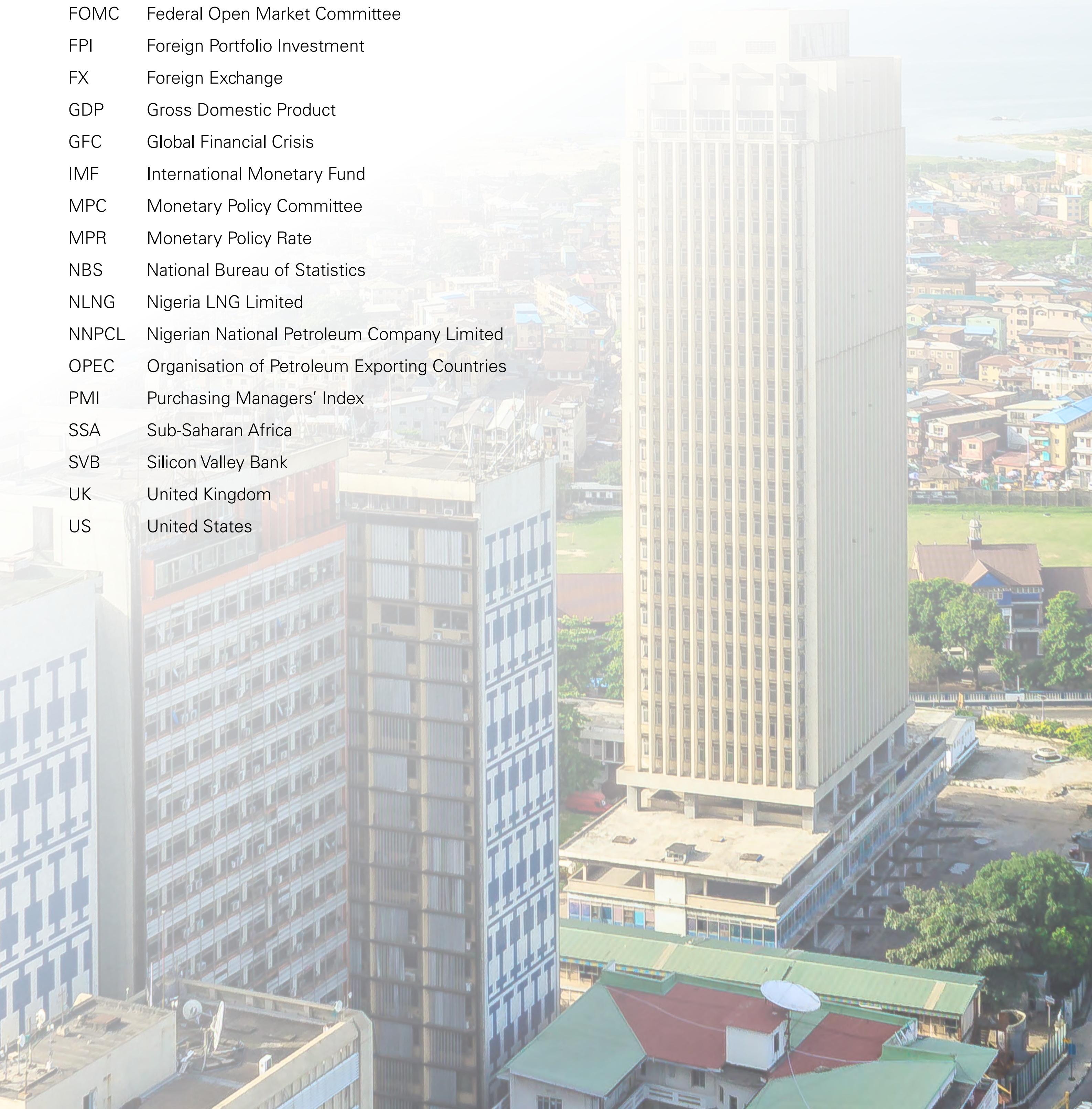
List of Acronyms

B2B	Business-to-Business
BIS	Bank for International Settlement
CBN	Central Bank of Nigeria
DMO	Debt Management Office
ECB	European Central Bank
EU	European Union
EV	Electric Vehicles
FAAC	Federation Account Allocation Committee
FDI	Foreign Direct Investment
FOMC	Federal Open Market Committee
FPI	Foreign Portfolio Investment
FX	Foreign Exchange
GDP	Gross Domestic Product
GFC	Global Financial Crisis
IMF	International Monetary Fund
MPC	Monetary Policy Committee
MPR	Monetary Policy Rate
NBS	National Bureau of Statistics
NLNG	Nigeria LNG Limited
NNPCL	Nigerian National Petroleum Company Limited
OPEC	Organisation of Petroleum Exporting Countries
PMI	Purchasing Managers' Index
SSA	Sub-Saharan Africa
SVB	Silicon Valley Bank
UK	United Kingdom
US	United States



1.0 Executive summary

The growth of the global economy in 2023 is nothing short of a tale of resilience as elevated inflation unprecedented in decades and several other headwinds dampened global growth, pushing the world economy closer to its pre-pandemic growth level. Headwinds from elevated price levels which caused significant drag in consumer demand, sustained interest rate hikes that disincentivised investments, weaker trade, and spates of geopolitical tensions which eroded investors' confidence by fuelling market uncertainties in addition to triggering supply chain disruptions all tested the resilience of the global economy.

While these headwinds were fierce enough to reverse some of the post-covid growth recovery of the global economy and drag some major economies to the brink of economic recession, they were not enough to plunge the resilient global economy into a recession as the economy emerged stronger than most outlooks at the start of the year. Global growth settled at an estimated 2.6% in 2023, according to the World Bank, as Central Banks in developed economies approached the end of their monetary tightening streak aimed at reining inflation to their 2% target. On the global horizon, we anticipate a moderate growth, lower inflation, and interest rate cuts after initial pause to observe the inflation-dampening impact of previous rate hikes.

In the Sub-Saharan Africa (SSA) region, economies were confronted with multiple layers of challenges ranging from sluggish growth, elevated inflation levels, debt sustainability problems, steep currency depreciation, and political tensions in 2023. Although external headwinds in the global economy also contributed to the experience, the region's challenges were more local than global as the macroeconomic performance of the region mirrored the impacts of headwinds arising from economic reforms, power challenges, and matured oil fields in the region's top 3 economies- Nigeria, South Africa and Angola, respectively. We anticipate an improvement in the region's performance in 2024 driven by easing financial conditions in advanced economies, sustained domestic monetary tightening, improved revenue mobilisation, greater fiscal discipline and debt restructuring.

In Nigeria, the pro-market reforms implemented by the new administration which appears to be tilting the balance of the economy in the direction of a private sector-led growth model weighed on the performance of the economy in 2023. Specifically, the twin reforms of fuel subsidy removal and exchange rate unification which caused a sharp depreciation of the naira fanned inflationary pressures and led to a more restrictive interest rate environment that jointly weighed on growth. Amidst the removal of the peg on the nation's exchange rate, the country also experienced problems of FX illiquidity and loss of investors' confidence which has only started to improve lately as implied by recent Moody's ratings.

Looking ahead, we anticipate that growth in Nigeria will strengthen to 3.0% in 2024 driven by the rebound of business activities in the non-oil sector as the impact of the twin reforms fades and our continuing expectation of improved oil production and oil prices in the global market. In addition, the Central Bank is more likely to maintain its hawkish posture and raise the MPR further in 2024 to tame inflation which we anticipate will hover around an annual average of 22% by the end of the year. Also, we expect the exchange rate to depreciate further in 2024 and settle significantly above current rates in both the official and parallel markets after initial early gains from government intervention.

1 Global Economic Review

1.0 Snapshot of the global economy in 2023

01
High Inflation and Monetary Tightening

02
Sluggish Growth

03
Geopolitical Tensions

04
Deglobalisation and trade fragmentation

05
OPEC + Supply cuts

06
Weak rebound of China's economy amid real estate crisis

07
Climate Change

1.1 The global economy in retrospect

Inflation: an outcome of policy and eventuality

The corona virus pandemic is no longer a global health emergency, but some of the fundamental economic distortions it produced lingered into 2023. The fiscal deficit spending and monetary responses adopted to stimulate economies in the wake of the pandemic came not only with the blessing of spurred growth, but also the curse of a heated global economy with suppressed inflationary pressures.

Supply-side disruptions caused by escalation of geopolitical tensions, particularly the protracted Russia-Ukraine war, further fanned the impending global inflation explosion. Other tensions that reinforced the impact of the Russia-Ukraine war on the global economy include the recent Israel-Palestine war, China-Taiwan conflict and the US-China trade conflict taking a technological dimension with restrictions to the supply of semi-conductors to China imposed by the United States (US). It was therefore not surprising that the surge in inflation, largely driven by energy and food inflation, linked to these supply-side disruptions remained a reoccurring theme in most macroeconomic discussions in 2023.

To combat inflation, central banks in most advanced economies embarked on a long streak of policy rate hikes to rein inflation from Q1 2022 to early Q3 2023 when the US Feds and the Bank of Canada last hiked their MPR by 250 basis points in July to 5.375% and 5%, respectively. Monetary authorities in England and Euro area also followed suit in August and September, with MPRs settling at 5.25% and 4.5% till date in both countries, respectively.

Consequently, inflation continued to abate for the most part of the year in developed economies assisted by lower energy inflation (Eurozone) and lower core inflation and wage growth (US). In the US, inflation decelerated to 3.1% in November 2023 from 6.4% at the start of the year in January. Monetary tightening efforts also bore fruits in Canada, UK and the Euro area as inflation tapered to 3.1%, 3.9% and 2.4%, respectively, in November. The pause in rate hikes by most central banks in advanced economies since Q3 2023 points to a possible attainment of an equilibrium in the fight against inflation and suggests a weak incentive for authorities to hike rates further as inflation continues to taper and inch closer to the 2% long term target of central banks.
Although we anticipate that most central banks may maintain the current interest rate plateau for

Inflation (%)

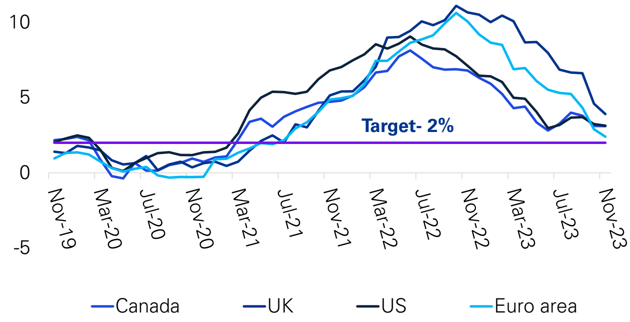


Figure 1: Inflation in advanced economies
Sources: BIS, KPMG Research

Re-emergence of supply chain pressures

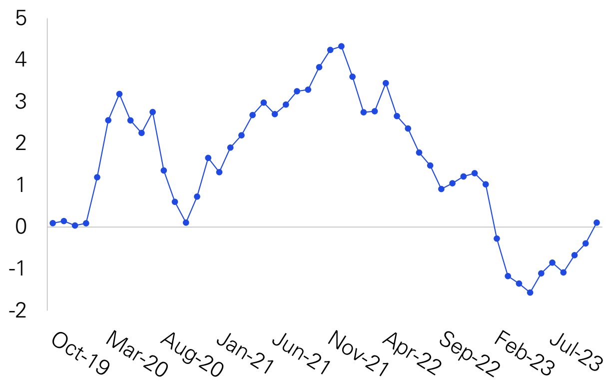


Figure 2: Global supply chain pressure index
Sources: Federal Reserve Bank of New York, KPMG Research

Monetary policy rates

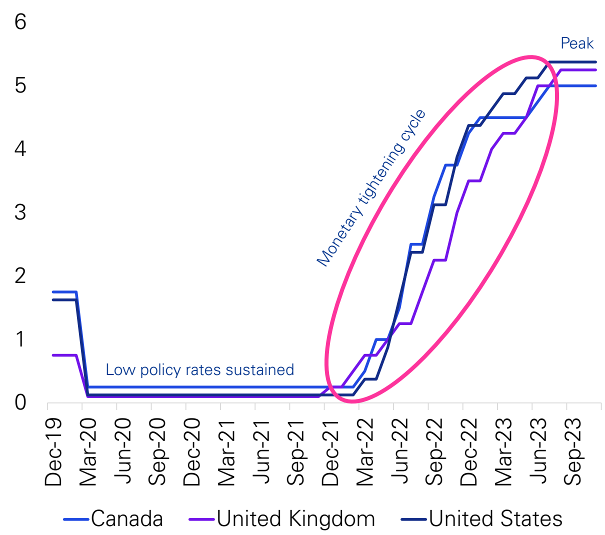


Figure 3: Monetary policy rates
Sources: BIS, KPMG Research

some time to fully observe the inflation-dampening impact of their long hawkish stance aimed at hitting the 2% inflation mark, we do not rule out the possibility of moderate upward rate adjustment by some central banks as core inflation yielded little and remained sticky even as headline inflation continued to abate, albeit still elevated and above the targets of central banks. Notwithstanding, we expect a generally lower interest rate environment in most advanced economies with rates likely hitting lows of 2.75% in the Eurozone and 4.75% in the US by the end of 2024 as policy focus tilts in the direction of growth stimulation.

