Macroeconomic Review H1 2023 & Outlook for H2 2023

November 2023

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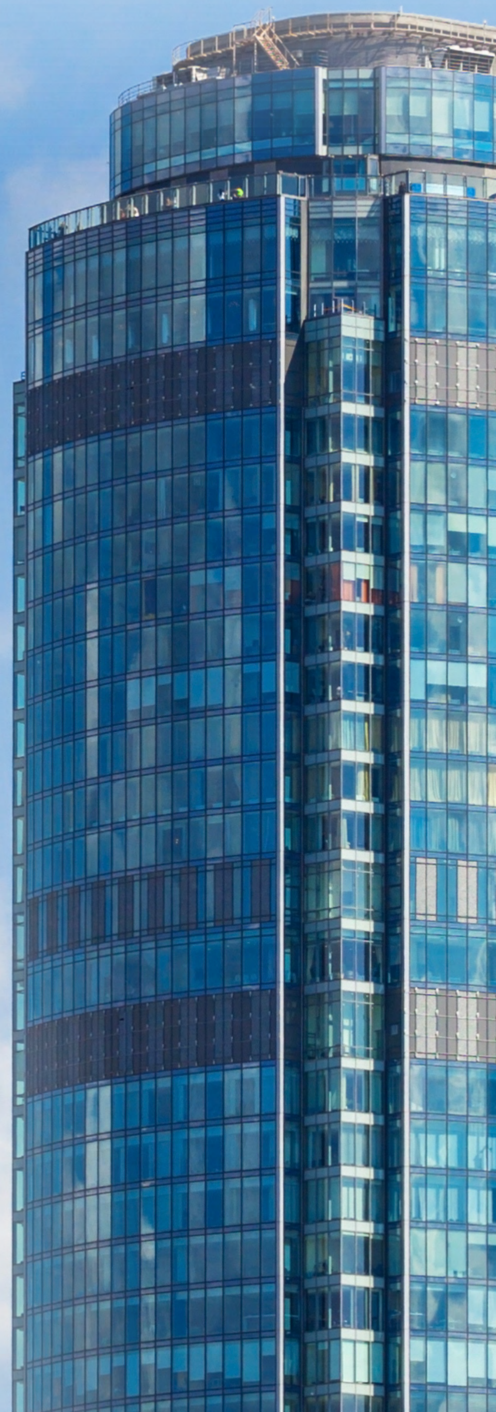

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List of Acronyms

BIS	Bank for International Settlements
BRICS	Brazil, Russia, India, China, and South Africa
CBN	Central Bank of Nigeria
DMO	Debt Management Office
FAAC	Federation Account Allocation Committee
FDI	Foreign Direct Investment
FPI	Foreign Portfolio Investment
FX	Foreign Exchange
GDP	Gross Domestic Product
ISI	Import-Substituting Industrialisation
MPC	Monetary Policy Committee
MPR	Monetary Policy Rate
NBS	National Bureau of Statistics
OECD	Organisation for Economic Cooperation and Development
OPEC	Organisation of Petroleum Exporting Countries
PMI	Purchasing Managers' Index
SSA	Sub-Saharan Africa
USD	United States Dollar

1.0 Executive summary

In this half-year report, we review key issues shaping the global economy in H1 2023 in addition to providing a snapshot of notable regional issues confronting Africa in the same period with a view to understanding Nigeria's external environment. We then dive into Nigeria's local context with special focus on its growth performance, the twin reforms of fuel subsidy removal and exchange rate liberalisation and their contribution to elevated inflation levels, external sector performance, and the performance of monetary and fiscal policy. We conclude the report by providing the outlook for H2 2023.

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2.0 Global Economic Review

Inflation continues to lose steam

In response to the continuous rate hikes and other monetary tightening strategies employed by major central banks across the world, inflation continued to ease through H1 2023 in advanced and emerging economies alike. From 9.06% in June 2022, its highest in four decades, US inflation eased to 2.96% in June 2023. Similarly, inflation in the Euro Area dropped from 10.62% in October 2022, which represents its all-time highest since its creation, to 5.52% by the end of Q2 2023. Similar trends of easing inflation were also observed in Canada, UK, China and India, bringing inflation closer to its pre-pandemic levels.

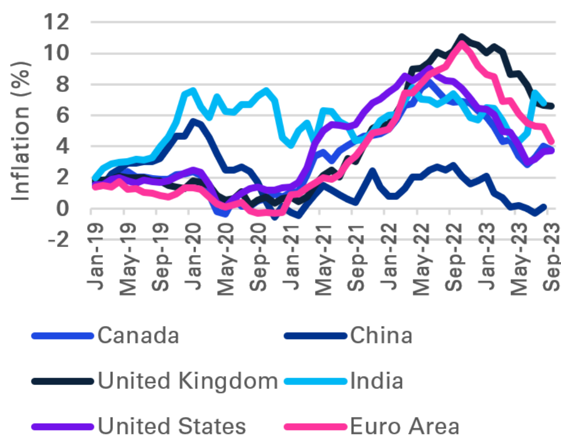

Figure 1: Inflation in some top economies
Sources: BIS, KPMG Research

This is unfolding against the backdrop of surge in energy and food prices across major economies caused by the novel corona virus pandemic which disrupted major supply chains globally, suppressed energy and commodity demands, and caused labour supply to shrink driving wages up. The uptick in inflationary pressure was further exacerbated and sustained by the contagion effect of the Russia-Ukraine war which started in early 2022.

Consequently, most central banks across the world adopted a long hawkish posture by raising their monetary policy rates (MPR) to stem the tide of inflation since 2021. In the US and UK, for example, the central banks have hiked rates by a total of 525 basis points and 490 basis points between July 2021 and July 2023, respectively.

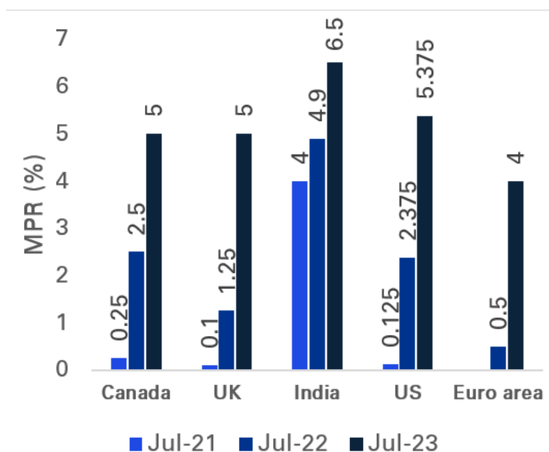

Figure 2: Interest rate in top economies
Sources: BIS, KPMG Research

Inflation remains above central bank targets

Despite the significant rein on inflation by central banks through the pursuit of aggressive monetary tightening complemented by improvements across commodity and energy supply chains, inflation still sits far above the targets of most central banks. The Bank of England, for example, notes that the inflation figure of 7.96% recorded in June 2023, which it attributes to improvements in energy costs, was still high and above its inflation target of 2%. Albeit smaller, the gap between the US Feds long term inflation target of 2% and the inflation estimate of 2.96% realised in June 2023 is also a case in point. Consequently, the purchasing power of consumers improved only slightly in H1 2023 as it remains impacted by high prices.

JP Morgan PMI slowed in last few months

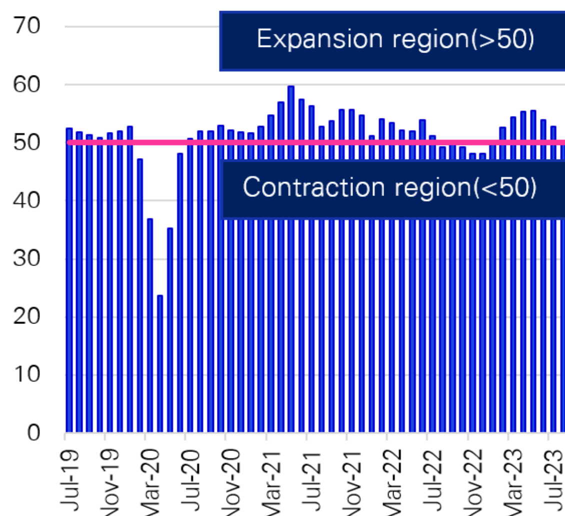

Figure 3: JP Morgan's Composite PMI
Sources: JP Morgan, KPMG Research

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The global manufacturing downturn exhibited signs of recovery at the onset of 2023, indicating that business activities experienced a modest uptick worldwide during the initial phase of H1 2023. The expansion in both the manufacturing and service sectors remained pivotal in bolstering this growth.

However, this trend waned in the latter part of H1, signaling an elevated risk of negative growth due to the deterioration in demand attributed to elevated prices, even as global inflationary pressures gradually subsided.

OPEC+ supply cuts pressure inflation

In April 2023, oil price hit $89 per barrel after the announcement of production cuts by the Organisation of Petroleum Exporting Countries and allies(OPEC+). With oil price and energy costs already sky-high and pressuring inflation upward, there are concerns that further supply cuts from OPEC+ and the consequent higher energy costs they engender may erode the modest gains recorded in the fight against inflation by world economies since 2022.

Higher energy costs are known to filter quickly into consumer prices, and this effect is historically stronger in import-dependent economies. Thus, apart from eroding purchasing power by raising inflation, supply cuts by OPEC+ may further push the global economy to the brink of recession by dampening its already weak recovery.

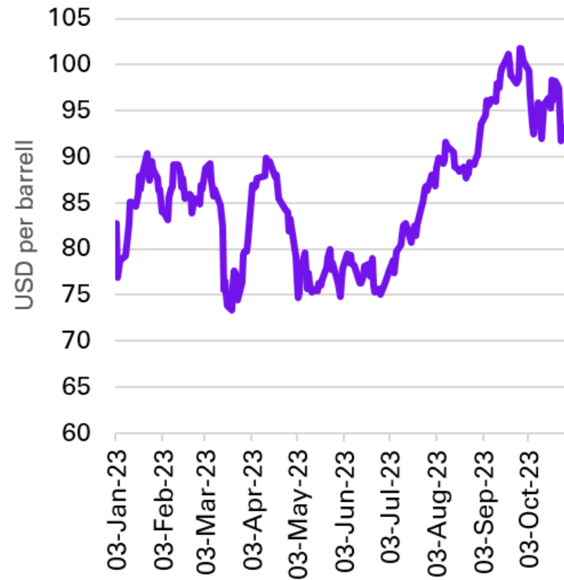

Figure 4: Trend of oil price
Sources: CBN, KPMG Research

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Global growth performance remains weak