Global growth: a tale of resilience

The growth of the global economy in 2023 is nothing short of a tale of resilience as elevated inflation unprecedented in decades and several other headwinds dampened global growth, pushing it closer to its pre-pandemic level. Headwinds from soaring price levels which caused significant drag in consumer demand (demand destruction), sustained interest rate hikes that disincentivised investments, and spates of geopolitical tensions which fuelled uncertainties that eroded investors' confidence in addition to triggering major supply chain disruptions all tested the resilience of the global economy in the period under review.

In addition, OPEC+ supply cuts which are major drivers of energy inflation, and the sub-par sluggish growth of the Chinese economy amid crisis in its real estate sector which contributes around a quarter (25%) of its GDP and weaker infrastructure investment below pre-pandemic levels further weighed on global growth as consumer demand and businesses shrank in response.

However, while these headwinds were fierce enough to reverse some of the post-covid growth recovery of the global economy and drag some major economies to the brink of economic recession, they were not enough to plunge the resilient global economy into a recession as the economy emerged stronger than most outlooks at the start of the year. For example, the Eurozone which inched closer to an economic recession, posting a 0.1% GDP contraction in Q3 2023, later ended the year with an estimated 0.4% growth, as increased energy costs, primarily driven by the Russia-Ukraine crisis, affected consumer spending and business activities, especially in the manufacturing sector. Likewise, China achieved a GDP growth rate of 5.2%, surpassing the 5% projection made by the Chinese Government. Furthermore, the country led global Electric Vehicles(EV) sales, reaching a remarkable 9.49 million units, outpacing all other countries in the world.

Country	2019	2020	2021	2022	2023*
World	2.6	-3.1	6.2	3.1	2.6
United States	2.3	-2.8	5.9	1.9	2.5
United Kingdom	1.6	-10.4	8.7	4.3	0.5
Canada	1.9	-5.1	5.0	3.4	1.3
Euro Area	1.6	-6.1	5.9	3.4	0.4
Japan	-0.4	-4.3	2.1	1.0	1.8
China	6.0	2.2	8.4	3.0	5.2

* denotes estimated growth rates

Sources: World Bank, IMF, KPMG Research

On the financial front, the global economy also demonstrated substantial resilience. But for the timely response of US and Swiss financial authorities, the woes of the world economy could have been more, and its resilience defeated by a financial turbulence similar to the 2007/2008 Global Financial Crisis (GFC).

In the first quarter of 2023, three major bank failures dominated the headlines- Silicon Valley Bank (SVB) and Signature Bank which are both major banks in the USA and Credit Suisse which is a global systemically important bank based in Switzerland. The failure of Signature Bank underscores the need for the US banking regulator to enhance capital controls and police the quality of assets provided by US banks. The situation also highlights the consequences of over-leverage resulting from declining yields, which were influenced by the Federal Open Market Committee (FOMC) rate hikes in response to inflation caused by a disjointed supply chain.

Notwithstanding, the swift response and bailout provided by both the US and Swiss authorities to prevent the domino effect of bank runs from spreading to other banks helped to restore stability as the financial system emerged almost unscathed, although some analysts maintain that some risks of financial stress related to this event may be lurking.

Looking ahead: Global outlook for 2024

Our outlook for the global economy is a generally stable and optimistic one, albeit with some tail risks.

Moderate Growth

We anticipate a generally moderate global growth in 2024 majorly driven by lower inflation, higher income and consumer demand, and expansion of the US economy. Our positive outlook is also anchored on documented early signs of China's real estate crises bottoming, which we expect will translate into near-term improvement in growth as the government continues to intensify stimulative measures. Our position is also reinforced by prospects of higher Chinese net exports driven by its diversification into renewable energy sources such as solar and wind powers. China is now the largest exporter of Electric Vehicles (EVs) from a net importer in 2019.

Inflation to taper

We expect inflation to lose steam and continue to decline at a steady pace in 2024 driven by lower energy prices as the Feds anticipates improvements in supply chains, especially as headline inflation in most advanced economies was largely driven by energy prices. There are early indications that the Feds, European Central Bank (ECB), and Bank of England (BoE) are likely at the end of their hiking cycles. The canary in the coal mine for global inflation level is how quickly the situation in the Red Sea can be resolved without further escalation.

Lower interest rate environment

On the interest rate horizon is a temporary hold-and-watch scenario which will gradually change to monetary easing and a lower interest rate environment driven by expectations of lower inflation as most major economies are reasonably closer to achieving their inflation target of 2%. Also, with further rate hikes bearing high risks of triggering an economic recession, the Fed and ECB are expected to reduce their policy rates to stimulate the economy. In fact, the market seems to be already gearing for this outcome as evidenced in lower bond-yields in recent times.

Risks to the global outlook for 2024

As the year 2023 unwinds and we forge ahead into the new year, we have identified the following key events with potentials to shape the global economy in 2024 and beyond:

- Renewed risk-aversion and capital flight in response to rising geopolitical tensions
- The US Presidential election in November and a possible re-emergence of Donald Trump and the Taiwan elections in January
- Relapse of the Chinese economy - An unlikely but possible deepening of the real estate crisis in China could weigh on global growth in 2024.
- A possible EU-China trade conflict escalation following the outcome of the European Commission's probe into China Electric Vehicles (EV) subsidies.
- Outbreak of new geopolitical tensions or escalation of current tensions, especially the Russian-Ukraine war, Israel-Palestine war and tensions in the Red Sea or Gulf of Aden
- Stronger-than-expected rebound in demand in developed markets which may push up prices and necessitate further monetary tightening by central banks, possibly slowing global growth in 2024.
- Greater commodity price and oil price volatility driven by climate change, OPEC+ supply cuts and escalation of geopolitical tensions are also important risks to the 2024 outlook.

The Israel-Palestine war raises greater fears about global energy inflation re-emerging as oil and gas tankers now take an additional 7 days to navigate the extended route around the Cape of Good Hope, aiming to avoid the Red Sea or Gulf of Aden where vessels originating from Western Europe and North America have higher prospects of being attacked unless Israel ends its occupation of Gaza. However, the likelihood that Israel might resist such a move, unless it engages in negotiations with the Houthi rebels, creates a scenario that could push crude oil prices back to $100 per barrel.

2 Regional Economic Review

2.0 Regional Economic Review

In 2023, economies in the Sub-Saharan Africa (SSA) region were confronted with multiple layers of challenges ranging from sluggish growth, elevated inflation levels, debt sustainability problems, steep currency depreciation, and political tensions.

Slower growth

Global polycrisis with dimensions such as heightened inflationary pressures, negative interest rate environment and deglobalisation slowed growth in SSA in 2023 as external demand weakened across the globe.

Despite moderate growth uptick in some economies like Tanzania and Uganda, the region's overall growth performance strongly mirrored the growth slowdown of its major economies– Angola, Nigeria, and South Africa caused by local headwinds.

The sluggish expansion of the South African economy, which accounts for approximately 20% of the region's GDP, persisted in 2023 primarily due to challenges in its power sector. These challenges continued to weigh on the country's growth in 2023, particularly affecting its manufacturing and mining production.

In Nigeria, currency redesign policy and reforms such as fuel subsidy removal, exchange unification and other fiscal and monetary reforms pursued since the transition to a new government in May 2023 triggered economic readjustments that delivered lower growth to the economy.

For Angola, issues of underproduction in the oil sector driven by the maturation of oil fields adversely affected the economy by limiting its capacity for growth by lowering oil revenue and government expenditure.

Growth slows in SSA major economies

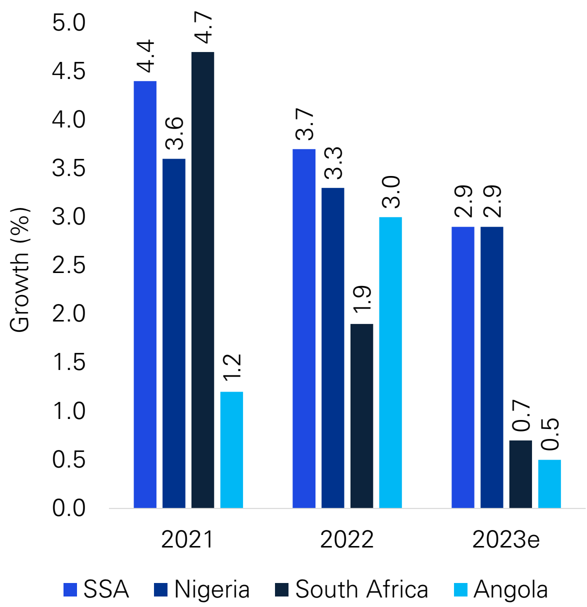


Figure 4: Sub-Saharan Africa Growth
Sources: World Bank, KPMG Research

SSA GDP-weighted composite PMI

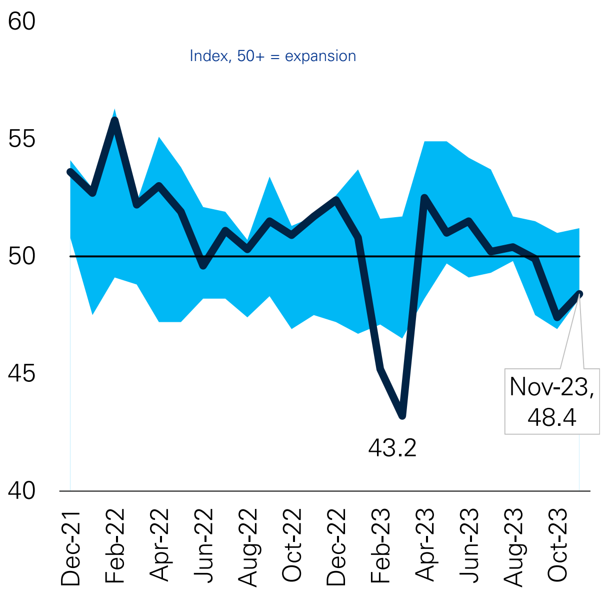


Figure 5: SSA Purchasing Manager's Index
Sources: World Bank, Haver Analytics, KPMG Research

Growth in SSA was also hampered by deterioration in business conditions, as seen in declining regional PMI data, amid higher interest rates on borrowing that reinforced the negative effect of inflation caused by soaring energy and input prices as well as sharp currency depreciation. Political instability and social unrests in countries such as Sudan, Chad and Niger also stalled growth. Yet the region's growth in 2023, estimated at 2.9% by the World Bank, still places it above the global average.

Inflation cools but remains elevated

Higher inflation remained a significant challenge confronting several economies in SSA. Driven by a combination of factors, including rising global energy and commodity prices, supply chain disruptions, climate change and domestic structural issues, the higher inflationary environment significantly impacted both businesses and consumers across the region in the year under review.