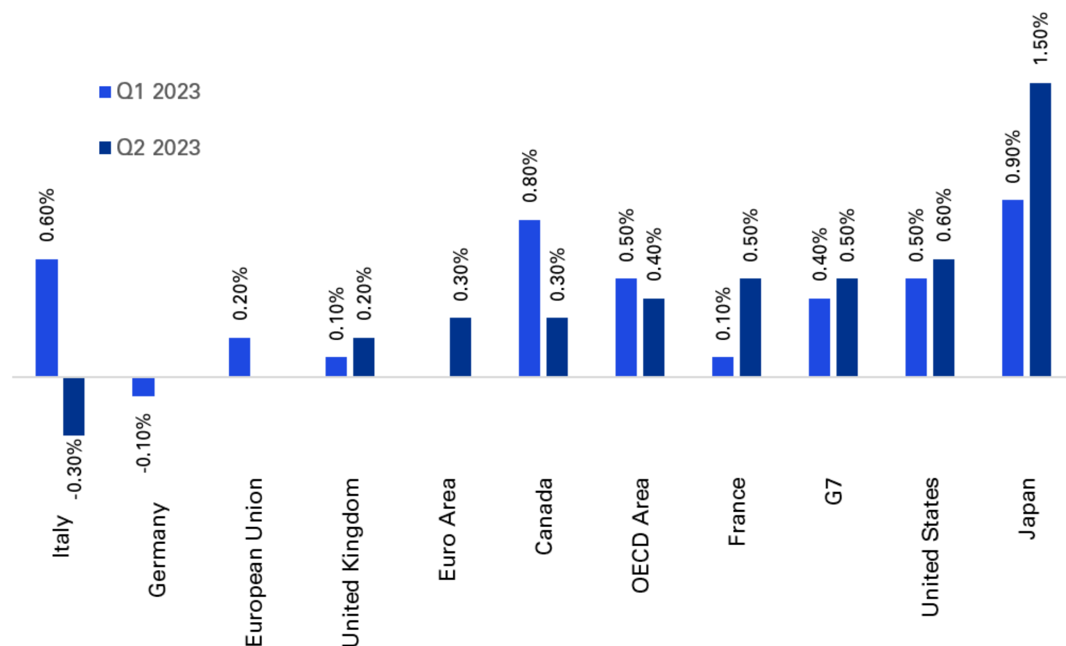

Figure 5: Seasonally adjusted changes in gross domestic product (quarter-on-quarter, %)
Sources: OECD, KPMG Research
Note: The Euro Area recorded zero growth in Q1 2023 while Germany and the European Union recorded zero growth in Q2 2023.

The global economy demonstrated resilience in the first half of 2023 with the normalisation of major supply chain disruptions caused by the Covid-19 pandemic as seen in the easing of delivery time and shipping costs to their pre-pandemic levels. Strong regulatory actions taken by the US and Swiss governments in their respective banking sectors also helped to avert a financial turbulence that would have depressed an already fragile global economy.

However, the growth recovery in major world economies remains modest and below pre-pandemic levels as elevated inflation continues to trigger monetary tightening which squeezes investment spending and the recovery of output growth in advanced economies. Consequently, the IMF anticipates that the world economy would grow by 3.0% in 2023 and 2.7% in 2024. Despite the weak rebound of demand from China's economy, Asia is still expected to be a major driver for global economic growth.

There are risks to the recorded modest growth upturn which can arise from OPEC+ supply cuts, the global impact of further escalation in the Russia/Ukraine war, slow down in China's economy and the persistence of inflation which can make the weak growth short-lived.

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3.0 Regional Economic Review

Slower growth performance

Global monetary tightening and economic downturn trickled into Sub-Saharan Africa and slowed the growth pace of the region in H1 2023, causing more downward revision in the growth forecasts of the World Bank for Sub-Saharan Africa's top three economies of Nigeria, South Africa, and Angola to 2.8%, 0.3% and 2.6%, respectively. The slowing growth momentum was also fuelled by local pressures arising from high and persistent inflation, domestic monetary tightening, social unrests, and waves of military coups affecting the region.

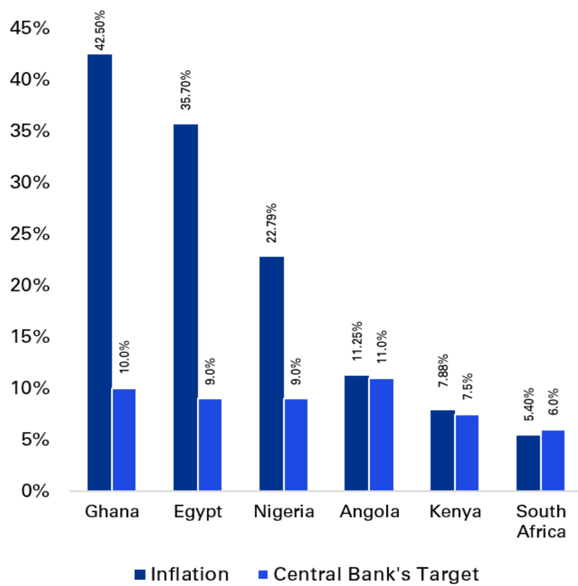

Figure 6: Regional inflation targets and realisations
Sources: Central Banks, KPMG Research

Debt sustainability problems

Furthermore, with public debt at decades high levels and lower aid inflow, monetary tightening in advanced economies have triggered a funding squeeze in the region through higher interest rates payments compounded by exchange rate problems that have made the repayment of debts denominated in dollar a burden. Consequently, some countries in the region have started struggling with loan payments. Ghana, for example, had to restructure its debt with creditors after defaulting on loan payments with its debt stock close to 90% of its total annual economic output.

Power shortages and military coups

Power shortages and episodes of military takeover of governments continue to destabilise the region. South Africa's economy continued to slow down due to persistent inflation, domestic policy tightening, weaker external demand, and acute power shortages over the past year which have negatively affecting several industries by driving up costs.

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4.0 Domestic Macroeconomic Review

4.1 Growth Performance

In the last two decades, the Nigerian economy has undergone major shifts in its growth pattern. Between 2000 and 2015, the economy grew between 6-7% when the economy was largely driven by private investment which accounted for 70% of Investments in the economy.

However, driven by a different growth strategy that increased the dominance of the public sector, the economy grew by an average of 1.1% in the last 8 years. We observe that the growth of the economy since 2015 has been largely driven by government consumption and Investment.

In H1 2023, the economy grew by 2.4% which is weaker than the growth rate of 3.3% recorded in H1 2022. On a quarter-on-quarter consideration, the economy improved only marginally from 2.3% in Q1 2023 to 2.5% by the end of Q2 2023.

This weak service sector-led growth is attributed to mild improvements in consumer spending on finance and insurance services in addition to information and communication. *In line with the agenda of the federal government to pursue a 6% annual growth in real GDP, we anticipate that growth will strengthen into H2 2023.*

A shift in growth strategy

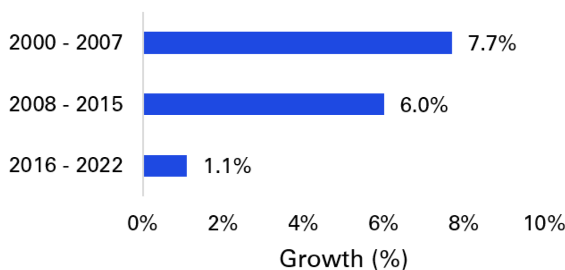

Figure 7: Growth strategy performance
Sources: NBS, KPMG Research

Growth remains slow and fragile

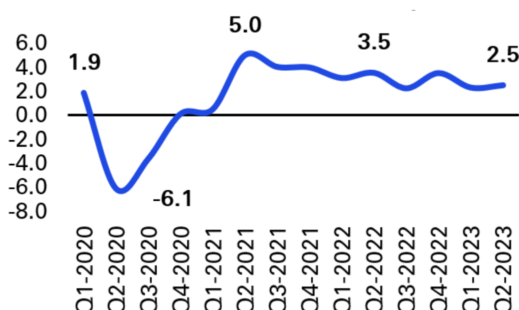

Figure 8: Real GDP Growth (Quarterly, %)
Sources: NBS, KPMG Research

Non-oil sector sustained growth in H1

The non-oil sector remains the life raft of the Nigerian economy with economic activities being driven by the expansion of the non-oil sector which accounts for about 95% of the total GDP. The non-oil sector grew by 3.6% in Q2 2023 while the oil sector which had been contracting since Q1 2020 got pushed deeper into recession by 13.43% below the zero line in Q2 2023 after a mild recovery that drove the oil sector to -4.2% growth contraction. Most of the non-oil sector growth in Q2 2023 was driven by Finance & Insurance (27%), Information & Communication (8.6%), Construction (3.4%), and Manufacturing (2.2%).

The oil sector, which accounts for a paltry 5% of GDP and is closely linked with more than half of all non-oil activities, faces several challenges that contribute to its shrinkage. These include underdevelopment, crude-oil theft, and pipeline vandalism. The sector is also affected by mismanagement and corruption, all of which have had impacts on oil output and exports.

Although the economy is currently largely driven by the non-oil sector, particularly by activities that are not oil dependent within the non-oil sector like Finance & Insurance and Information & Communication Technology, there is still a strong need for diversification from oil dependency.

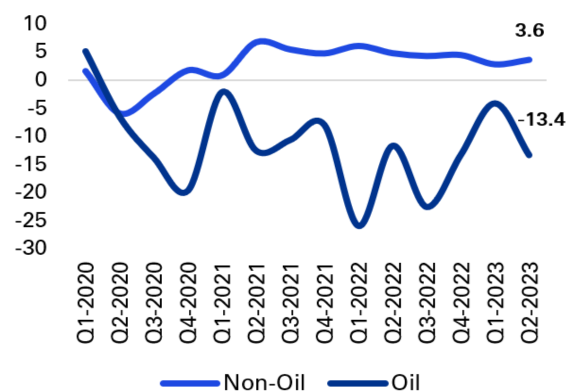

Figure 9: Oil and Non-oil sector growth (%)
Sources: NBS, KPMG Research

Stanbic IBTC PMI shows weak business performance

According to the Stanbic IBTC PMI, the country's private sector condition weakened significantly in the first half of 2023, with minor recovery recorded in April and May 2023 later offset by the end of June. This was generally due to the naira

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redesign policy which created liquidity problems in Q1 2023, foreign exchange illiquidity and the removal of fuel subsidy which not only raised energy and other input costs, but also adversely affected consumer spending.

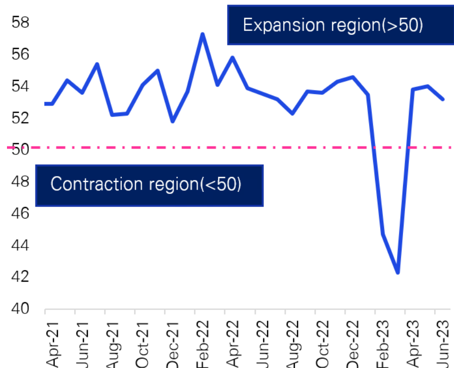

Figure 10: Stanbic IBTC PMI
Sources: NBS, KPMG Research

4.2 Rising Inflation

Inflation: A hard nut to crack

Nigeria started 2023 contending with persisting inflation driven majorly by widespread fuel and Naira scarcity, Russian/Ukraine war and the residual influence of supply-side disruptions caused by the Covid-19 pandemic that pushed headline inflation to 22.04% by March 2023.

However, by the end of H1 2023, the twin reforms implemented in both the fiscal and monetary space by the new administration, namely, the removal of fuel subsidy and the liberalisation of the foreign exchange market became the major drivers fanning inflation, pushing headline and food inflation to 24.08% and 26.98%, respectively, by July 2023.

The liberalisation of the foreign exchange market complicated the ability of the CBN to maintain internal price stability as the free fall of the Naira since the departure from fixed exchange rate regime resulted in higher imported inflation from input costs. The depreciation also switched local and foreign demands to Nigeria's local products, further mounting pressures on inflation.

The removal of fuel subsidy also raised transport costs and production costs via higher energy cost as the average price of petrol in June 2023 exceeded its average price in the same period in 2022 by about 210%. Higher transport and production costs dampen consumer spending and strains the operating costs of producers, leading to higher inflation.

Consequently, to stem growing inflation, the Monetary Policy Committee (MPC) retained its hawkish stance by increasing the Monetary Policy Rate (MPR) to its highest level in over two decades in July 2023 from 18.5% to 18.75%, representing a 250 basis points increase. The Cash Reserve Ratio remained, however, unaltered.