Consequently, monetary authorities in most SSA countries adjusted their policy rates with a notable focus on the MPR. Although inflation continued to cool in SSA from a regional average of 11.6% in January 2023 to 8% in October in response to the sustained hawkish posture of most central banks, it nonetheless remained elevated above the targets of central banks in most countries, providing impetus for sustained monetary tightening.

Funding squeeze and debt sustainability issues

The region also recorded major episodes of defaults on debt repayment with additional risks of default by countries still looming on the back of higher interest payments on dollar-denominated debts because of tighter financial conditions in most advanced economies. Currently, close to 11% of SSA's GDP goes into interest payments. At the county level, the data is even more sobering as a growing number of countries now expend more than 50% of government revenue on debt servicing amid weaker currencies, further raising the risk of stagflation debt crisis as well as concerns around debt sustainability in a period of weaker aid inflow. According to the IMF, four countries (Chad, Ethiopia, Ghana, and Zambia) in the region had made formal requests for debt treatment by October 2023. Despite these moves, higher risks of financial distress and debt default may surface if inflationary pressures and another round of financial tightening re-emerges on a global scale.

SSA inflation (%)

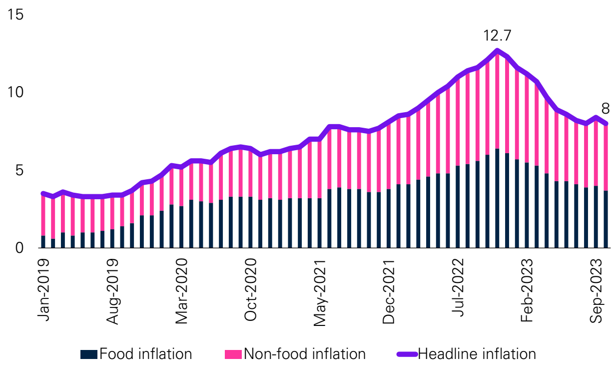


Figure 6: Inflation in SSA
Sources: IMF, Haver Analytics, World Bank, KPMG Research

Inflation and cental bank targets

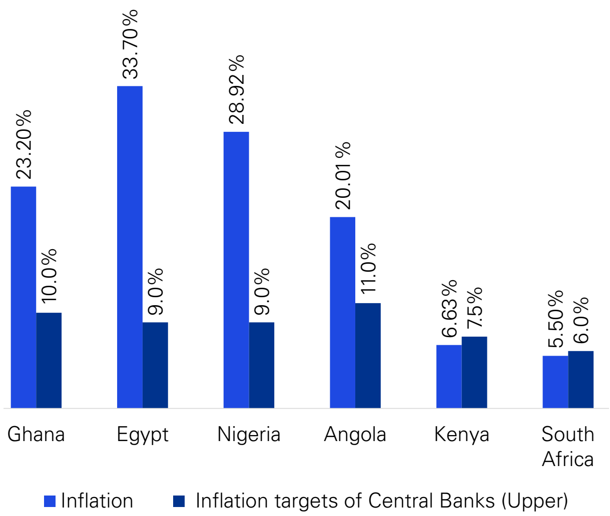


Figure 7: Inflation targets and realisations in SSA
Sources: Central banks, KPMG Research

Public debt and interest payments in SSA

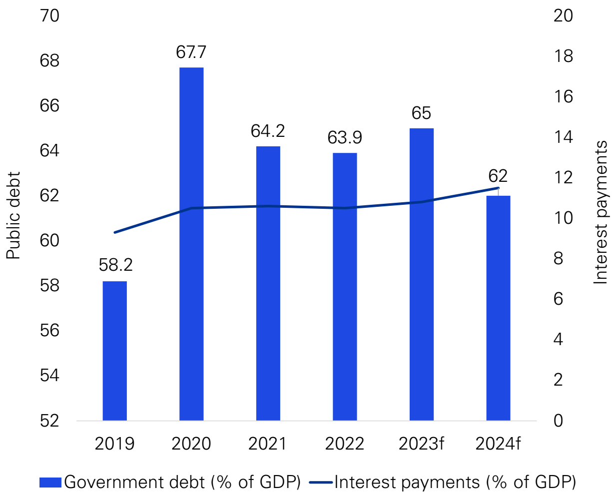


Figure 8: Public debt and interest payments
Sources: IMF, World Bank, KPMG Research

Outlook: What is on the horizon for SSA?

Growth to strengthen

Growth in SSA is expected to firm up in 2024 driven by lower inflationary pressures, reduced volatility, improvements in financial conditions, and strong growth in East Africa and the region's service sector.

Inflation to ease

Inflationary pressures in SSA is expected to lose steam as external conditions improve and domestic central banks sustain monetary tightening to tame inflation.

Monetary tightening to continue

Central banks in SSA are expected to maintain their hawkish posture to rein in inflation which still stands above the target of most central banks.

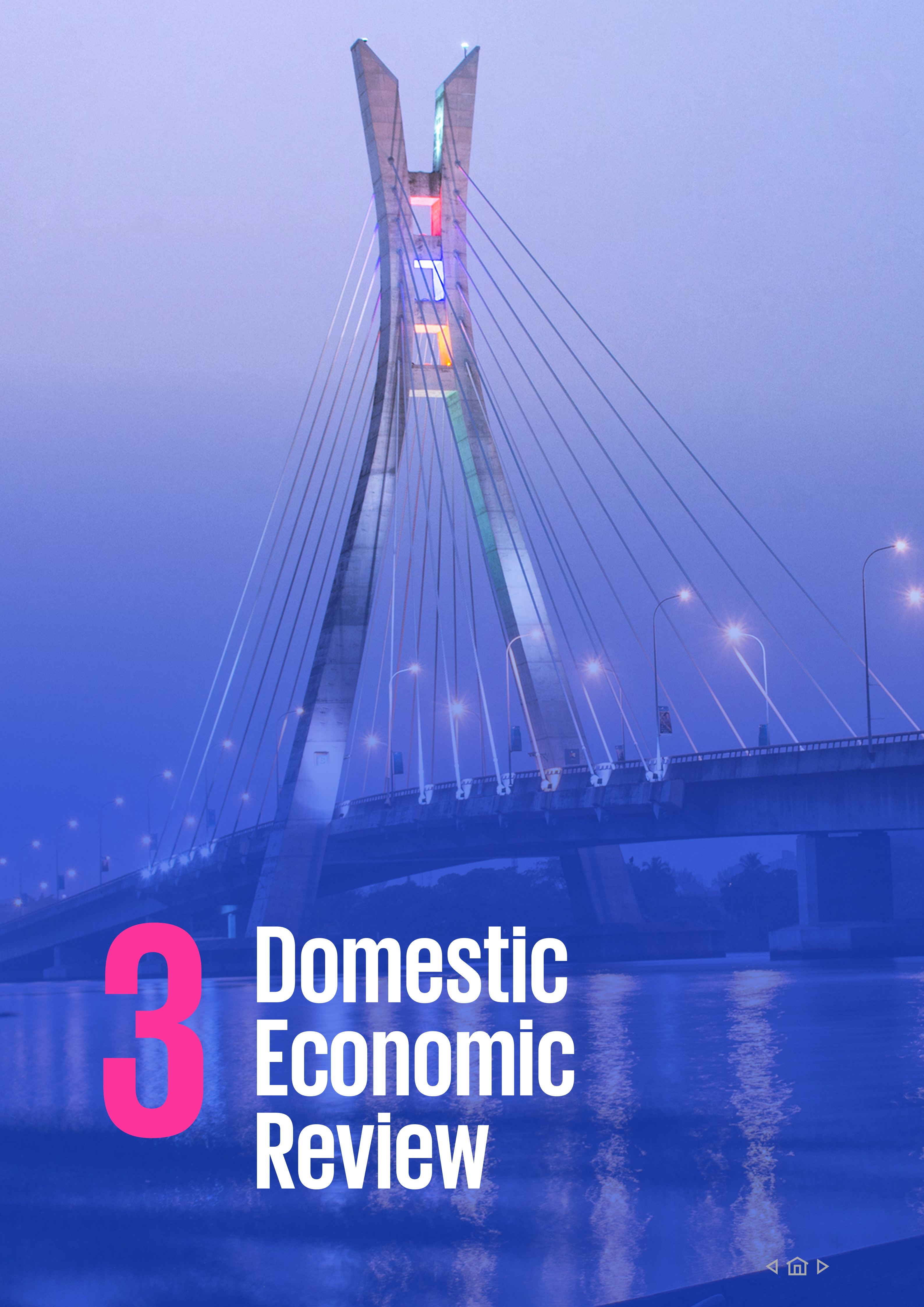
Debt servicing burden to reduce

We anticipate a moderate reduction in debt burden in SSA driven by greater debt restructuring, improved revenue mobilisation, greater fiscal discipline, and possible transition of central banks in advanced economies to a dovish stance in monetary policy conduct to avert heightened risks of stagflationary debt crisis.

FDI inflow to rise

SSA gained significantly from Europe's diversification away from Russian energy supplies. Africa's geology with abundant natural resources puts it in a vantage position as its large deposits of hydrocarbons and copper belt puts it in the spotlight as a critical driver for global energy transition. Gold and phosphates concentration in Nigeria's mining sector is another conduit for FDI inflow.

While a quicker resolution of the power sector challenges in South Africa is considered a potentially significant tailwind to our regional growth outlook, global geopolitical tensions that can trigger another surge in global energy and commodity prices, political instability from military coups, the continent's four main 2024 elections in Ghana, Rwanda, Senegal, and South Africa, and climate change challenges constitute important risks to the outlook.



3 Domestic Economic Review

3.0 Domestic Economic Review

01 Reserves depletion

02 High headline and food inflation

03 Fuel subsidy removal

04 Slow and sluggish economic growth

05 Elevated debt levels

06 Currency depreciation

07 Insecurity

3.1 Timeline of key events in Nigeria in 2023

Events	Q1	Q2	Q3	Q4
Monetary	▪ Cash crunch ▪ MPC adjusts MPR to 17.5% ▪ MPC adjusts MPR to 18%	▪ Naira float ▪ MPC adjusts MPR to 18.5%	▪ Appointment of a new CBN Governor ▪ CBN reintroduced Bureau de Change entities. ▪ MPC adjusts MPR to 18.75%	▪ Removal of Forex ban on 43 items ▪ Downgrade of Nigeria to standalone market from frontier market by MSCI ▪ Delisting of Union Bank from NGX ▪ Dangote refinery received first crude oil ▪ Cash crunch resurfaces
Fiscal	▪ 2023 budget signed	▪ Signing of the 2023 Finance Act ▪ Removal of Fuel Subsidy ▪ The President approves the Implementation of the 2023 Fiscal Policy Measure and Tariff Amendment	▪ Establishment of a Presidential Committee on Fiscal Policy and Tax Reforms	▪ Supplementary budget for 2023 ▪ 2024 budget presentation by the FG ▪ Securitisation of NNPC dividends.
Social/ Political	▪ Elections	▪ Swearing-in of a new President ▪ Dangote Refinery Commissioning	▪ Inauguration of a new cabinet	▪ Insecurity

3.2 Nigeria: Caught in a web of domestic and global headwinds.

Inflation: a necessary tax to avoid a fiscal cliff

One keyword that continued to resonate in consumer, business, and policy circles in Nigeria in 2023 was "inflation", as the economy grappled with elevated inflation unprecedented in decades. Although headwinds from the global economy also filtered into domestic prices, the high inflation in 2023 is largely linked to the market reforms pursued by the new administration since the transition to a new government in May 2023.

Notably, the removal of fuel subsidy which caused the price of petrol to rise by 220% year-on-year in November 2023 and the depreciation of the Naira by over 50% since the transition to a managed float FX regime largely fanned most of the surge in price levels, with food inflation mostly affected. By December 2023, headline and food inflation had hit highs of 28.9% and 33.9%, respectively, with the inflation unprecedented in almost two decades showing no sign of losing steam soon.

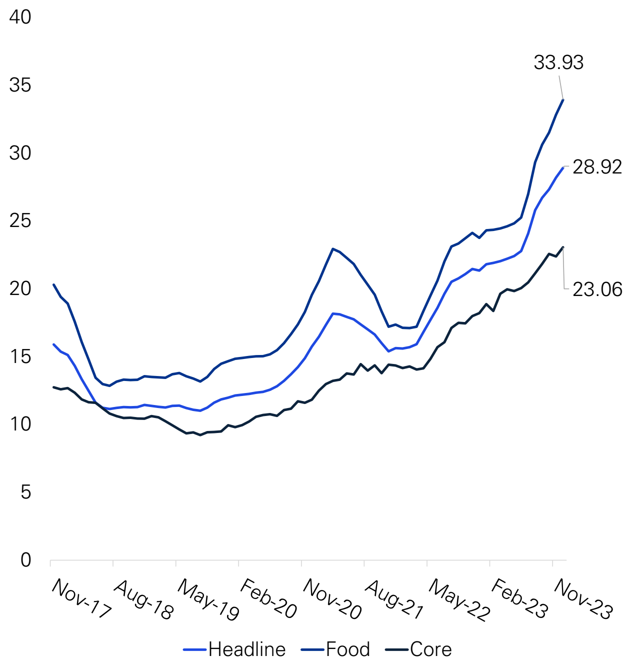


Figure 9: Inflation in Nigeria
Sources: NBS, KPMG Research

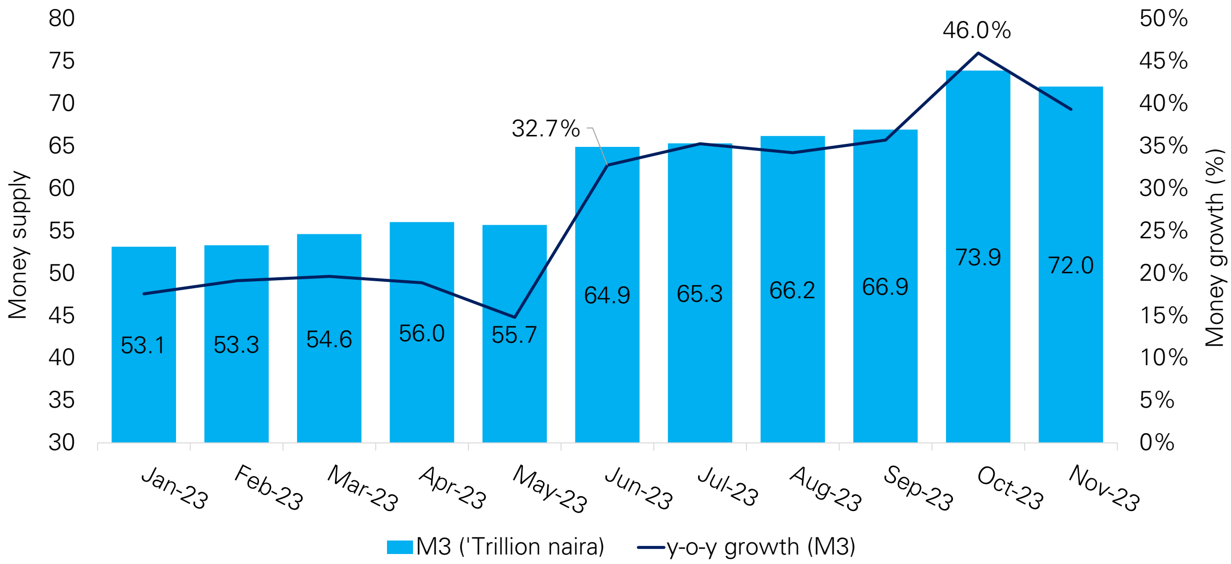


Figure 10: Money supply growth
Sources: NBS, KPMG Research

Furthermore, the inability of the Nigerian government to adhere to the 15% limit on Ways & Means till Q4 2023 and the accretion of revaluation losses by the CBN from FX forwards and swaps with local and international banks have also made it difficult to address the rising black market premium in the FX markets, thus contributing to supply side inflationary shocks.

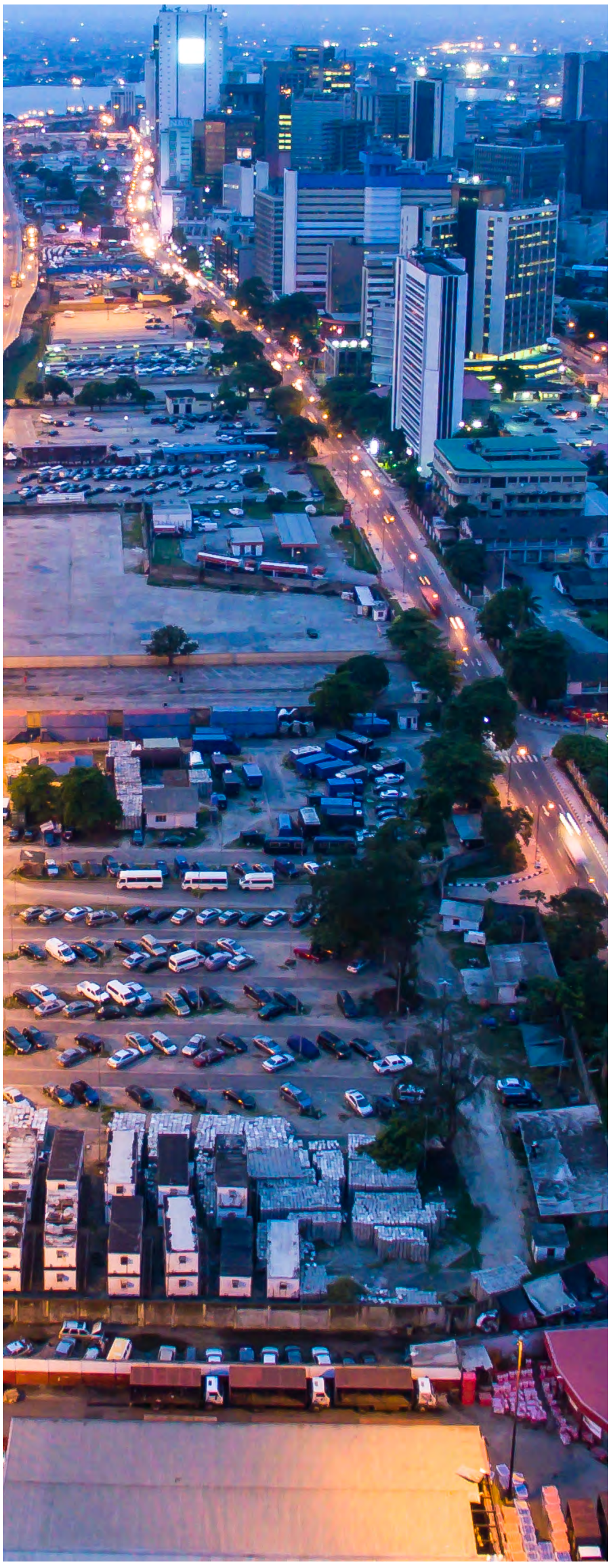
In response to the surge in inflation, the CBN continued to tighten financial conditions by raising the MPR four times from 16.5% in 2022 to 18.75% in 2023, in addition to mopping up liquidity in the open market and allowing rates on long-term bills to rise. However, inflation yielded little and remained stubbornly high despite the rate hikes by the apex bank, a strong affirmation of the hypothesis that Nigeria's inflation is largely inelastic to monetary policy instruments since inflation is dominantly supply-side driven.

Interestingly, there was also a matching expansion in money supply by the monetary authorities as broad money supply climbed rapidly from N55.7 trillion in May 2023 to N73.9 trillion in October 2023 after the transition to a new government, representing about 46% y-o-y increase in money supply. While this behaviour of the apex bank has some conflict with its price stability mandate, we recognise that the trade-off may be necessary for the stabilisation of an already fragile growth.

This was in addition to the role played by structural bottlenecks, such as huge infrastructure gaps that cost the economy around 55%-72% in post-harvest losses before agricultural produce reach final consumers, climate change issues such as flooding and extreme temperatures that constrain agricultural productivity, and spates of insecurity in strategic farming regions, that account for the most share of food inflation which is the largest driver of overall inflation in Nigeria. Therefore, sustainably addressing the persistent inflation problem in Nigeria would require market-led efforts targeted at addressing these supply-side issues.

We expect inflation to ease by H2: 2024 principally driven by base effect, but inflation will remain elevated at double-digits. Specifically, we anticipate that inflation will hover around an annual average of 22% by the end of 2024. The new elevated price regime is also expected to persist because of price stickiness problems that characterise Nigeria like most other developing economies.

Also noteworthy from a welfare perspective is the growing popularity of "flavorflation" in the Nigerian market as businesses increasingly struggle to maintain profit margins in the new inflationary environment. We maintain that the government has an urgent role to play in reversing this emerging practice by deploying relevant strategies within its arsenal to flatten the inflation curve in addition to improving regulatory standards without hampering the growth of businesses.



Growth: Is stagflation here?

The uphill climb of Nigeria in the year under review started with the cash crunch crisis which dragged into Q1 2023 from late 2022, causing money in circulation to drop by 70.2% from N33.3 trillion in October 2022 to as low as N982.1billion in February 2023. Initial challenges caused by the naira redesign policy dealt the first blow to real output which quickly contracted to 2.31% in Q1 2023 from 3.52% in the preceding quarter.

Growth was further depressed in 2023 by the fallouts of the market reforms pursued by the new pro-market administration which appears to be tilting the balance of the economy in the direction of a private sector-led growth model.

The greater pressure on domestic prices and the sharp depreciation of the naira by more than 50% harbingered by the fuel subsidy removal and exchange rate reforms also strained consumer wallets and dampened spending in addition to squeezing business margins through higher energy and transport costs as well as higher import prices, weighing significantly on economic activities and stalling growth in a period characterised by greater market uncertainties.

Carrying most of the weight of the lacklustre growth in real GDP in the first three quarters of 2023 is the non-oil sector which continued to demonstrate resilience as the backbone of the Nigerian economy despite its weaker year-on-year growth of 3.03% in response to local headwinds. The non-oil sector growth in Q3 2023 was driven by services which was the fastest growing (3.99%), followed by agriculture and industry which grew by 1.30% and 0.46%, respectively, in the same period.

On the contrary, the oil sector remained trapped in recession, driven principally by the age-long issue of underproduction caused by underinvestment, oil theft, and oil infrastructure vandalism which kept oil production below OPEC+ quota allocation. However, there are early indications that Nigeria may soon be turning the corner as recent data shows that oil production improved steadily from 1.17mbpd in July 2023 to 1.42mbpd by the end of December 2023 on the back of greater drive to increase production and block leakages with improved security of critical oil infrastructure, bringing the contraction of the oil sector to 0.85% year-on-year in Q3 2023 which moved the oil sector closer to the much-needed exit from recession.