Concerns have however been raised in some quarters over the consistency of the measures adopted by the CBN to tackle inflation as inflation remained untamed in addition to the regulatory body matching its rate hikes with higher money supply. For example, the supply of broad money rose by 9.73% in Q2 2023. *Yet, under assumptions of monetary independence, the CBN is expected to maintain its current hawkish posture by raising the MPR for monetary tightening.*

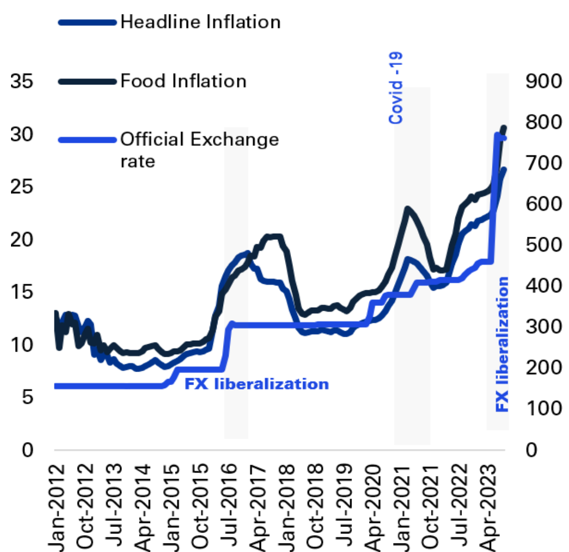

Figure 11: FX unification and inflation
Sources: CBN, NBS, KPMG Research

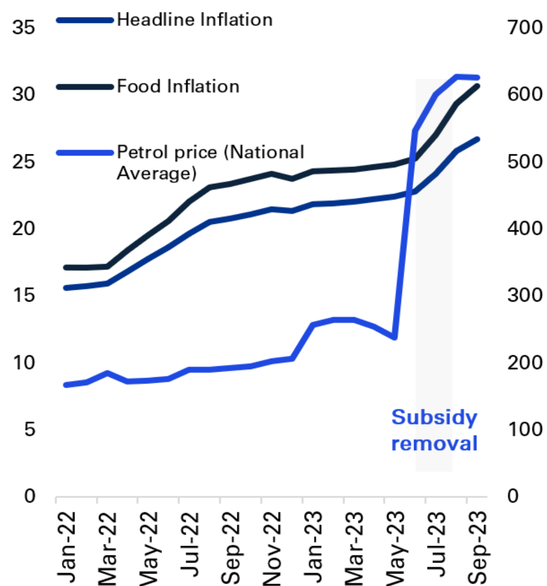

Figure 12: Fuel subsidy removal and inflation
Sources: NBS, KPMG Research

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4.3 External Sector Performance

Resilient trade balance, but non-oil exports remain weak

Nigeria's trade balance remained resilient in H1 2023. Trade balance improved from ₦927 billion in Q1 2023 to ₦1.29 trillion in Q2 2023. The growth in the trade balance in H1 2023 was driven by increases in the contribution of both oil and non-oil exports to total exports which rose by 8.15% while imports only grew marginally by 2.99% because of the depreciation of the naira.

Imports rose to ₦5.73 trillion in Q2 2023 representing an import expansion of 2.69% from ₦5.56 trillion recorded in Q1 2023. However, compared to Q2 2022, imports contracted by 10.53%. Also, the top import items on Nigeria's import bill for Q2 2023 include Ordinary Motor Spirit (21.5%), Used Vehicles (12.82%), Gas oil(4.03%), Durum wheat(3.64%) and Kerosine type jet fuel (2.51%).

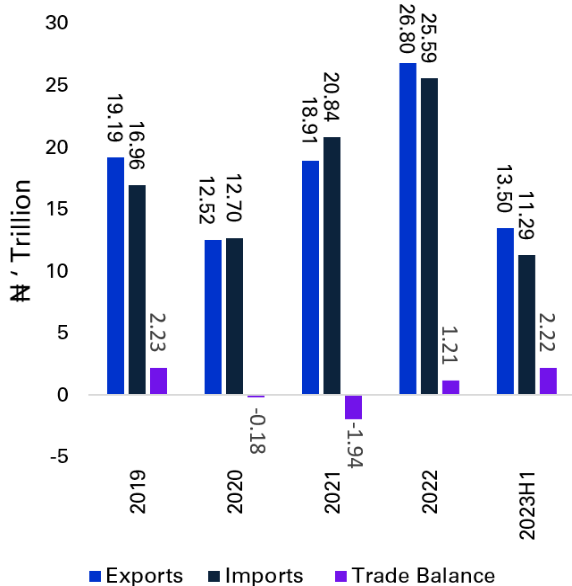

Figure 13: Nigeria's trade performance
Sources: NBS, KPMG Research

Share of items in trade basket (%)

Similarly, the nation's exports increased to ₦7.02 trillion. This represents a quarter-on-quarter expansion of 8.15% and a year-on-year decline of 5.2%. In its composition, the exports basket is still dominated by crude oil and other oil products which account for over 90% of total exports in Q2 2023, leaving non-oil exports with less than 10% share of total exports.

Despite the negative effect of the depreciation of the Naira and fuel subsidy removal on purchasing powers and consumer spending, manufactured goods still constituted about 53% of goods imported into Nigeria valued at ₦3.02 trillion in Q2 2023. This is a huge loss to the economy and a major source of foreign exchange pressure that can be reversed by strategically stimulating the manufacturing sector.

Therefore, import-substituting industrialisation (ISI) which stimulates and enables the manufacturing sector can ease foreign exchange pressure in Nigeria by up to $12bn annually in the long-term.