Growth of money in circulation

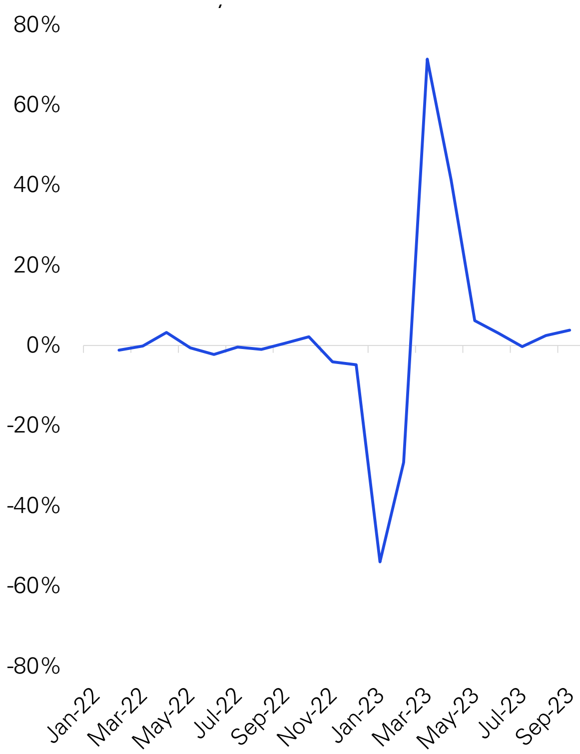


Figure 11: Money in circulation
Sources: CBN, KPMG Research

Purchasing manager's index

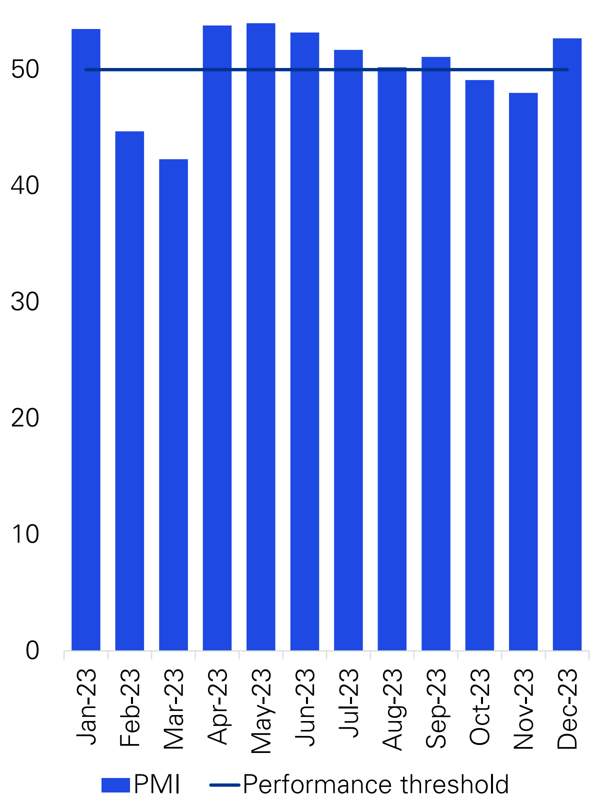


Figure 12: Purchasing Manager's Index
Sources: Stanbic IBTC PMI, KPMG Research

We expect Nigeria's growth to strengthen to 3.0% in 2024 driven by the rebound of business activities in the non-oil sector as the impact of the twin reforms fades and our continuing expectation of improved oil production and oil prices in the global market. However, we anticipate that a further depreciation of the Naira may constitute a major tail risk that can potentially weigh on growth in 2024 given the huge CBN FX backlogs and declining capital importation. Another important risk to the outlook is a possible increase in interest rates by the CBN to tame elevated inflation, which may dampen investment spending.

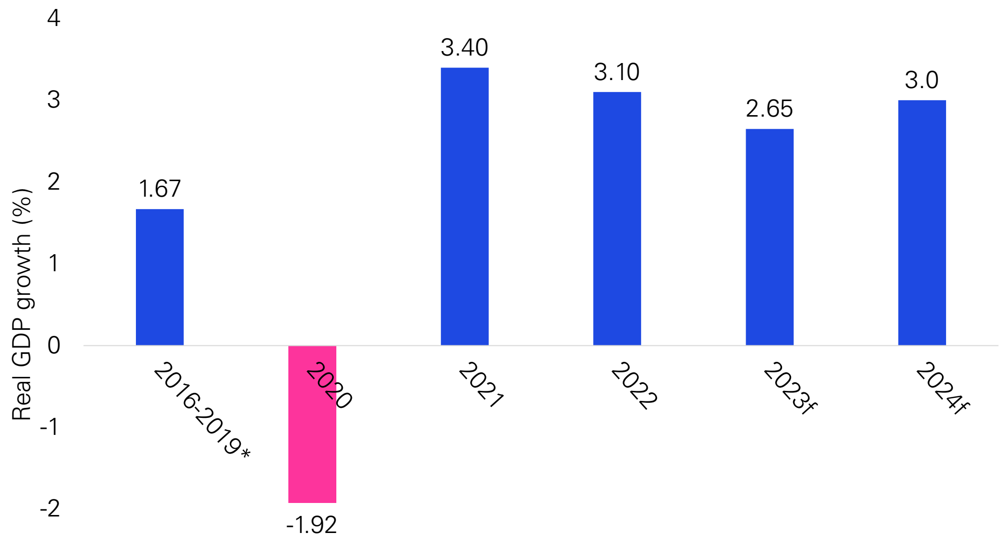


Figure 13: Real GDP growth
Sources: NBS, KPMG Research

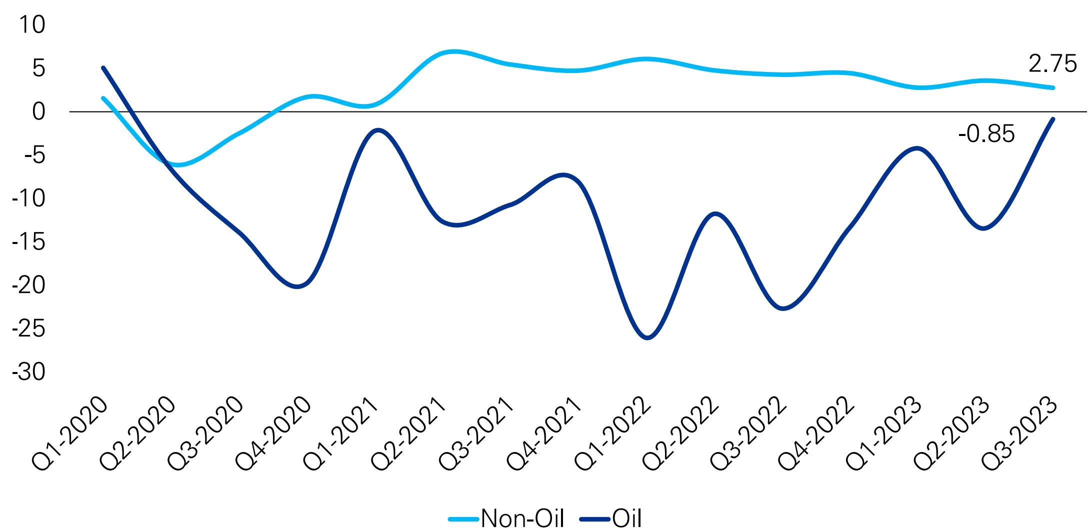


Figure 14: Oil and non-oil GDP
Sources: NBS, KPMG Research

Sectoral performance snapshot

	Oil Sector	Non-oil Sector	Agriculture	Industry	Services
Growth	**-6.16** ▲ y-on-y -20.16 previous	**3.03** ▼ y-on-y 5.04 previous	**0.63** ▼ y-on-y 1.97 previous	**-0.39** ▲ y-on-y -5.70 previous	**4.25** ▼ y-on-y 7.05 previous
Drivers	• Crude Petroleum and Natural gas	• Services - 59.40% • Agriculture - 26.30%	• Crop Production - 90.96% • Livestock - 5.90%	• Manufacturing - 47.15% • Mining and Quarrying - 30.37% • Construction - 18.78%	• ICT - 31.43% • Trade - 28.49% • Real Estate - 9.64% • Finance and Insurance - 8.87%
Challenges	• Underproduction • Oil theft • Underinvestment • Vandalism • Corruption • Insecurity	• Dependence on oil sector • Infrastructure gap • Structural bottlenecks • Low production	• Climate change • Low technology • Infrastructural gap • Poor distribution	• Low investment • Low output • Power instability • Access to markets	• Increased PMS prices • FX liquidity • Regulatory changes and policy reforms
Enablers	• Petroleum Industry Act • Improved Surveillance	• Access to funding • Market distribution • Innovation	• Government intervention • Export through AfCFTA • Youth involvement	• Access to raw materials Financing	• Expenditure management • Innovation • AI

Note: Estimates are for the first three quarters of the year

4 Monetary Policy Review

4.0 Monetary Policy Review

The struggle to maintain both domestic price stability and external stability in a period of prolonged negative external sentiment and dimming investor confidence was the major issue that kept Nigeria's monetary authorities awake for the most part of 2023 as the year commenced with Naira scarcity caused by the poorly implemented Naira redesign policy of the Central Bank of Nigeria (CBN).

According to the apex bank, the Naira redesign initiative was aimed at strengthening monetary policy control, in addition to addressing other social trends like kidnapping and money laundering, as over 70% of cash in circulation was outside bank vaults. However, the policy yielded unintended consequences, resulting in higher inflation rates and diminished economic growth.

By H2:2023, the problem had evolved significantly as the new administration quickly moved to the adoption of a market-reflective exchange rate by allowing the Naira to float against other currencies in the FX market, amongst other reforms aimed at promoting greater price discovery in the FX market and ensuring a willing-buyer-willing-seller basis for FX transactions.

While the gap between the official and parallel FX rates initially narrowed as intended, the market quickly adjusted till the gap was restored at elevated levels because of FX shortages in the official market which caused the Naira to depreciate by 90% and 58% between June 2023 and December 2023 in the official and black market, respectively, causing many corporates to declare FX losses.

The sharp depreciation of the Naira caused by the exchange rate unification reform reinforced the inflationary impact of fuel subsidy removal that was simultaneously pursued by fiscal authorities, creating an even more daunting task of price stabilisation for the apex bank as headline inflation accelerated from 21.82% in January 2023 to as high as 28.9% in December 2023.

In response, the CBN raised and held the MPR at 18.75% since July 2023 till the end of the year to rein domestic inflation, but the general price level remained stubbornly high at its highest level in 18 years. This weak transmission from monetary policy to inflation was not unexpected as monetary policy is better deployed to address demand-pull inflation.

Exchange Rate Movements

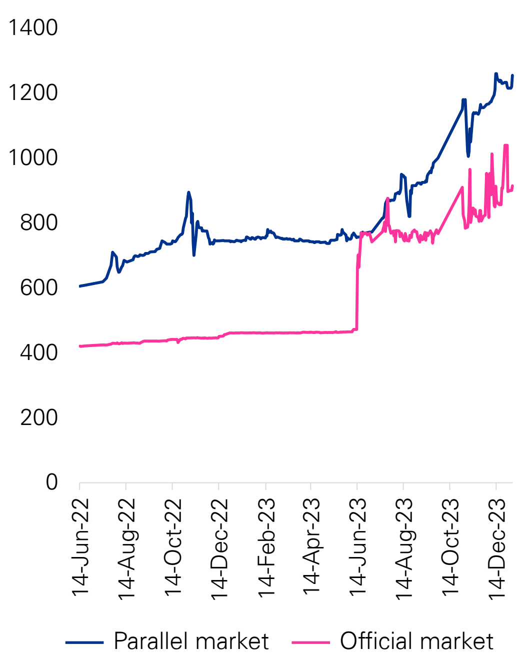


Figure 15: Exchange rate
Sources: CBN, KPMG Research

Gross External Reserves (Billion US$)

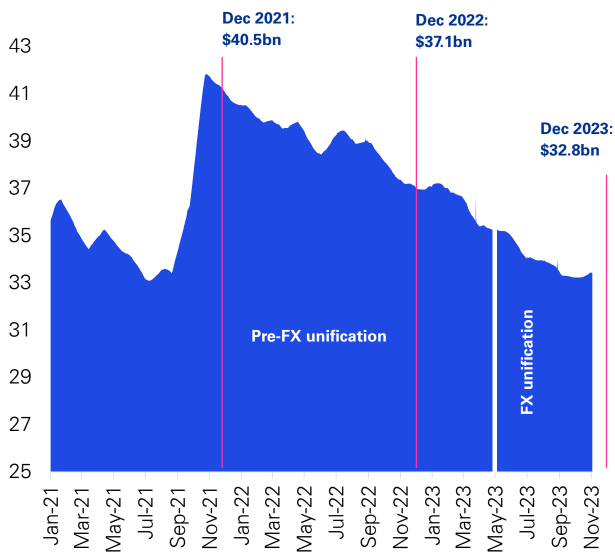


Figure 16: Gross external reserves
Sources: CBN, KPMG Research

Also, the gradual depletion of the country's reserve which is barely able to provide import cover for 6 months, as opposed to the Guidotti rule that stipulates that net external reserves should be sufficient to cover for balance of payment positions for the intervening period of 12 months, made defending the Naira become even more difficult with implications for inflation and external confidence in the economy as reserves depleted by about 11% in 2023, settling at $32.8bn.

Furthermore, the economy also grappled with issues of uncleared FX backlogs, delayed commercial letters of credit which disrupt smooth international trade transactions, delays in capital and dividend remittance, delays in processing of Form A, and difficulty in fund repatriation by multinational firms. These issues not only exacerbated the negative effect of the naira depreciation, but also led to negative sentiments on the economy as seen in earlier ratings of several credit rating agencies which signalled a growing loss of confidence and heightened risks of capital flights in the Nigerian market, evidenced in both the exit of major multinational firms and capital importation figures which hit an all-time low of $654.7 million in Q3 2023.

To resolve the issue of FX illiquidity, the government proposed to clear backlogs of FX forward contracts using $7bn NLNG dividend securitization and another $3.3billion crude oil prepayment loan facility from Afreximbank out of which the first tranche of $2.25bn was received in December 2023. While we laud these initiatives aimed at bringing stability to the FX market by the government, we maintain that these initiatives may only mask the FX problem by easing FX pressures in the short to medium term, apart from having the potential to strain future expenditure and debt.

Additionally, we posit that these initiatives might further encumber the ability of the NNPCL to meet up with its domestic crude oil supply obligations to domestic commercial refiners and limit the ability of the government to raise oil and gas revenues to fund deficits in future budgets, especially considering that concerns have been raised in some quarters that the term sheet of the Afreximbank deal may not fully align with global standards for negotiating such agreements.

Alternatively, Nigeria can sustainably overcome its FX illiquidity challenges and attract foreign exchange to meet the burgeoning needs of its import bills and other uses by clearing outstanding FX backlogs and deliberately improving the ease of doing business, developing its currency futures market, dismantling all impediments to capital flows, and ensuring smooth and transparent FX transactions that will attract remittances through official sources.

Agency	Rating	Sentiment	Date
Moody's	Caa1	Stable	Jan 2023
S&P	B-	Negative	Feb 2023
S&P	B-	Stable	Aug 2023
Moody's	Caa1	Positive	Dec 2023

Our expectation on interest rates is that the central bank may maintain its hawkish posture and raise the MPR further in 2024 to tighten financial conditions with a view to driving inflation down. However, this outcome will be conditional on the degree of monetary independence exercised by the CBN as the historical risk of interference by fiscal actors to spur growth via higher investment cannot be ruled out.

Also, we expect the exchange rate to depreciate further and settle significantly above current rates in both the official and parallel markets after initial early gains that will be driven by increased dollar supply from government intervention in the FX market.

5 Fiscal Policy Review

5.0 Fiscal Policy Review

Crude oil production and price

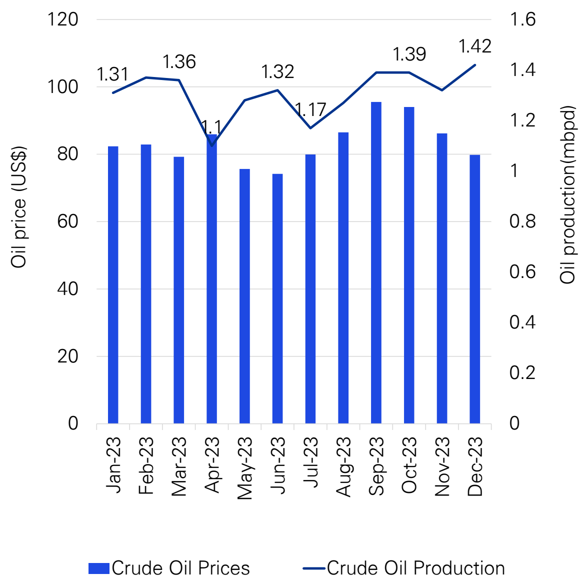


Figure 17: Oil production and oil price
Sources: CBN, KPMG Research

FAAC Allocation (Billion naira)

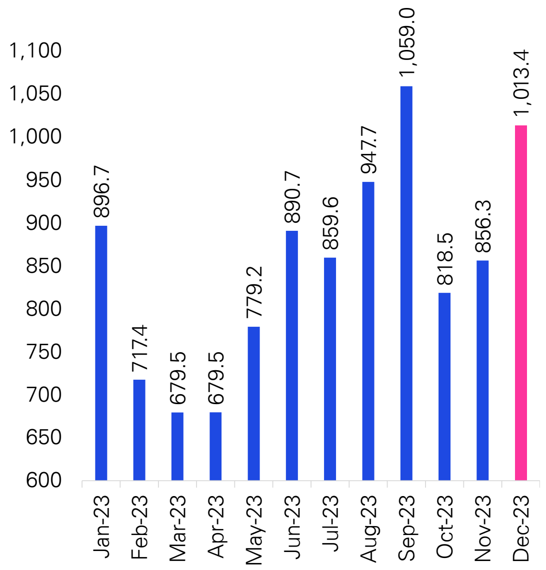


Figure 18: FAAC allocation
Sources: NBS, DMO, KPMG Research

Nigeria's fiscal landscape in 2023 was shaped by a combination of moderate increases in oil price and production, growing debt stock and debt servicing payments, fuel subsidy removal and exchange rate reforms.

Revenue performance in the period under review was boosted by higher oil prices in the global market driven by geopolitical tensions and supply chain disruptions. Motivated by a strong drive to boost oil production, the new administration made efforts to attract greater investments into the oil sector and enhance the security of oil infrastructure to prevent oil theft and leakages. Consequently, local oil production showed improvement throughout most of the period since the start of H2:2023, reaching 1.42 million barrels per day in December 2023. However, this still represented an under-performance as oil production consistently remained below the OPEC+ production quota despite the improvements recorded.

Furthermore, the decision of government to remove fuel subsidy and unify exchange rates also assisted government revenue performance in H2:2023. Savings from the discontinuation of fuel subsidy payments lessened the fiscal burden on the government as the resources became available for competing uses. Also, higher exchange rate gains from the exchange rate unification reform also resulted in a huge revenue windfall for the government as evident in the more than 30% increase in FAAC allocation to the 3 tiers of govt between May and December 2023.

Ballooning public debt and debt servicing payments

Despite the revenue windfall from the removal of fuel subsidy and unification of exchange rates, Nigeria continued to record a deterioration in its debt stock and debt servicing profile.

Driven by the need to finance fiscal deficits on the back of revenue underperformance caused by weak oil and non-oil revenue mobilisation, the country's debt stock hit N87.9 trillion by the end of Q3 2023, marking a year-on-year increase of 99.5%.

Similarly, nearly half (45.6%) of total expenditure and 80.9% of government revenue went into debt servicing, giving little room of 11.6% of total spending for capital expenditure.

Public debt stock (Trillion naira)

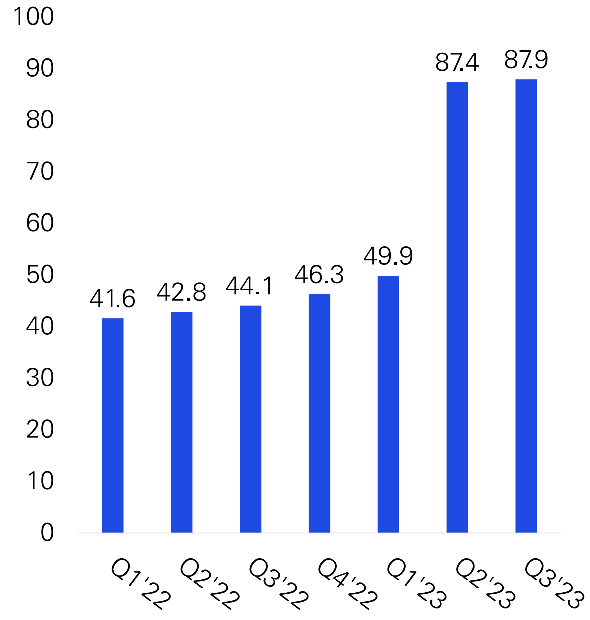


Figure 19: Public debt stock
Sources: DMO, KPMG Research

In its composition, the debt stock of the government comprised largely of domestic debt which accounted for 63.6% in Q3 2023 while external debt accounted for 36.4% in the same period.

The ballooning public debt stock and associated debt servicing costs continue to limit the fiscal space for public investment in critical infrastructure needed to catalyse industrialisation-led growth, apart from weighing on government's ability to spend on healthcare, security and education.

On public debt, we anticipate further increases in debt stock in 2024 as the government seeks to finance the 2024 fiscal deficit of N9.18trillion. However, we are concerned that the government's focus on domestic markets for borrowing may crowd out private investment as the government joins the competition for scarce local capital to finance its deficits, thereby raising the cost of capital for businesses.

2024 FGN Budget Corner:

2024 Budget Assumptions

Oil price benchmark ($/b)	77.96
Oil production (mbpd)	1.78
Inflation (%)	21.4
Exchange rate (N/$)	800
GDP growth rate (%)	3.88

Revenue (₦'tn)

	2023*	2024
Oil	2.29	9.21
Independent and other sources	6.33	3.52
Non-oil revenue	2.43	6.86

Expenditure (₦'tn)

	2023*	2024
Recurrent non-debt	9.32	8.76
Debt service/ Sinking Fund	6.56	8.28
Capital expenditure	7.96	9.99
Statutory transfers	0.99	1.74
Budget Deficit	13.78	9.18

*denotes approved plus supplementary budget figures

How attainable are the budget assumptions?

Assumption #1:

Oil price benchmark - $77.96pb

The oil price benchmark of $77.96 per barrel is considered realizable as it is consistent with the projections of most global organizations, including the $83 per barrel forecast by JP Morgan for 2024. Since oil price is determined by both demand and supply, we recognise that this benchmark can be further boosted by either supply-side disruptions arising from geo-political tensions that trigger oil price surge or possible demand surge from a strong resurgence of the Chinese economy, which accounts for approximately 22% of global oil demand.

Assumption #2:

Oil production – 1.78mbpd

Our optimism about Nigeria's potential to attain the projected 1.78mbpd oil production in 2024 is premised on growing success in boosting oil production evidenced by recent rises in oil production from 1.17mbpd in July 2023 to 1.42mbpd in December 2023. However, this will require a consolidation of initial efforts made to address issues of underinvestment, oil theft and oil infrastructure vandalism that have jointly delivered lower oil production to Nigeria.

Assumption #3:

Inflation (%) – 21.4%

While this inflation expectation is a reasonable approximation, we posit that a few observed budgetary and non-budgetary factors could drive inflation above target. Firstly, the 2024 expenditure projection of 28.77 trillion is inherently inflationary as it implies higher liquidity in an environment with already elevated inflation level.

In addition, we note that the progressive expansion of money supply (M3) by the CBN after the democratic transition in May 2023 may constitute a risk to the realization of the inflation target of 21.4%, if sustained. Lastly, Nigeria's inflation is largely driven by supply-side bottlenecks such as climate change problems like flooding, low agricultural productivity, widespread insecurity in strategic agricultural communities, and the lack of critical infrastructure which together culminate in higher cost-push inflation. These issues are still major risks to the inflation target of 21.4%.

Although we align with the FGN 2024 budget that Nigeria's inflation will remain elevated at double-digits in 2024, we however estimate that inflation is likely to moderate to a higher 22% at best largely due to the onset of the base effect in the absence of repeated shocks and the CBN's switch to inflation-targeting in its conduct of monetary policy, and not because of improvements in Nigeria's supply-side economics.

Assumption #4:
Exchange Rate (N/$) - 800

In the near term, the unresolved issues in the FX market previously highlighted in the monetary section of this report informs our expectation that the Naira is likely to depreciate further and settle comfortably above the N800 assumption in both the official and parallel markets after initial gains from increased dollar supply to the FX market from government intervention.