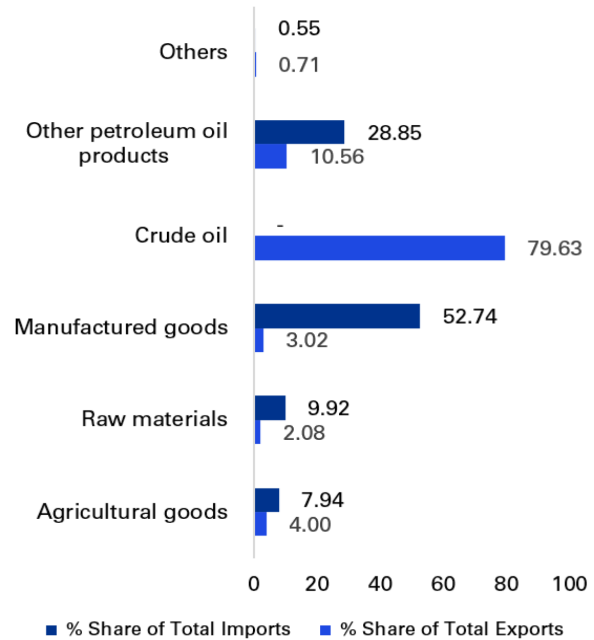

Figure 14: Composition of international trade
Sources: NBS, KPMG Research

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4.4 Monetary policy performance

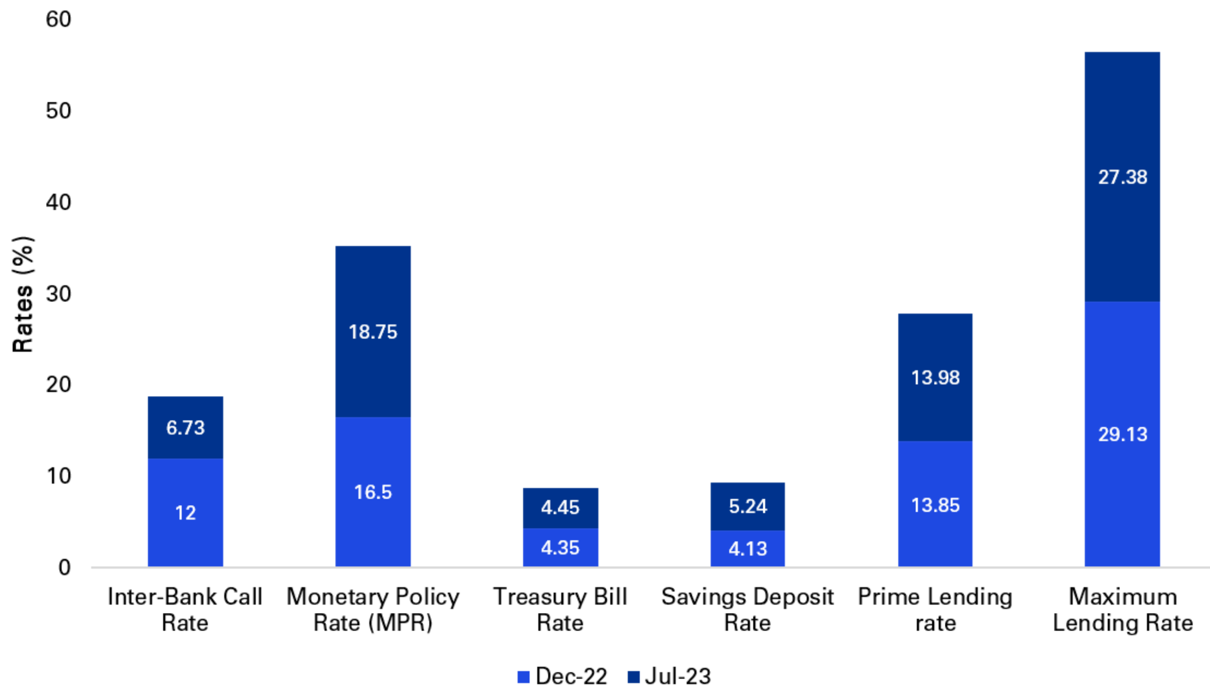

Figure 15: Some key interest rates in the economy
Sources: CBN, KPMG Research

In the pursuit of its mandate to maintain price stability, external stability and stimulate economic growth, the CBN manipulates various interest rates within the economy. In the last half year, however, the task of maintaining domestic price stability has become even more challenging for the apex bank as inflation remained rigidly on double digits with no tendency to ease soon. Consequently, the CBN continued to respond by increasing the MPR. Between year-end 2022 and Q2 2023, the CBN hiked the MPR by 225 basis points to douse inflation, bringing the MPR to its highest level in two decades.

Nevertheless, inflation continued to soar despite hikes in rates as headline inflation climbed steadily from 21.34% in December 2022 to 22.79% by the end of June 2023, raising questions on whether inflation in Nigeria has become a non-monetary phenomenon or monetary policy has become less effective. We note that there are major rooms for improvement in monetary policy conduct as an unhealthily wide disparity still exists between the economy's baseline rate (MPR) and other interest rates in the economy. For example, whilst the CBN raised the MPR to 18.75% in H1 2023, other interest rates in the economy responded poorly with low elasticity. At the extreme, the inter-bank call rate declined by more than half from 12% in December 2022 to 6.73% by the end of H1 2023.

However, we also note that sustainably taming inflation would require not only monetary responses which are generally more apt for addressing demand-pull inflation, but also addressing underlying supply-side problems driving cost-push inflation. This may require focusing on ways to boost local production, improve local infrastructure, cut energy and transportation costs, and boost foreign exchange inflow.