Assumption #5:
GDP Growth Rate (%) - 3.88%

On the growth prospects of Nigeria in 2024, most economic analysts expect the Nigerian economy to strengthen in 2024, but the outlook mostly suggests a moderate rebound. The slow growth rebound will be driven by factors such as the lingering effect of the twin reforms of fuel subsidy removal and exchange rate unification which continue to squeeze business margins and dampen consumer demand through weaker purchasing power. In addition, further escalation of ongoing wars in Russia-Ukraine, Israel-Palestine, as well as tensions in the Red Sea, and even fresh outbreaks of geopolitical tensions may stall Nigeria's projected growth performance via a knock-on effect. These risk factors, coupled with the weak change in capital expenditure pattern observed in the 2024 budget, form the basis of our opinion that the 3.88% growth rate assumed in the 2024 budget may prove difficult to realise. However, we anticipate that the growth of the economy will hover around 3.0% in 2024.

In conclusion, while we recognise that some of the 2024 budget parameters and projections are attainable, we note that there are significant opportunities for improvement. There is the need to considerably improve on allocations to capital expenditure to support growth, cut the cost of governance to lower recurrent expenditure, optimize revenue mobilisation, consolidate efforts on boosting oil production, and deploy robust risk control strategies to assist budget performance.

Delivering impact with the 2024 budget:

Key focus areas

Revenue Mobilisation	Natural resources	Taxation	Leverage technology	Privatisation and disposal of dead assets
Expenditure management	Performance-based budgeting	Cost of governance	Fiscal discipline	Debt management
Economic and policy environment	Economic diversification	Infrastructural development	Target sectors with high employment impacts	Strengthen macroeconomic fundamentals
	Ease of doing business	Investors' confidence	Stronger institutions and rule of law	Security

6 External Sector

6.0 External Sector

Nigeria's trade sector benefitted significantly from the exchange rate unification reform pursued by the new administration as the depreciation of the Naira continued to strengthen purchasing powers abroad while destroying purchasing powers locally, driving the growth in net exports earnings recorded in 2023

Net exports hit N3.52 trillion at the end of Q3 2023, higher than the total annual net exports realised in the last four years, driven largely by the devaluation of the naira and assisted by improved crude oil exports earnings on the back of higher crude oil production and elevated oil prices in the global market.

In addition, a year-on-year analysis of trade data in the first three quarters reveals that the increase in net export recorded in 2023 was more driven by a greater growth in export earnings (13.9%) than a contraction in the import bills(-2.4%) relative to 2022 figures.

The export basket was also skewed in favour of the oil sector as export growth was majorly driven by crude oil exports and the export of other oil products. In terms of numbers, crude oil and other oil exports accounted for 91.3% of the total export basket while non-oil exports accounted for less than 10% of the export basket in 2023.

Net exports (₦'trillion)

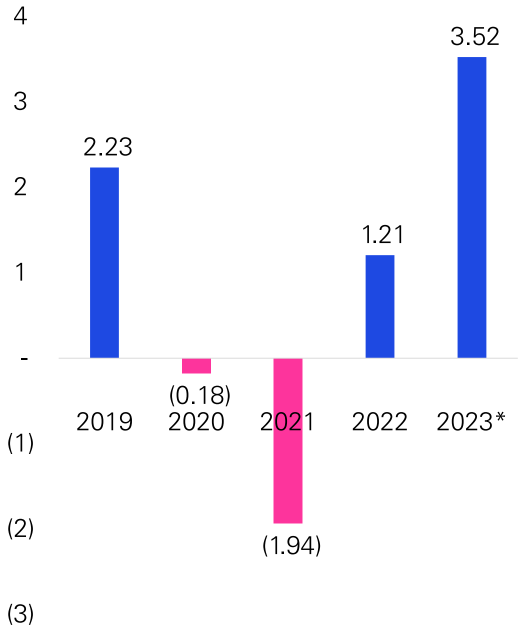


Figure 20: Net exports
Sources: NBS, KPMG Research
Note: ** denotes q1 to q3 estimate*

Growth of Imports and Exports (%)

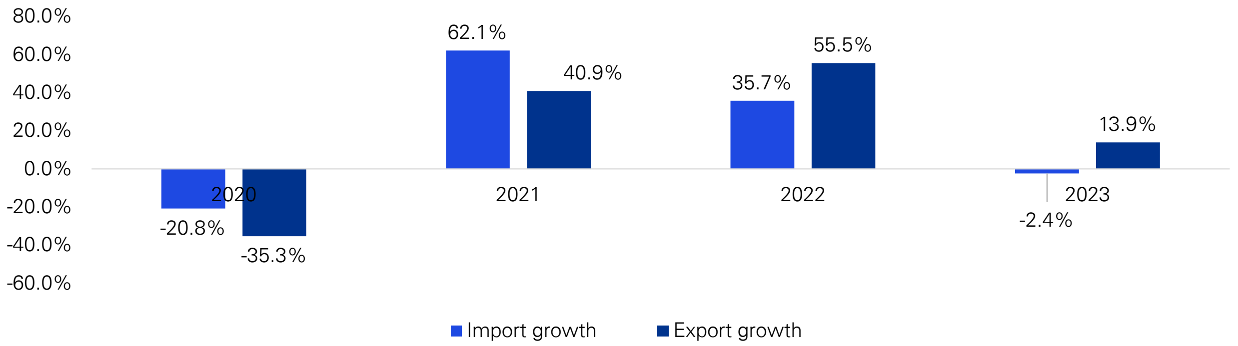


Figure 21: Growth of import and export
Sources: NBS, KPMG Research

Further disaggregation revealed that the non-oil export contribution to total exports stood at 8.67%, a decline when compared to the same period in 2022 and 2021 when non-oil export accounted for 9.54% and 11.32% of total exports, respectively. This indicates that the export performance of the non-oil sector was weaker in 2023 as crude oil and other oil products increasingly accounted for the larger chunk of exported value.

Export basket composition

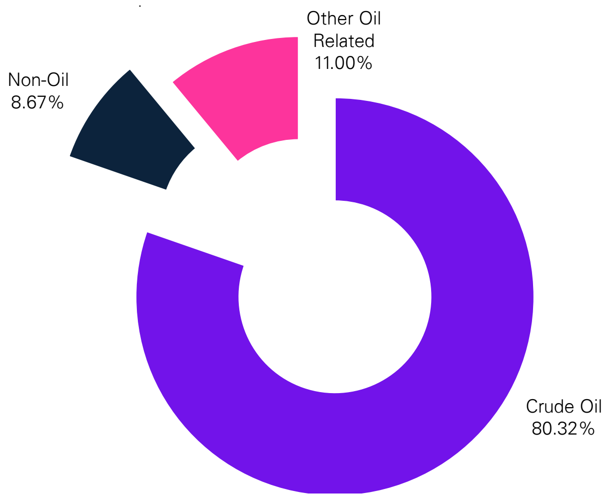


Figure 22: Export basket composition
Sources: NBS, KPMG Research

However, the contribution of non-oil exports to total exports showed improvement across some sub-sectors in 2023. Specifically, the agricultural sector contribution grew from 2.23% in 2022 to 3.35% in 2023, and solid minerals rose from 0.31% in 2022 to 0.44% in 2023. On the contrary, there was a decline in the value of raw materials exported, dropping from 4.0% in 2022 to 2.30% in 2023, and manufacturing decreased from 2.91% in 2022 to 2.34% in 2023.

Further disaggregation of oil exports shows that the percentage of crude oil in total oil exports increased to 80.32% in 2023 from 78.74% in 2022 highlighting the continued dominance of crude oil exports and a continued reliance on oil as a primary driver of Nigeria's export revenue. There is therefore the need for strategic efforts to diversify the export base of the economy and reduce vulnerability to external shocks and vulnerabilities in the global oil market by promoting the non-oil sectors to enhance the resilience of Nigeria's external trade.

Export basket composition

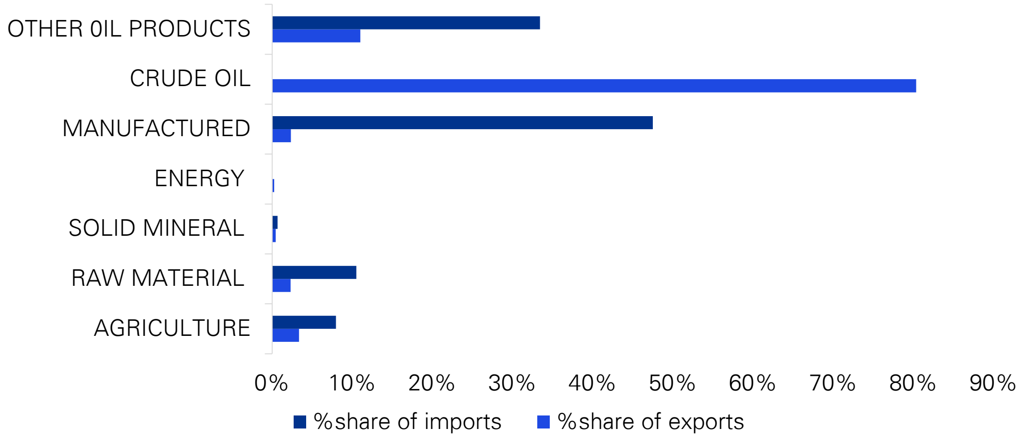


Figure 23: Share of imports and exports
Sources: NBS, KPMG Research

Despite the growth of net exports, we are concerned that these gains are not as stellar as expected and may only represent revaluation gains of currency depreciation, pointing to deeper problems that the nation needs to address in its trade sector. On a deeper level, there is also an overarching statistical need for metrics that measure trade performance in real terms by adjusting for the effects of movements in exchange rate and domestic inflation.

To fully benefit from depreciation by using trade as an engine of economic prosperity, Nigeria needs to reconfigure its trade sector by developing its port infrastructure to global standards and adopting smooth technology-driven processes in ports by eliminating administrative bottlenecks and other impediments to trade, apart from expanding and diversifying the economy's productive base by incentivising the production of globally competitive products that conform with international regulatory standards.

Looking on the horizon, we expect net exports to remain strong in 2024 driven by higher crude oil exports and continuing currency depreciation. However, weak global economic conditions, geopolitical tensions, exchange rate volatility, and a rise in trade protectionism by trade partners are important risks to this outlook.

Capital importation

Nigeria's capital importation also signaled the current challenges in the macroeconomy as capital imported in the first three quarters of 2023 hit its lowest level compared to similar periods in the last 10 years and is poised to hit its all-time annual lowest. Capital imported into Nigeria dropped significantly in the first three quarters of 2023 by 34% from $4.27 billion recorded in the same period last year to $2.82 billion in 2023, with most capital coming from the United Kingdom (30.9%).

Although weak global economic conditions also contributed, the dip in capital importation was largely driven by continuing negative market sentiments on Nigeria and its assets despite initial reforms pursued by the new administration being viewed positively in the investment community. Greater market uncertainty amid higher exchange rate volatility, negative real returns on investments driven by the higher inflation environment in Nigeria, and FX illiquidity affecting fund repatriation dampened investor confidence, leading to a decline in Foreign Direct Investment (FDI) which is a major source of long-term capital by about half. Reversing the trend of persistent decline in FDI will require the creation of an enabling environment and regulatory framework that will improve the general ease of doing business in Nigeria.

Similarly, the economic environment faced considerable uncertainties following numerous reforms initiated by the new administration. These uncertainties caused investors to panic, redirecting their capital towards safer havens with lower risks and higher returns. Consequently, there was a notable decline in Foreign Portfolio Investment (FPI), amounting to approximately 61% during the initial three quarters of 2023 compared to the corresponding period in 2022 as FPI settled at $156.7 million below the $1 billion psychological threshold, marking the first time it had dropped below this level since 2013.

Capital importation, Q1 to Q3 ($'billion)

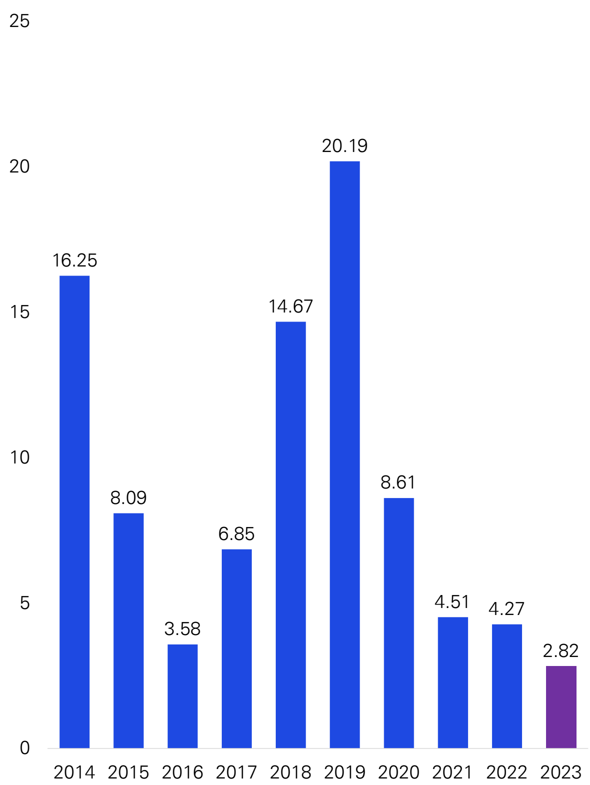


Figure 24: Capital importation
Sources: NBS, KPMG Research

Capital importation growth, Q1 to Q3 (%)

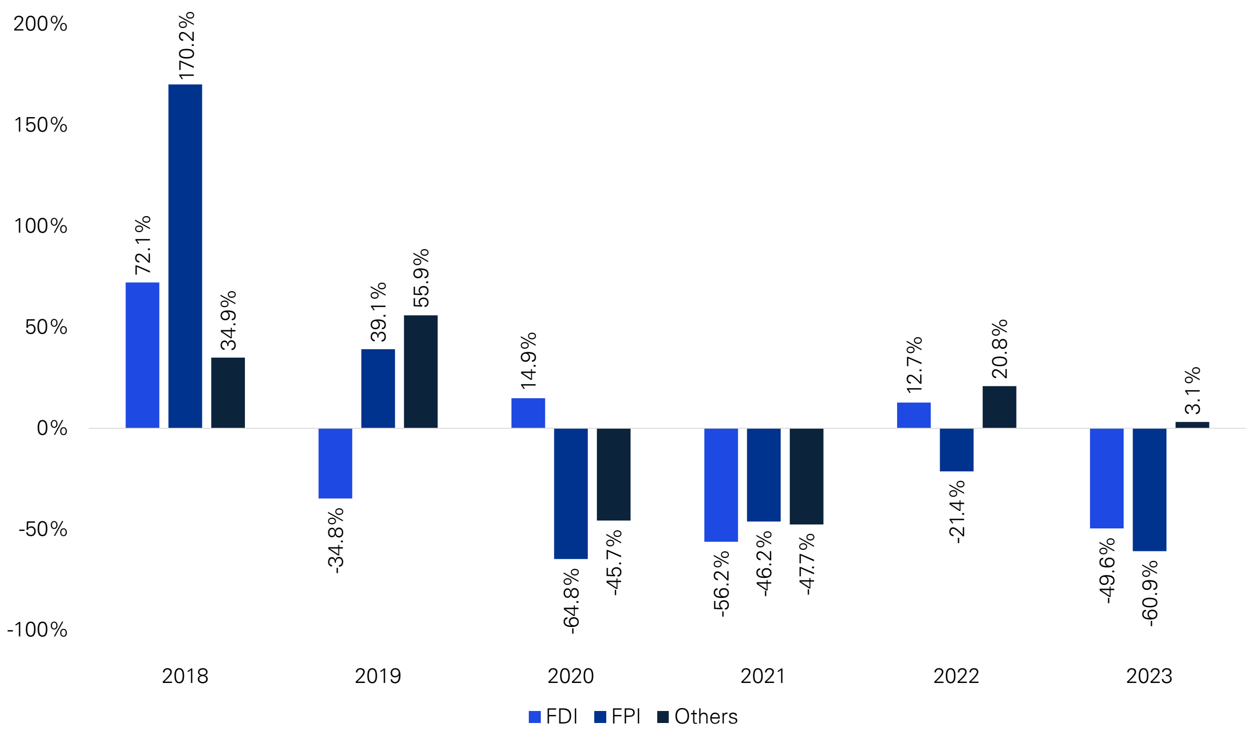


Figure 25: Capital importation growth
Sources: NBS, KPMG Research

The fact that other investments (63.2%) which includes trade credits, loans, currency deposits, and other claims overly dominated every other component of Nigeria's capital importation in 2023 is a concern given their short-term nature, especially with the greater debt servicing burden associated with the loan component of other investments in a period of globally elevated interest rates requiring greater fiscal discipline.

Share of capital importation Q1 to Q3 (%)

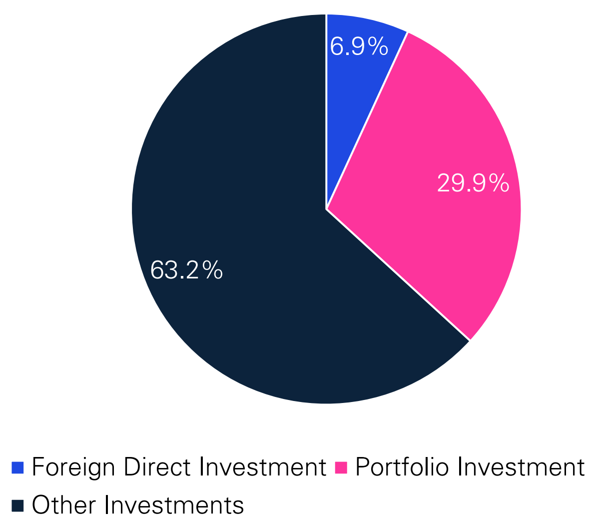


Figure 26: Share of capital importation
Sources: NBS, KPMG Research

Capital imported by types, annual ($'billion)

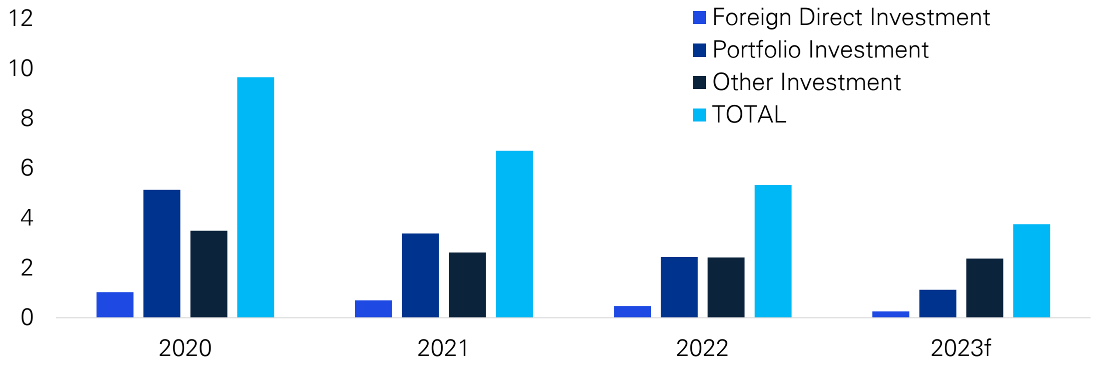


Figure 27: Capital importation by types
Sources: NBS, KPMG Research

Capital Importation by sectors(%)

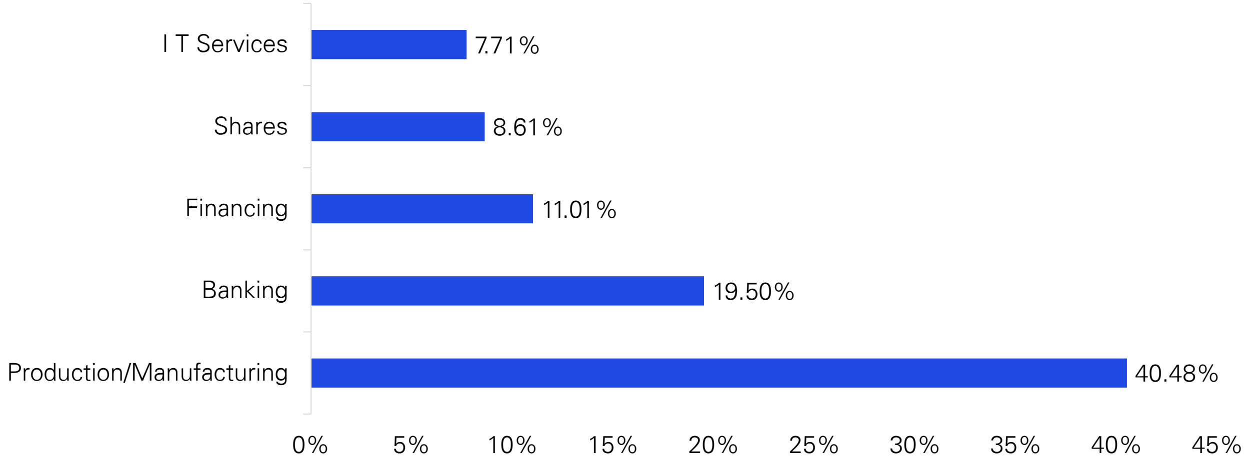


Figure 28: Capital importation by sectors
Sources: NBS, KPMG Research

Driven by our continuing expectations that ongoing efforts to restore investors' confidence and attract long-term and short-term investments into Nigeria will be sustained as well as historical evidence of underlying cyclicality in capital importation, we project that capital importation may begin to improve modestly by the end of 2024. The caveat to this projection, however, is that both fiscal and monetary actors need to ensure a stable and enabling macroeconomic climate by making the necessary investment in critical infrastructure which is usually a key consideration in the case of FDI, dismantling structural and regulatory bottlenecks impeding free capital flows, ensuring policy consistency, and improving macroeconomic fundamentals.

7 Sector Review

7.0 Sector review – Emerging trends and challenges

Financial Service Industry (FSI)

Key Trends

- Appointment of a new CBN governor
- Bank recapitalisation
- Digital transformation and Fintech innovation
- Deeper financial inclusion

Major Challenges

- FX pressure and inflation
- Monetary tightening
- New regulations and policy summersault
- Cybersecurity

Technology, Media & Telecommunication (TMT)

Key Trends

- 5G licensing
- Enhanced fintech and digital payment
- Data privacy and regulation
- Rapid growth of eCommerce
- Adoption of cloud computing and data

Major Challenges

- FX illiquidity
- Cybersecurity threats
- Inadequate infrastructure
- Regulatory challenges

Consumer & Industrial Markets (CIM)

Key Trends

- Shifting consumer preferences
- Increasing ESG compliance
- Deepening e-commerce penetration

Major Challenges

- FX illiquidity and volatility
- Shrinking consumer wallet
- Poor power and road infrastructure
- Disjointed supply chains
- Frequent changes in regulatory environment
- Unfavourable tax environment

Energy & Natural Resources (ENR)

Key Trends

- Removal of fuel subsidy
- Increased investments in renewable energy
- Implementation of Electricity Act
- Regulatory, commercial, and fiscal reforms in specific sectors
- Petroleum Industry Act
- Growing ESG concerns
- Dangote refinery

Major Challenges

- Volatility in oil market
- Insecurity and oil theft
- Infrastructural deficit
- Poor technology adoption
- Policy uncertainties

Infrastructure, Government & Healthcare (IGH)

Key Trends

- Increasing adoption of digital transformation
- Transition to new government
- Growing adoption of data-driven decisions

Major Challenges

- Ballooning public debt
- Bureaucracy and policy implementation lags
- Huge funding gap for critical projects
- Low rural penetration in healthcare access
- FX illiquidity and supply chain disruption hits hard on the pharmaceutical industry

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