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Depletion of external reserves

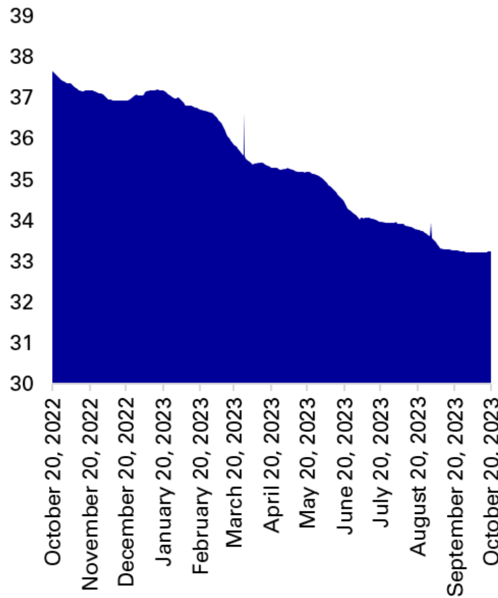

Figure 16a: Gross external reserves **(Billion US$)**
Sources: CBN, KPMG Research

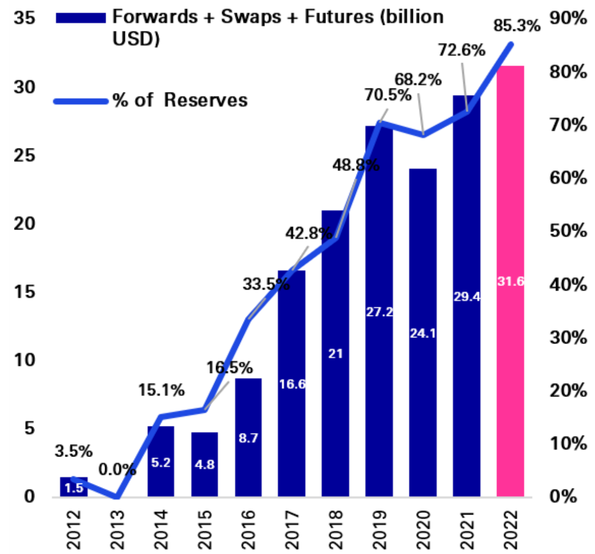

Figure 16b: Forwards, swaps and futures
Sources: CBN, KPMG Research

Foreign reserves are accumulated to provide economic buffers to meet foreign debt obligations, pay import bills and for intervention in the foreign exchange market to stabilise the Naira against major world currencies. However, the move to a floating exchange rate regime in June 2023 placed further downward pressures on the already dwindling stock of foreign reserve. Recent CBN data shows that Nigeria's foreign reserve was depleted by about $2.95bn (8%) from $37.07bn on January 3 2023 to $34.12bn by June 30 2023. However, this data likely overstates the current reserve position of the CBN as evidenced in a past report by JP Morgan Chase which demonstrates that Nigeria's foreign reserve estimates fail to adjust for some major borrowings, currency swaps and foreign exchange forwards. Thus, the external reserve position of Nigeria is likely weaker than documented, apart from it being quickly depleted.

Largely, the continuous depletion of foreign reserves has been attributed to weak capital inflow signaling low investor confidence in the economy. In the second quarter of 2023, for example, total capital importation stood at $1.03bn, representing a contraction of 9.04% compared to the first quarter and a year-on-year decline of 32.9%. The capital importation for Q2 2023 was largely composed of trade credits, loans, currency deposits and other claims which jointly accounted for 81.3% of total capital importation. This was followed by weak FPI and FDI inflows which stood at $106.85 million and $86.03 million in Q2 2023, respectively. This weak capital inflow put strains on the foreign reserves and limits the ability of the CBN to manage the floating of the naira and put inflation in check. Consequently, the Naira continues to depreciate and the gap between the official rate and parallel market rate has increased steadily since the removal of the FX peg. Foreign exchange premiums are now almost at pre-liberalisation levels, suggesting that the market has learned and adjusted back to its pre-liberalisation level. This reflects the weak ability of the CBN to stabilise the naira arising from weak capital inflow as a result of low investor confidence in the economy.

According to the Debt Management Office (DMO), Nigeria's total debt stock by the end of June 2023 stood at ₦87.4 trillion representing about 43.3% of GDP. With an already high debt profile, the recorded depletion of foreign reserves will adversely affect the ability of the Nigerian government to borrow money from local and international credit markets because of debt sustainability concerns and the risk of default. This would mean higher interest rate on borrowing, higher public debt levels and the attendant risks of debt monetisation and higher inflation.

We expect that the depletion of foreign reserves and the consequent depreciation of the Naira and inflation will continue into the short and medium terms, unless the CBN builds up its reserve position by boosting non-oil and oil receipts, implementing import management policies, creating an environment that attracts foreign direct investments and portfolio investments as well as personal remittances.

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4.5 Fiscal policy performance

Oil production in Nigeria averaged 1.3mbpd in the first half of 2023. This is despite a major dip recorded in April 2023 which brought oil production down to 1.1mbpd, a figure at significant variance with the daily quota. Oil production however rebounded in Q2 2023 as production hit 1.32mbpd in June 2023. The recorded improvement in daily oil production is indicative of the success of various security measures put in place by the government in strategic oil-producing regions to address the issue of oil theft.

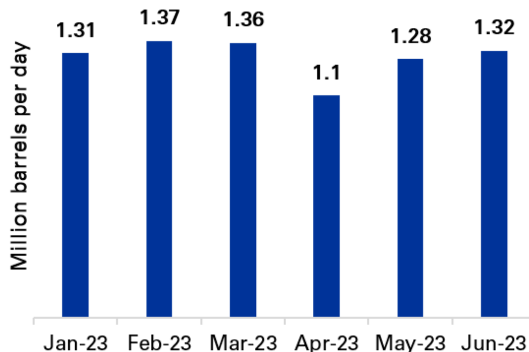

Figure 17: Crude oil production (mbpd)
Sources: OPEC, KPMG Research

Despite these short-term gains, the age-long problem of crude oil theft still poses a major risk to both the revenue performance of government and the Nigerian economy as a whole, as recent data indicates a significant number of oil theft incidents. These thefts not only disrupt oil production but also hinder the growth of the oil sector. Another risk factor to the revenue performance of the government is the volatility of oil price in the global market. However, with OPEC+ supply cuts driving oil prices up and sustained improvement in oil production, we anticipate that government revenue performance will improve.

Public's short-term loss, government's gain

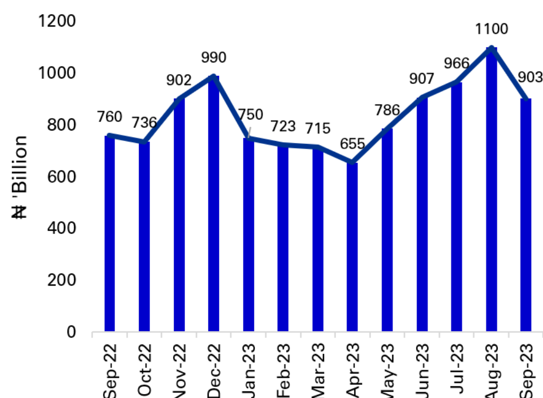

Figure 18: FAAC allocation
Sources: NBS, KPMG Research

Since the removal of fuel subsidy and unification of exchange rate which were major events for H1 2023, the inflows that accrued to the Federation Account Allocation Committee (FAAC) continued to climb steadily from ₦655bn in April to ₦907bn in June 2023.

Given the modest increase in oil price and the weak oil output within the period, the increasing inflow to the FAAC signals an improvement in government's revenue profile coming from windfalls realised from crude oil receipts that are now higher in naira terms. This greater flow is expected to stimulate economic growth and potentially slow the pace of debt accumulation if the government restrains itself from expending the windfall on recurrent items.

Growing public debt concerns

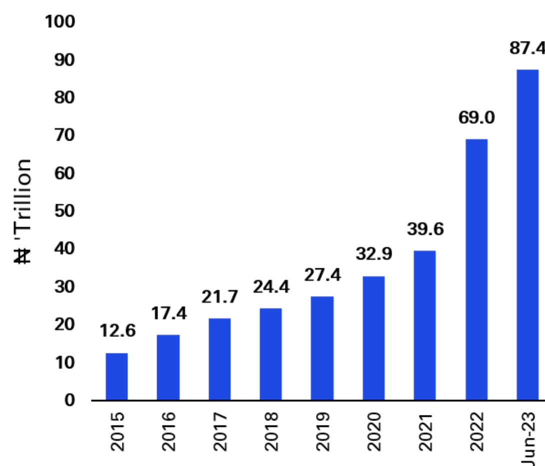

Figure 19: Public debt profile
Sources: DMO, KPMG Research

Nigeria's rising debt profile continued into H1 2023. According to the Debt Management Office (DMO), Nigeria accumulated more than its entire debt for 2016 just halfway into 2023 with debt stock reaching ₦87.4 trillion in June 2023, exceeding the ₦77 trillion projection made by DMO in Q1 2023. Prolonged budget deficits, expenditure on infrastructure, economic downturns, and lack of fiscal discipline contribute to rising public debt in Nigeria.

Apart from debt servicing burdens, rising public debt can significantly reduce the credit rating of Nigeria and fuel economic instability. According to the World Bank, debt servicing is projected to be about 120% of Nigeria's revenue by the end of 2023. In the next half of 2023, we expect to see major tax reforms and improved debt management to address the rising public debt.

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5.0 Outlook for H2 2023

5.1 Inflation to persist

We anticipate that the current inflationary pressure in the economy will persist into H2 2023. Headline and food inflation are unlikely to ease soon as the depreciation of the naira continues to reinforce the inflationary impact of fuel subsidy removal via higher input prices and production costs caused by imported inflation. Specifically, our model suggests that the combined influence of fuel subsidy removal and foreign exchange liberalisation may drive headline inflation to about 30% by December 2023.

5.2 Fuel subsidy and FX reforms will deliver lower GDP growth for Nigeria

We expect the Nigerian economy to grow by 2.6% in 2023, lower than both the revised World Bank's 2023 forecast of 2.8% for Nigeria and the 3.1% growth rate achieved in 2022. In addition to the effect of the Naira redesign policy, the weak growth for 2023 will be driven by low crude oil output, high inflation which weakens consumer demand, weak growth of the private sector as several corporates organisations continue to declare huge foreign exchange losses in the first half of 2023 , and the FX and subsidy reforms which are further expected to weaken consumer demand and raise cost of doing business even for the rest of the year.

5.3 Interest rate may not be hiked further

The new administration targets an annual economic growth of 6% in the 2023-2026 period which it seeks to achieve by stimulating the private sector by improving the general ease of doing business and lowering interest rate. This puts the administration in a ticklish position as incentivising the private sector by reducing the interest rate have opposite implications for domestic price stability, apart from raising concerns about monetary independence.

5.4 Government finances will Improve in the Short term

Government revenue is expected to increase for the rest of 2023 especially with the removal of subsidy, exchange rate gains, and the implementation of proposed tax reforms. The higher inflow from FAAC is also expected to slow down the pace of debt accumulation and reduce fiscal deficits in the short term. However, government accountability, transparency, and efficiency in the management of the fiscal gains should be the priority. Notwithstanding, oil theft remains a major risk to the revenue performance of the government as growing cases of oil theft imply huge revenue losses to the government. To mitigate this risk, the government will need to intensify its effort to address oil theft through a multi-dimensional approach that will include the adoption of enhanced security measures, more community engagements and empowerment and the utilisation of advanced surveillance technology.

In addition to the above, other factors to look out for in H2 2023 and beyond are:

- the commencement of operations of the Dangote refinery
- implementation of critical reforms by the CBN to address foreign exchange illiquidity problems
- government fiscal and trade agenda as well as reforms across MDAs.

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Contact us

Dr Yemi Kale
Partner & Chief Economist
KPMG in Nigeria
E: oyeyemi.kale@ng.kpmg.com

Contributors

Busayo Olanrewaju-Afuye
Associate, Research and Insights
KPMG in Nigeria

Fatai Shuaib
Associate, Research and Insights
KPMG in Nigeria

Festus Ogunbayo
Analyst, Research and Insights
KPMG in Nigeria

home.kpmg/ng
home.kpmg/socialmedia

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